



ALLIED  
PROPERTIES REIT

# Growth from a Strong Foundation

Annual Report 2005

## CORPORATE PROFILE

Allied Properties Real Estate Investment Trust is a leading owner of Class I office properties in Canada.

Class I office properties are created through the adaptive re-use of light industrial structures in urban areas. They typically feature high ceilings, abundant natural light, post and beam structural frames, exposed interior brick and hardwood floors. When restored and retrofitted to the standards of the REIT's portfolio, Class I buildings can satisfy the needs of the most demanding office and retail tenants. When operated in the coordinated manner of REIT's portfolio, these "better-than-new" buildings become a vital part of the urban fabric and contribute meaningfully to a sense of community.

The Class I value proposition includes

- proximity to the downtown core in areas well served by public transportation,
- distinctive internal and external environments that assist tenants in attracting, retaining and motivating employees and
- significantly lower overall occupancy costs than the office towers in the downtown core.

The value proposition has proven appeal to a diverse base of business tenants, including the full range of service and professional firms, telecommunications and information technology providers, media and entertainment groups and selected retail uses.

The REIT operates in three target markets, downtown Toronto, downtown Montreal and downtown Winnipeg. The REIT intends to continue the consolidation process in its Toronto target market and to expand the foothold it has established in its Montreal and Winnipeg target markets.

## FINANCIAL HIGHLIGHTS

	2005 <sup>1</sup>	2004 <sup>2</sup>
Occupancy	97.0%	99.2%
Rental revenue	51,170	34,565
Net rental income	33,906	22,537
Distributable income <sup>3</sup>	19,082	11,923
Distributable income per unit	1.363	1.325
Pay-out ratio	87.9%	88.1%

1. For the year ended December 31, 2005.

2. For the year ended December 31, 2004.

3. Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration. See page 22 for details.

*Total portfolio size at year-end 2005*

2,321,507 sq. feet



*Total area added in 2005*

691,925 sq. feet



*% increase in area*

42%

*Total distributable income in 2005*

\$19,082,000



*Total distributable income added in 2005*

\$7,159,000



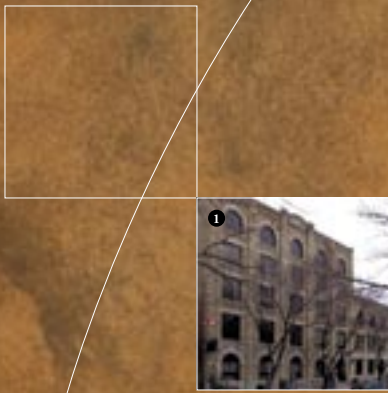
*% increase in distributable income*

60%

2005 ACQUISITIONS

Our portfolio grew  
by 42%

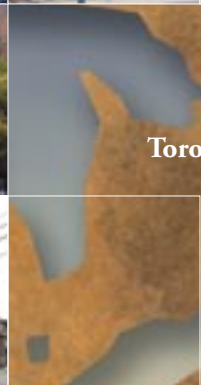
to 37 properties with 2,321,507 square feet of GLA. By year-end, the Toronto component was 1,893,802 square feet, the Montreal component 388,395 square feet and the Winnipeg component 39,310 square feet.



Winnipeg



Toronto



## Winnipeg +39,310 square feet

This target market includes the Exchange District, a 30-block area just to the north of Portage and Main. By year-end, it contained 1.8 million square feet of Class I space. The Winnipeg component of our portfolio represented a very modest percentage of this space, leaving considerable room for growth.



Montreal

## Montreal +182,261 square feet

This target market includes Old Montreal, the International District and Downtown East. By year-end, it contained 13.3 million square feet of office space. The Montreal component of our portfolio represented approximately 3.0% of the total office space, giving us a solid operating and investment foothold with considerable room for growth.

# Toronto

## +468,769 square feet

This target market includes the areas to the east and west of Toronto's downtown core, specifically Downtown East, Downtown West and King West. By year-end, it contained 14 million square feet of office space, half of which was Class I office space. The Toronto component of our portfolio represented approximately 13.5% of the total office space and 26% of the Class I space, giving us a very strong platform with considerable room for growth.

①	115 Bannatyne Avenue	Winnipeg	39,310 square feet
②	67 Richmond Street West	Toronto	50,664 square feet
③	579 Richmond Street West	Toronto	29,311 square feet
④	141 Bathurst Street	Toronto	10,521 square feet
⑤	602-606 King Street West	Toronto	60,412 square feet
⑥	469 King Street West	Toronto	73,844 square feet
⑦	662 King Street West	Toronto	31,817 square feet
⑧	312 Adelaide Street West	Toronto	71,795 square feet
⑨	208-210 Adelaide Street West	Toronto	12,330 square feet
⑩	200 Adelaide Street West	Toronto	28,024 square feet
⑪	116 Simcoe Street	Toronto	13,819 square feet
⑫	489 Queen Street East	Toronto	32,592 square feet
⑬	100 Lombard Street	Toronto	44,600 square feet
⑭	145 Berkley Street	Toronto	10,625 square feet
⑮	3575 St. Laurent Boulevard	Montreal	182,261 square feet



## REPORT TO UNITHOLDERS

Our job is to build a great real estate business, one that serves your interests consistently and well. Certainly annual results matter...a lot. And 2005 was a year of very good results. Prospects also matter. Over the course of the year, we increased the depth and breadth of our portfolio and internalized property management, further strengthening our prospects for growth.

Our focus is office space. Convenient locations, distinctive internal and external environments and lower overall occupancy costs are our strengths. We intend to build on these strengths to serve our customers ever better and, in so doing, to serve your interests ever more successfully.

### Results

Stable and growing monthly distributions are the hallmark of success. In March of 2005, one year following our first

distribution increase and two years following our IPO, we increased our annual distribution by 3.5% to \$1.18 per unit. By year-end, we increased distributable income to \$1.36 per unit, bringing our pay-out ratio to a conservative 87.9%.

Unit price appreciation also represents success. Our units closed the year at \$16.95, bringing your total return<sup>1</sup> for 2005 to 32.7%.

1. Unit price appreciation plus cash distributions, assuming reinvestment through our DRIP.

The table below sets out distributable income, distributable income per unit, annual distribution level per unit at year-end, pay-out ratio and total return for each year since our IPO:

	Dec. 31, 2003*	Dec. 31, 2004	Dec. 31, 2005
Distributable income	\$6.9 million	\$11.9 million	<b>\$19.0 million</b>
Distributable income per unit	\$1.122	\$1.325	<b>\$1.363</b>
Annual distribution level per unit at year-end	\$1.10	\$1.14	<b>\$1.18</b>
Pay-out ratio	85.0%	88.1%	<b>87.8%</b>
Total return	41.4%	18.1%	<b>32.7%</b>

\*partial year from February 20, 2003.

## Portfolio

We began 2005 with 22 predominantly Class I office properties in our Toronto and Montreal target markets. Over the course of the year, we completed 15 acquisitions for \$119 million. 13 were part of our consolidation strategy in Toronto, one strengthened our foothold in Montreal and one expanded our geographic focus to include a third target market, the Exchange District in Winnipeg. Two of the acquisitions came through the development pipeline with Allied Canadian Development Corporation. Another two were properties under development, affording us the opportunity to create value through repositioning and redevelopment. Several of the acquisitions afforded near-term internal growth opportunities.

At year-end, the Toronto component of our portfolio was approaching two million square feet. When we started, we owned approximately 8% of the total office space in our Toronto target market and 12% of the Class I office space. We now own approximately 13.5% of the total office space in the target market and a full 26% of the Class I office space, giving us a very strong operating platform.

The Montreal component was approaching 400,000 square feet, representing a solid investment and operating

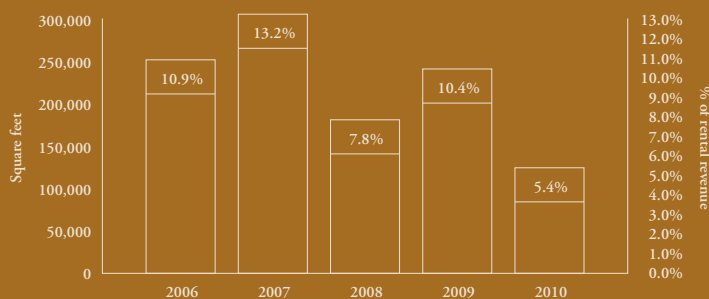
foothold. Already, we have seen our specific expertise translate into tangible operating and leasing results in Montreal. The Winnipeg component remained undersized, something we intend to correct. Even in this small component we have seen our expertise translate into tangible operating and leasing results.

With minor and temporary exceptions, the 3% vacancy at year-end was evenly spread across our three target markets and the six sub-markets within the Toronto target market. Weighted average lease term was five years and the average net rent per occupied square foot was \$17.72.

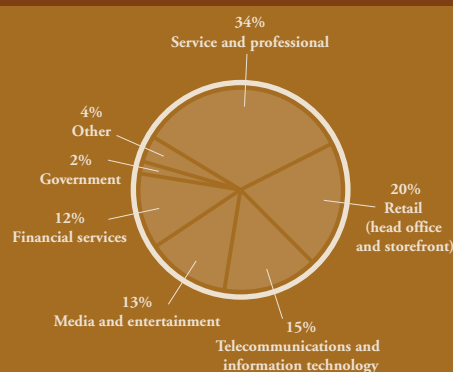
Acquisitions increased the size of our portfolio by 42% and had positive impact on our key portfolio attributes at year-end.

- Our **tenant-mix** provides stability. As a percentage of gross revenue, financial-service tenants increased from 6% to 12% and media and entertainment tenants from 9% to 13% since our IPO. Service and professional tenants declined from 41% to 34% and retail tenants from 21% to 20% in the same period.
- Our **top-10 tenants** by gross revenue also provide stability. They represented 37% of our gross revenue, compared to 49% at the time of our IPO.

Lease Maturity Schedule



Tenant Mix





- Our **lease maturity schedule** is moderate and balanced, which bodes well for stability going forward. Our leases mature at an average rate of 9.5% per year going forward five years, compared to 13% at the time of our IPO.

Declining cost of capital favoured our acquisition program. We raised \$75 million in equity through three bought deals, one in January at \$13.00 per unit, one in April at \$14.00 per unit and one in October at \$15.50 per unit. We also secured \$44 million in new mortgage financing, increasing the weighted average term to maturity of our mortgages to 7.3 years, reducing the weighted average interest rate on our mortgages to 6.0% and bringing our year-end debt-ratio to 51%.

### Management

By early 2005, our portfolio had grown to a point where the economies of scale necessary for profitable property management were clearly in place. Accordingly, our trustees initiated a process that resulted in the acquisition of Allied Canadian Development Corporation's property management business. This business involves the provision of property management and related services internally and to third-party owners of commercial real estate.

This acquisition was truly transformative. Not only did it round-out our operating platform and deepen our management team, it gave us the ability to develop additional service-based sources of income as we continue to grow. Our property management team has already secured several new third-party property management contracts and is hard at work pursuing additional opportunities.

Once a property is acquired, management and leasing are everything. With a full internal compliment of real estate professionals, we intend to manage our properties for all they're worth. And, of course, we intend to acquire more and more properties for our real estate professionals to manage and lease.

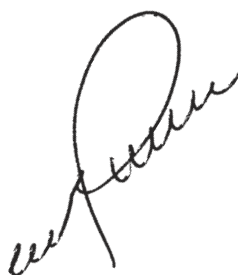
### Outlook

As a leading provider of Class I office space in Canada, we have competitive advantages. We intend to capitalize on our operating advantages by working on a property-by-property basis to boost our same-asset net rental income. We intend to capitalize on our acquisition advantages by making accretive acquisitions that add to the operating coherence of our portfolios in Toronto, Montreal and Winnipeg.

### Thanks

Gordon Gray has decided to retire as a trustee at the upcoming annual meeting. Gordon chaired the audit committee since our IPO and has had a truly formative impact on our business. Management, trustees and unitholders alike have benefited from Gordon's contribution and owe him great thanks.

Our management team gave it their all in 2005. And our trustees were as supportive throughout the year as they were demanding. All of which made for strong results and encouraging prospects. To our management team and trustees, I express sincere thanks. And to you, my fellow unitholders, I extend an equal measure of gratitude for your ongoing support and encouragement.

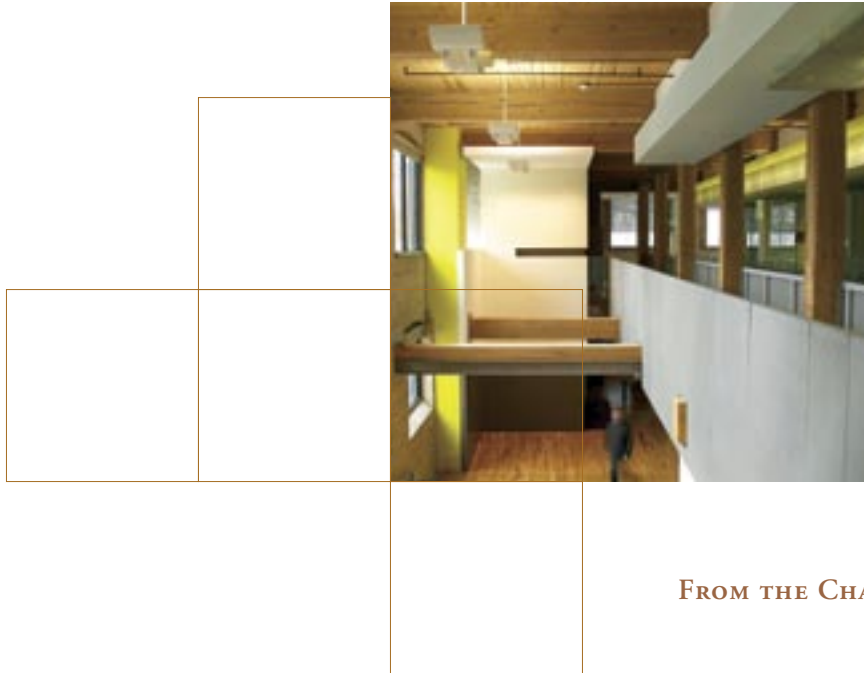


**Michael R. Emory**

*President and Chief Executive Officer*

### Top-10 Tenants

	% of Rental Revenue		% of Rental Revenue
Desjardins	7.9%	Algorithmics	2.7%
Cossette Communications	6.0%	Indigo Books & Music	2.4%
MTS Allstream	4.3%	Nelvana	2.3%
Publicis Toronto	3.2%	Blast Radius	2.3%
St. Joseph Media	3.2%	DWL	2.2%



#### FROM THE CHAIRMAN

## What really counts is building a great real estate business.

As you will read in this annual report, 2005 was another good year for the REIT. We continued to grow our asset base, to increase our distributions, and to expand our business capabilities. I am very pleased to report that the relationship between management and the board remains very strong. Throughout the year, management was continually challenged and supported in its pursuit to accomplish its business plan. The results speak for themselves. The board looks forward to continuing to assist management in achieving its objectives.

It is with regret that we will be losing Gordon Gray's input as a trustee as of our upcoming annual meeting. Gordon's decision to retire is understandable, but he will be missed.

Finally, I want once again to thank you, our unitholders, for your strong ongoing support. We will endeavor to continue to earn that support as we make progress in building a great real estate business.

**Gordon R. Cunningham**  
*Chairman*

## Trustees and Management

### GERALD R. CONNOR

Mr. Connor is Chairman of Cumberland Private Wealth Management Inc., which currently manages assets in excess of \$1.3 billion for institutions and high net worth investors. Prior to founding Cumberland Private Wealth Management Inc. in 1997, Mr. Connor was President of Connor, Clarke & Company Ltd. and Chairman of the board of directors of Connor, Clarke & Lunn Investment Management.

### GORDON R. CUNNINGHAM – CHAIRMAN

Mr. Cunningham is a founding partner of Cumberland Private Wealth Management Inc. He is also a director of Intertape Polymer Group Inc. Positions Mr. Cunningham has previously held include President and Chief Executive Officer of London Insurance Group and London Life Insurance Company. Mr. Cunningham was also formerly a partner at the law firm of Torys.

### MICHAEL R. EMORY

Mr. Emory is President and Chief Executive Officer and a trustee of the REIT. He is also President and Chief Executive Officer and a director of Allied Canadian Development Corporation, positions he has held since 1988. Before then, Mr. Emory was a partner with the law firm of Aird & Berlis LLP, specializing in corporate and real estate finance.

### GORDON C. GRAY

Mr. Gray is retired. He has previously held positions as Chairman, President and Chief Executive Officer of both Rio Algom Ltd. and Royal LePage Ltd.

### ROBERT W. MARTIN

Mr. Martin is a director of Enbridge Inc., Enbridge Gas Distribution and HSBC Bank Canada. He is also a Director of York University Foundation and an Honorary Governor of York University.

### T. IAIN RONALD

Mr. Ronald is Chairman of the board of trustees of TransAlta Power L.P. and BFI Canadian Income Fund. He is also a director of Loblaw Companies Ltd., Leon's Furniture Ltd. and Strongco Inc., and past Vice-Chairman of the board of Canadian Imperial Bank of Commerce.

### DANIEL F. SULLIVAN

Mr. Sullivan is Deputy Chairman of Scotia Capital Inc., the corporate and investment banking division of Bank of Nova Scotia. Mr. Sullivan has over 30 years of experience in the investment banking industry, and has extensive experience in real estate financing and the acquisition and disposition of commercial properties. Mr. Sullivan is a director of Camco Inc. and has served on the boards of Allstream Inc., Cadillac Fairview Corporation, Monarch Developments and Schneider Corporation.

### WAYNE L. JACOBS

Mr. Jacobs is Executive Vice President of the REIT. He is also Executive Vice President and a director of Allied Canadian Development Corporation, positions he has held since 1995. Before joining Allied Canadian Development Corporation in 1992, Mr. Jacobs was employed by CB Richard Ellis, a leading national real estate brokerage firm.

## CORPORATE GOVERNANCE

### MARIANNE O'LEARY

Ms. O'Leary is Vice President, Operations of the REIT. She is also Senior Vice President of Allied Canadian Development Corporation, a position she has held since 1995. Prior to joining Allied Canadian Development Corporation in 1988, Ms. O'Leary was employed by Roycom Securities Inc. where she assisted in the formation of Roycom's Pagebrook Real Estate Mutual Fund, an early real estate based mutual fund. Ms. O'Leary is a Real Estate Institute of Canada Certified Property Manager (CPM) and Certified Manager of Condominiums (CMOC).

### TOM WENNER

Mr. Wenner is Chief Financial Officer and Secretary of the REIT. Mr. Wenner was previously employed by Allied Canadian Development Corporation as Vice President, Finance and was previously employed by The Bank of Nova Scotia, Corporate Banking and by Deloitte & Touche. Mr. Wenner is a Chartered Accountant.

**Forward-Looking Disclaimer**

The terms "Allied Properties," "the REIT," "we," "us" and "our" in the following Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") refer to Allied Properties Real Estate Investment Trust and its consolidated financial position and results of operations for the year ended December 31, 2005. This MD&A should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2005. Historical results and percentage relationships contained in our annual consolidated financial statements and MD&A, including trends which might appear, should not be taken as indicative of our future results, operations or performance. Unless otherwise indicated, dollar amounts in this MD&A are in thousands.

Certain information included in this MD&A contains forward-looking statements within the meaning of applicable securities laws, including, among other things, statements concerning our objectives and our strategies to achieve those objectives, statements with respect to Management's beliefs, plans, estimates and intentions and statements concerning anticipated future events, circumstances, expectations, results, operations or performance that are not historical facts. Forward-looking statements can be identified generally by the use of forward-looking terminology, such as "indicators," "outlook," "objective," "may," "will," "expect," "intend," "estimate," "anticipate," "believe," "should," "plans," "continue" or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect Management's current beliefs and are based on information currently available to Management.

The forward-looking statements in this MD&A are not guarantees of future results, operations or performance and are based on estimates and assumptions that are subject to risks and uncertainties, including those described below in this MD&A under "Risks and Uncertainties," which could cause actual results, operations or performance to differ materially from the forward-looking statements in this MD&A. Those risks and uncertainties include risks associated with property ownership, geographic concentration, asset-class concentration, competition for real property investments, financing and interest rates, government regulations, environmental matters, construction liability and unitholder liability. Material assumptions that were made in formulating the forward-looking statements in this MD&A include the following: that the general economy remains stable; that the REIT's current target markets remain stable; that interest rates and capitalization rates are stable; and that the equity and debt markets continue to provide access to capital. Although the forward-looking statements contained in this MD&A are based on what Management believes are reasonable assumptions, there can be no assurance that actual results, operations or performance will be consistent with these statements.

All forward-looking statements in this MD&A are qualified by this forward-looking disclaimer. These statements are made as of March 15, 2006, and, except as required by applicable law, we undertake no obligation to update publicly or revise any such statements to reflect new information or the occurrence of future events or circumstances.

March 15, 2006

**Business Overview and Strategy**

The REIT is an unincorporated closed-end real estate investment trust created pursuant to the Declaration of Trust dated October 25, 2002, as amended and restated on February 6, 2003 ("Declaration"). The REIT is governed by the laws of Ontario. The units of the REIT are publicly traded on the Toronto Stock Exchange under the symbol AP.UN. Additional information relating to the REIT is available on SEDAR at [www.sedar.com](http://www.sedar.com).

The objectives of the REIT are to provide stable and growing cash distributions to its unitholders and to maximize unitholder value through the effective management and the accretive growth of its portfolio.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### PROPERTY PORTFOLIO

The REIT completed its Initial Public Offering ("IPO") on February 20, 2003. The net proceeds of the IPO were used to acquire a portfolio of 14 predominantly Class I office properties in downtown Toronto with approximately 820,000 square feet of gross leasable area ("GLA"). The REIT acquired eight additional properties in 2003 and 2004, seven in downtown Toronto and one in downtown Montreal, bringing the 2004 year-end total to 22 properties with 1.64 million square feet of GLA.

The REIT made the following acquisitions in 2005, bringing the portfolio to 37 properties with just over 2.3 million square feet of GLA:

Class I Office Property	Acquired	Office GLA	Retail GLA	Total GLA
469 King Street West, Toronto	Jan 1, 2005	62,594	11,250	73,844
3575 Saint-Laurent Boulevard, Montreal	April 18, 2005	164,797	17,464	182,261
115 Bannatyne Avenue, Winnipeg	June 1, 2005	34,495	4,815	39,310
602–606 King Street West, Toronto	July 8, 2005	37,299	23,113	60,412
67 Richmond Street West, Toronto	Oct. 11, 2005	44,870	5,794	50,664
579 Richmond Street West, Toronto	Nov. 1, 2005	29,311	–	29,311
141 Bathurst Street, Toronto	Nov. 1, 2005	10,521	–	10,521
662 King Street West, Toronto	Nov. 1, 2005	29,691	2,126	31,817
312 Adelaide Street West, Toronto	Nov. 1, 2005	63,904	7,891	71,795
208–210 Adelaide Street West, Toronto	Nov. 1, 2005	12,330	–	12,330
200 Adelaide Street West, Toronto	Nov. 1, 2005	28,024	–	28,024
116 Simcoe Street, Toronto	Nov. 1, 2005	13,819	–	13,819
489 Queen Street East, Toronto	Nov. 1, 2005	32,592	–	32,592
100 Lombard Street, Toronto	Nov. 1, 2005	44,600	–	44,600
145 Berkeley Street, Toronto	Nov. 1, 2005	10,625	–	10,625
<b>Total</b>		<b>619,472</b>	<b>72,453</b>	<b>691,925</b>

Two of the properties acquired in 2005, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, are properties under development, in that they are undergoing the repositioning and redevelopment necessary for them to function as high quality, income-producing, Class I office properties. The costs related to these redevelopments are comprised of acquisition costs and external and internal costs directly related to the repositioning and redevelopment, including administrative costs and carrying costs.

The REIT's portfolio of predominantly Class I office properties accommodates a diversified base of business tenants. Class I office properties are created through the adaptive re-use of light industrial structures in urban areas. They typically feature high ceilings, abundant natural light, post and beam structural frames, exposed interior brick and hardwood floors. When restored and retrofitted to the standards of the REIT's portfolio, Class I buildings can satisfy the needs of the most demanding office and retail tenants. When operated in the coordinated manner of REIT's portfolio, these buildings become a vital part of the urban fabric and contribute meaningfully to a sense of community.

The REIT is a leading provider of Class I office and ancillary retail space and intends to build on this advantage by consolidating ownership in large, fragmented and growing target markets. Through this consolidation, the REIT will strive to realize ever greater operating efficiencies, to diversify further its tenant-mix and to reduce further its reliance upon any particular tenant.

The REIT has an option agreement ("Option Agreement") with Allied Canadian Development Corporation ("Developer"), a leading developer of Class I office properties, pursuant to which the Developer must offer to sell to the REIT at fair market value all developed or redeveloped office properties upon substantial completion. Three of the properties in the REIT's portfolio were acquired pursuant to the Option Agreement.

The REIT's portfolio has operated stably. The chart below summarizes the levels of GLA and leased area in the portfolio since the REIT's IPO:

	IPO	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
GLA (square feet)	820,120	984,856	1,636,343	<b>2,321,507</b>
% leased	96.9	97.5	99.2	<b>97.0*</b>

\*not including property under development, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto

Stable portfolio operations and manageable growth in assets have enabled the REIT to achieve its overriding objective of providing regular and growing cash distributions to unitholders. The chart below summarizes the annualized cash distribution level and the total annual return for each fiscal year since the REIT's IPO:

	IPO Feb. 20, 2003	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
Distribution level per unit annualized	\$1.10	\$1.10	\$1.14	<b>\$1.18</b>
Total return with reinvestment through DRIP	N/A	40.7%	17.6%	<b>32.3%</b>
Total return without reinvestment	N/A	38.0%	16.2%	<b>31.3%</b>

#### PROPERTY MANAGEMENT

On July 4, 2005, with an effective date of July 1, 2005, the REIT's wholly owned subsidiary, Allied Properties Management Limited Partnership ("Property Manager"), completed the acquisition of the property management business of the Developer, which involved the provision of property management and related services to the REIT and to third-party owners of commercial real estate in Toronto.

The Developer was appointed by the REIT as its property manager at the time of the REIT's IPO. The principal reason for the external arrangement was the fact that the REIT's initial portfolio was not large enough on its own for the property management function to be undertaken profitably.

Recognizing the substantial growth of the REIT's portfolio by early 2005, the Trustees of the REIT established an Independent Committee to consider the possibility of internalizing the property management function. The Independent Committee retained Desjardins Securities Inc. to act as its financial advisor.

On completion of the evaluation process by the Independent Committee and Desjardins Securities Inc., the independent Trustees of the REIT approved the acquisition ("Property Management Acquisition") by the REIT of the property management business of the Developer for a base price of \$8.5 million and an additional payment on March 31, 2007, equal to the lesser of \$0.9 million and the amount, if any, by which a five-times multiple of actual EBITDA from the business in 2006 exceeds the base price. Desjardins Securities Inc. delivered its opinion that the acquisition was fair, from a financial point of view, to unitholders.

The Developer employed 44 employees in its property management business, all of whom became employees of the Property Manager on closing of the Property Management Acquisition. The Developer and its operating principals have agreed not engage in the third-party property management business. The Developer is no longer entitled to use the name "Allied Properties" or the logo associated with the name "Allied Properties," which name and logo became the sole and exclusive property of the REIT on closing of the Property Management Acquisition. The Developer will continue to engage in the business of real estate development, subject to the provisions of the Option Agreement.

## Performance Indicators

The REIT measures the long-term success of its strategies through key financial and operating performance indicators.

### FINANCIAL INDICATORS

#### 1. Distributions

The REIT is focused on increasing distributions to its unitholders on a regular and prudent basis. During its first 12 months of operations, the REIT made regular monthly distributions of \$1.10 per unit on an annualized basis. In March of 2004, the REIT increased its monthly distributions by 3.6% to \$1.14 per unit on an annualized basis. In March of 2005, the REIT increased its monthly distributions by 3.5% to \$1.18 per unit on an annualized basis.

#### 2. Distributable Income

Increasing distributions can be achieved prudently by increasing Distributable Income, as defined in the Declaration ("DI"). In 2003, the REIT forecast \$1.06 per unit in DI and achieved \$1.122 per unit. In 2004, DI was \$1.325 per unit, up 18% from the abbreviated comparable period in 2003. In 2005, DI was \$1.363 per unit, up 2.8% from 2004. See "Distributable Income" below.

#### 3. DI Pay-Out Ratio

To ensure it retains sufficient cash to meet its capital improvement and leasing objectives, the REIT will strive to maintain an appropriate DI pay-out ratio, the ratio of actual distributions to DI in a given period. In 2003, the REIT forecast a DI pay-out ratio of 90% and achieved a DI pay-out ratio of 85%. In 2004, the REIT achieved a DI pay-out ratio of 88.1%. In 2005, the REIT achieved a DI pay-out ratio of 87.9%.

#### 4. Adjusted Funds From Operations

Increasing distributions cannot be achieved prudently without reference to adjusted funds from operations ("AFFO"), as this financial indicator takes account of capital expenditures and leasing expenditures while ignoring the impact of step-rent revenue. In 2004, AFFO per unit was \$1.132 per unit. In 2005, AFFO per unit was \$1.238 per unit, up 9.4% from 2004. See "Adjusted Funds from Operations" below.

#### 5. AFFO Pay-Out Ratio

To ensure it retains sufficient cash to meet its capital improvement and leasing objectives, the REIT will strive to maintain an appropriate AFFO pay-out ratio, the ratio of actual distributions to AFFO in a given period. In 2004, the REIT achieved an AFFO pay-out ratio of 103.2%. In 2005, the REIT achieved an AFFO pay-out ratio of 96.7%.

#### 6. Debt Ratio

Gross Book Value ("GBV") is defined pursuant to the Declaration as the book value of the assets of the REIT shown on the most recent balance sheet plus accumulated depreciation and amortization and an amount equal to the property management internalization expense recorded by the REIT in the year ended December 31, 2005. A conservative ratio of debt to GBV ("Debt Ratio") mitigates unitholder risk. In 2003, the REIT forecast a 56.0% Debt Ratio and finished the year with a 51.2% Debt Ratio. At the end of 2004, the Debt Ratio was 56.3%. At the end of 2005, the Debt Ratio was 51.0%.

### OPERATING INDICATORS

#### 1. Tenant Retention and Replacement

The REIT places a high value on tenant retention, as the cost of retention is typically lower than the cost of securing new tenancies. If retention is neither possible nor desirable, the REIT will strive for high-quality replacement tenants. Leases representing 207,584 square feet of GLA matured in 2005. At the end of 2005, the REIT had renewed leases



representing 97,752 square feet of this GLA and re-leased another 60,793 square feet of this GLA, representing 77% of the GLA covered by the maturing leases. It had also renewed leases representing 126,590 square feet of GLA maturing in 2006, 5,900 square feet of GLA maturing in 2007 and 32,719 square feet of GLA maturing in 2009.

## 2. Occupancy

The REIT strives to maintain consistently high levels of occupancy. By the end of 2003, the REIT increased its leased area to 97.5%. By the end of 2004, the REIT's leased area was 99.2%. By the end of 2005, the REIT's leased area was 97.0% (not including 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, properties under development).

## 3. Same-Asset Net Operating Income

The REIT strives to maintain or increase same-asset net operating income over time. Same-asset refers to those properties that were owned and operated by the REIT for the entire period in question and for the same period in the prior year. Ignoring the step-rent revenue and the amortization of the fair value assigned to above-market and below-market rents with respect to acquired properties (the marked-to-market rent adjustment), same-asset net operating income was \$17,356 in 2005, up 4.8% from 2004.

## 4. Leasing Expenditures

The REIT monitors leasing expenditures carefully. 192,164 square feet of the GLA leased in 2005 involved the lease of originally vacant space in 2005 or the renewal or replacement of leases that matured in 2005. \$1,620 of the leasing expenditures incurred or committed to in 2005 relate to this space. This represents \$8.43 per leased square foot.

## 5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2005, the REIT incurred \$1,118 in expenditures for capital improvements. This represents \$0.59 per square foot of the average size of the REIT's portfolio over the course of 2005.

## SUMMARY

The following table summarizes the key financial and operating performance indicators for 2005 and 2004, as well as the change between the two years.

	2005	2004	Change
Year-end distribution level per unit annualized	\$ 1.18	\$ 1.14	\$ 0.04
DI per unit	\$ 1.363	\$ 1.325	\$ 0.038
DI pay-out ratio	87.9%	88.1%	(0.2%)
AFFO per unit	\$ 1.238	\$ 1.132	\$ 0.107
AFFO pay-out ratio	96.7%	103.2%	(6.8%)
Debt Ratio	51.0%	56.3%	(5.3%)
Renewal/replacement % of leases maturing	77%	94%	(17%)
End of period occupancy	97.0%	99.2%	(2.2%)
Same-asset net operating income	\$ 17,356	\$ 16,565	\$ 791
Leasing expenditures	\$ 1,620	\$ 1,768	\$ (148)
Leasing expenditures per leased square foot	\$ 8.43	\$ 9.55	\$ (1.08)
Capital expenditures	\$ 1,118	\$ 559*	\$ 559
Capital expenditures per portfolio square foot	\$ 0.59	\$ 0.43*	\$ 0.16

\*not including leasing expenditures in connection with the leasing of space that was vacant or substantially un-renovated at the time of the REIT's IPO or significantly reconfigured to accommodate high-value new tenancies

### **Business Environment and Outlook**

The downtown Toronto office market strengthened in 2005, with the overall vacancy rate declining to 9.2% and the Class I category recording positive absorption of 257,946 square feet.<sup>1</sup>

The downtown Montreal office market was stable in 2005, with the overall vacancy rate declining to 12.7%.<sup>2</sup> While Class I office space is not tracked separately in Montreal, there is data available on the Old Montreal sub-market. In 2005, there was positive absorption of 15,215 square feet in Old Montreal.<sup>3</sup>

The Winnipeg office market was also stable in 2005, with a year-end vacancy rate of 7.8%.<sup>4</sup> While Class I office space is not tracked separately in Winnipeg, Colliers International observed that “businesses continue to be lured to renovated historic buildings in the Exchange area in downtown Winnipeg.”<sup>5</sup>

In summary, the REIT's target markets are stable, with little new supply of office space generally and Class I office space in particular. Combined with the operating advantages stemming from the size and quality of the REIT's portfolio, the stable markets afford Management a reasonable basis for confidence in the REIT's near-term performance.

The REIT intends to continue the consolidation process in its Toronto target market and to expand the foothold it has established in its Montreal and Winnipeg target markets.

The REIT has not established a rigid target in terms of the allocation of its portfolio between the Toronto, Montreal and Winnipeg target markets. At the end of 2005, the properties in the Toronto, Montreal and Winnipeg target markets (including properties under development) represented 81.6%, 16.7% and 1.7%, respectively, of the total GLA in the portfolio.

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1. Colliers International, *Greater Toronto Office Quarterly Update, Fourth Quarter 2005*.

2. Colliers International, *Greater Montreal Office Quarterly Update, Fourth Quarter 2005*.

3. Colliers International, *Greater Montreal Office Quarterly Update, Fourth Quarter 2005*.

4. Colliers International, *Winnipeg Year-End Office Report, December 2005*.

5. Colliers International, *Winnipeg Year-End Office Report, December 2005*.

## Summary Information and Performance for the Year ended December 31, 2005

The following sets out summary information and financial results for the year ended December 31, 2005, and the comparable period in 2004 and the change between the two.

(in thousands except for per unit and % amounts)	2005	2004	Change	% Change
Revenue from rental properties	\$ 51,170	\$ 34,565	\$ 16,605	48.0%
Rental property operating cost	18,264	12,028	6,236	51.8%
Net rental income	33,906	22,537	10,369	46.0%
Real estate service income	162	–	162	
Financing expense				
Interest	10,088	7,441	2,647	35.6%
Amortization – Mortgage premium	(530)	(444)	(86)	19.4%
Depreciation and amortization				
Rental properties	6,071	4,209	1,862	44.2%
Deferred leasing cost	622	228	394	172.8%
Origination cost and acquired tenant relationships	5,267	1,545	3,722	240.9%
Acquired contracts and customer relationships	48	–	48	
Deferred financing cost	216	126	90	71.4%
Computer and office equipment	16	–	16	
Income from operations	11,270	9,432	1,838	19.5%
Trust expense	2,001	1,565	436	27.9%
Property management internalization expense	7,877	–	7,877	
Net income	1,392	7,867	(6,475)	(82.3%)
Amortization				
Rental properties	6,071	4,209	1,862	44.2%
Mortgage premium	(530)	(444)	(86)	19.4%
Acquired leases	2,082	820	1,262	153.9%
M-T-M acquired leases	229	(18)	247	(1,372.2%)
Acquired tenant relationships	3,185	725	2,460	339.3%
Acquired contracts and customer relationships	48	–	48	
Step-rent adjustments	(1,381)	(1,325)	(56)	4.2%
Property management internalization expense	7,877	–	7,877	
LTIP compensation expense	109	89	20	22.5%
DI	\$ 19,082	\$ 11,923	\$ 7,159	60.0%
Weighted average units outstanding (basic)	14,004	8,996	5,008	55.7%
Weighted average units outstanding (diluted)	14,249	9,101	5,148	56.6%
Distributions	16,761	10,506	6,255	59.5%
DI per unit (basic)	\$ 1.363	\$ 1.325	\$ 0.037	2.8%
DI per unit (diluted)	\$ 1.339	\$ 1.310	\$ 0.029	2.2%
DI pay-out ratio	87.9%	88.1%	(0.2%)	
FFO	21,229	13,849	7,380	53.3%
FFO per unit (basic)	\$ 1.516	\$ 1.539	\$ (0.024)	(1.5%)
FFO per unit (diluted)	\$ 1.490	\$ 1.522	\$ (0.032)	(2.1%)
FFO pay-out ratio	79.0%	75.9%	3.1%	

## MANAGEMENT'S DISCUSSION AND ANALYSIS

(in thousands except for per unit and % amounts)	2005	2004	Change	% Change
AFFO	<b>17,338</b>	10,179	7,159	70.3%
AFFO per unit (basic)	<b>\$ 1.238</b>	\$ 1.132	\$ 0.107	9.4%
AFFO per unit (diluted)	<b>\$ 1.217</b>	\$ 1.118	\$ 0.098	8.8%
AFFO pay-out ratio	<b>96.7%</b>	103.2%	(6.8%)	
Net operating income	<b>31,754</b>	21,194	10,560	49.8%
Same-asset net operating income	<b>17,356</b>	16,565	791	4.8%
Total assets	<b>\$ 384,538</b>	\$ 266,835	\$ 117,703	44.1%
Total debt (excludes premium on assumed debt)	<b>\$ 210,093</b>	\$ 154,273	\$ 55,820	36.2%
Debt to GBV	<b>51.04%</b>	56.30%	(5.26%)	
Total GLA (s.f., not including properties under dev.)	<b>2,266</b>	1,640	626	38.2%
Leased GLA (s.f., not including properties under dev.)	<b>2,197</b>	1,627	570	35.0%
Leased GLA (% total GLA)	<b>97.0%</b>	99.2%	(2.2%)	

Net income for the year ended December 31, 2005, was \$1,392, as compared to net income of \$7,867 in the year ended December 31, 2004. Net income per unit (basic) for the year was \$0.099, as compared to net income per unit (basic) of \$0.874 in the comparable year. The year-over-year decline in net income was due entirely to expense of \$7,877 associated with the internalization of property management (see "Property Management Internalization Expense" below).

DI for the year ended December 31, 2005, increased by 60.0% to \$19,082 from \$11,923 for the year ended December 31, 2004. DI per unit (basic) for the year was \$1.363, as compared to \$1.325 in the comparable year.

### NET RENTAL INCOME

Net rental income for the year ended December 31, 2005, increased by 46.0% to \$32,906 from \$22,537 in the same year ended December 31, 2004, as follows:

- (i) \$188 due to the increase in same-asset net rental income from properties owned for the entire year and the entire comparable year;
- (ii) \$9,640 due to net rental income from properties acquired in 2004 and the year; and
- (iii) \$541 due to the internalization of the property management function effective July 1, 2005.

Net rental income per occupied square foot for the year ended December 31, 2005, was \$17.72, as compared to \$17.55 in the year ended December 31, 2004.

### REAL ESTATE SERVICE INCOME

The Property Manager provided real estate services to third-party owners of commercial real estate from the effective date of July 1, 2005. For the year ended December 31, 2005, real estate services income was \$162.

#### PROPERTY MANAGEMENT ACQUISITION BENEFIT

The economic benefit to the REIT of the Property Management Acquisition from the effective date of July 1, 2005, to December 31, 2005, is summarized in the following table:

(in thousands)	July 1 to December 31, 2005
Increase in net rental income	\$ 541
Real estate service income	162
Reduction in leasing expenditures payable as leasing fees	49
Reduction in capital expenditures payable as project management fees	47
Total	\$ 799

This is consistent with Management's expectations for the period in question.

#### PROPERTY MANAGEMENT INTERNALIZATION EXPENSE

The Property Management Acquisition was recorded using the very specific guidance of the Emerging Issues Committee of the Canadian Institute of Chartered Accountants in EIC-138, "Internalization of the Management Function in Royalty and Income Trusts". Except for the portion of the acquisition cost allocated to (i) tangible assets and (ii) the component of the acquired business that relates to providing services to third-party owners, the acquisition cost was treated as a penalty cost for the early termination of the original property management agreement between the REIT and the Developer and was expensed in the year ended December 31, 2005. \$77 was allocated to tangible assets and recorded accordingly on the REIT's balance sheet. \$959 was allocated to the third-party component of the acquired business and was recorded as acquired contracts and customer relationships on the REIT's balance sheet. The remainder of the acquisition cost, \$7,877, was recorded as property management internalization expense in the year ended December 31, 2005.

#### FINANCING EXPENSE

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on assumed mortgages reduced financing expense by \$530 in the year ended December 31, 2005.

Financing expense for the year ended December 31, 2005, increased by 36.6% to \$9,558 from \$6,997 in the year ended December 31, 2004, due to the increase in financing expense associated with properties acquired in 2005.

#### DEPRECIATION AND AMORTIZATION

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the year ended December 31, 2005, increased by 44.2% to \$6,071 from \$4,209 in the year ended December 31, 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in-place leases acquired on acquisition of a rental property on a straight-line basis over the term of the corresponding lease. Deferred financing cost is amortized on a straight-line basis over the term of the corresponding debt.

#### TRUST EXPENSE

Trust expense includes cost incurred by the REIT that is not directly attributable to rental property, such as officers' compensation, trustees' fees, professional fees for legal and audit services, trustees' and officers' insurance premiums and general administrative expenses.

Trust expense for the year ended December 31, 2005, increased by 28% to \$2,001 from \$1,565 in the year ended December 31, 2004, primarily due to an increase in executive management staff, salary levels and year-end bonuses.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### LEASING ACTIVITY

Leasing activity for the year ended December 31, 2005, is summarized in the following table:

	Vacant or Maturing	Leased in 2005	% Leased in 2005	Vacant End of 2005*
Vacant GLA on January 1, 2005	15,555	12,547	81	3,008
Vacant GLA on acquisition in 2005*	37,691	21,072	56	16,619
GLA that matured in 2005	207,584	158,545	77	49,039
Subtotal	260,830	192,164	74	68,666
GLA maturing in 2006		126,590		
GLA maturing in 2007		5,900		
GLA maturing in 2009		32,719		
Total		357,373		

\*not including properties under development, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto

15,555 square feet of GLA were vacant at the beginning of 2005. During the year ended December 31, 2005, the REIT

- (i) acquired properties with 37,691 square feet of vacant GLA, not including properties under development, bringing the total originally vacant GLA to 53,246 square feet and
- (ii) leased 33,619 square feet of the 53,246 square feet of originally vacant GLA, leaving 19,627 square feet of the originally vacant GLA vacant at the end of the year.

Leases for 207,584 square feet of GLA matured in 2005. During the year ended December 31, 2005, the REIT

- (i) renewed or replaced leases for 158,545 square feet of the GLA that matured in the year, leaving 49,039 square feet of the GLA that matured in the year vacant at the end of the year,
- (ii) renewed leases representing 126,590 square feet of GLA maturing in 2006,
- (iii) renewed leases representing 5,900 square feet of GLA maturing in 2007 and
- (iv) replaced a portion of a lease representing 32,719 square feet of GLA maturing in 2009.

### CAPITAL EXPENDITURES

The REIT's portfolio requires ongoing investments for general capital improvements and tenant installation costs related to new and renewal leasing. These include the following: maintenance capital expenditures; in-suite or base-building improvements made in connection with the leasing of vacant space or the renewal or replacement of tenants occupying space covered by maturing leases; and improvement allowances, inducements and commissions paid in connection with the leasing of vacant space and the renewal or replacement of tenants occupying space covered by maturing leases. In the year ended December 31, 2005, expenditures for capital improvements were \$1,118. The REIT incurred or committed to \$1,620 in leasing expenditures (\$8.43 per leased square foot) in connection with the lease of originally vacant space in 2005 or the renewal or replacement of leases that matured in 2005. The REIT also committed to \$1,355 in leasing expenditures (\$8.20 per leased square foot) in connection with the renewal or replacement of leases that mature in 2006, 2007 and 2009.

### Distributable Income

The REIT defines DI as the net income of the REIT determined in accordance with Canadian generally accepted accounting principles ("GAAP") adjusted by adding back or deducting as required:

- (i) depreciation on rental properties;
- (ii) amortization of the premiums or discounts on assumed mortgages;
- (iii) non-cash rental revenue recorded to recognize rental income rateably over the life of each lease;

- (iv) non-cash compensation expense with respect to the LTIP;
- (v) amortization of values ascribed in a building acquisition to in-place leases and tenant relationships;
- (vi) amortization of values ascribed in a building acquisition to above-market and below-market leases;
- (vii) amortization of values ascribed in the Property Management Acquisition to acquired contracts and customer relationships; and
- (viii) property management internalization expense recorded in connection with the Property Management Acquisition.

DI is a non-GAAP financial measure and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. The REIT considers DI to be a measure of its overall operating performance and is one of Management's key performance indicators.

Pursuant to the Ontario Securities Commission Revised CSA Staff Notice 52-306, the Commission recommends that distributable cash (which is synonymous with DI) be reconciled to cash flows from operating activities as presented in the financial statements. Set out below is this reconciliation.

(In thousands)	2005	2004
Cash from operating activities	\$ 7,859	\$ 13,678
Amortization of deferred leasing and financing cost	(838)	(354)
Amortization of computer and office equipment	(16)	—
Change in non-cash operating items	4,200	(1,401)
Property management internalization expense	7,877	—
<b>DI</b>	<b>\$ 19,082</b>	<b>\$ 11,923</b>

Distributions for the year ended December 31, 2005, were \$16,761, representing a DI pay-out ratio of 87.9%, as compared to distributions for the year ended December 31, 2004, of \$10,506, representing a DI pay-out ratio of 88.1%.

### Funds From Operations

Funds From Operations ("FFO") is a non-GAAP financial measure and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. The REIT considers FFO to be an indicative measure of operating performance, one that is widely used by the real estate industry. The following sets out FFO, calculated in accordance with recommendations of Real Property Association of Canada in its White Paper on Funds From Operations dated November 30, 2004, and adjusted to add back the property management internalization expense recorded by the REIT in the year ended December 31, 2005.

(In thousands)	2005	2004
Net income	\$ 1,392	\$ 7,867
Amortization on rental properties	6,071	4,209
Amortization of deferred leasing expenses	622	228
Amortization of origination cost and acquired tenant relationships	5,267	1,545
Property management internalization expense	7,877	—
<b>FFO</b>	<b>\$ 21,229</b>	<b>\$ 13,849</b>

Distributions for the year ended December 31, 2005, represented an FFO pay-out ratio of 79.0%, as compared to distributions for the year ended December 31, 2004, which represented an FFO pay-out ratio of 75.9%.

### Adjusted Funds From Operations

AFFO is a non-GAAP financial measure and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. The REIT considers AFFO to be an indicative measure of operating performance, one that is becoming more widely used by the real estate industry. The following sets out AFFO, calculated in accordance with what Management believes to be industry practice.

(in thousands)	2005	2004
FFO	\$ 21,229	\$ 13,849
Step-rent adjustments	(1,381)	(1,325)
M-T-M acquired leases	228	(18)
Leasing expenditures	(1,620)	(1,768)
Capital expenditures	(1,118)	(559)
<b>AFFO</b>	<b>\$ 17,338</b>	<b>\$ 10,179</b>

Distributions for the year ended December 31, 2005, represented an AFFO pay-out ratio of 96.7%, as compared to distributions for the year ended December 31, 2004, which represented an AFFO pay-out ratio of 103.2%.

### Financial Condition

The REIT finances its operations through three sources of capital: (i) mortgage debt secured by the REIT's rental properties, (ii) secured short-term debt financing with Canadian chartered banks and (iii) equity. As at December 31, 2005, the REIT had mortgage debt of \$198,048, bank indebtedness of \$12,045 and unitholders' equity of \$156,978.

The Declaration provides for a maximum Debt Ratio of 60% excluding convertible debentures (or 65%, including the entire principal pursuant to any convertible debentures outstanding). GBV is defined pursuant the Declaration to mean the book value of the assets of the REIT shown on the most recent balance sheet of the REIT plus accumulated depreciation and amortization and an amount equal to the property management internalization expense recorded by the REIT in the quarter ended September 30, 2005. As at December 31, 2005, the Debt Ratio was 51.0%, compared to 56.3% as at December 31, 2004.

### UNITHOLDERS' EQUITY

As at December 31, 2004, the REIT had a market capitalization of approximately \$143,323 based on a closing unit price of \$13.80 on the Toronto Stock Exchange. As at December 31, 2005, the REIT had a market capitalization of approximately \$271,521 based on a closing unit price of \$16.95.

In the year ended December 31, 2005, the REIT issued a total of 5.63 million units for equity contributions of \$78,539. Costs incurred to issue the units were \$3,754. Units were issued as follows:

- (i) on January 4, 2005, the REIT issued 1.9 million units at \$13.00 per unit for gross proceeds of \$24,700;
- (ii) on April 18, 2005, the REIT issued 2.15 million units at \$14.00 per unit for gross proceeds of \$30,100;
- (iii) on November 1, 2005, the REIT issued 1.3 million units at \$15.50 per unit for gross proceeds of \$20,150;
- (iv) in the year ended December 31, 2005, the REIT issued 123,000 units at \$10.00 per unit for \$1,230 to certain officers and trustees who exercised options under the REIT's Unit Option Plan;
- (v) in the year ended December 31, 2005, the REIT issued 76,224 units to certain officers and trustees under the LTIP at \$13.46 per unit for \$1,026, plus compensation costs of \$109; and
- (vi) in the year ended December 31, 2005, the REIT issued 83,649 units under its distribution re-investment plan at an average price of \$14.63 per unit for \$1,224.



The REIT adopted a Unit Option Plan at the time of its IPO and granted at that time options to the trustees and officers of the REIT to acquire 345,000 units at an exercise price of \$10.00 per unit prior to February 19, 2008. In 2004, the maximum number of units reserved for the Unit Option Plan was reduced from 604,390 units to 345,000 units. In 2004 and in the year ended December 31, 2005, the trustees and officers of the REIT exercised 263,500 options in accordance with their terms. As at December 31, 2005, 81,500 options were outstanding, all of which had vested.

In May of 2004, the REIT adopted the LTIP whereby trustees and officers of the REIT (“Participants”) may from time to time, at the discretion of the Trustees and subject to regulatory approval, subscribe for units at a market price established in accordance with the provisions of the LTIP. The price for the units is payable as to 5% upon issuance and as to the balance (“LTIP Loan”) over 10 years with interest on the LTIP Loan at an annual rate established in accordance with the provisions of the LTIP. The units issued pursuant to the LTIP are registered in the name of a Custodian on behalf of the Participants who are the beneficial owners. The units are pledged to the REIT as security for payment of the LTIP Loan, and all distributions paid on the units are forwarded by the Custodian to the REIT and applied first on account of interest on the LTIP Loan and then to reduce the outstanding balance of the LTIP loans. The maximum number of units reserved for the LTIP is 259,390 units, of which 147,500 units were issued in 2004 and 76,224 in the year ended December 31, 2005.

#### MORTGAGES PAYABLE

Mortgages payable as at December 31, 2005, consisted of mortgage debt of \$198,048 and premium on mortgages assumed (net of accumulated amortization) of \$828.

GAAP requires that the mortgages payable assumed on acquisition of properties be recorded at fair value. The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using market rates for debt of similar terms and credit risks.

The following sets out the maturity schedule of the REIT’s mortgage debt, together with the weighted average interest on the mortgages that mature in the respective year.

	Periodic Principal Payments	Balance Due at Maturity	Total Principal	% of Total Principal	Weighted Average Interest Rate of Maturing Mortgages
2006	\$ 5,309	\$ —	\$ 5,309	2.7%	N/A
2007	5,449	19,408	24,857	12.5%	6.44%
2008	4,735	14,404	19,139	9.7%	5.95%
2009	4,779	8,735	13,514	6.8%	6.84%
2010	4,991	1,926	6,917	3.5%	5.26%
Thereafter	22,461	105,851	128,312	64.8%	
<b>Total</b>	<b>\$ 47,724</b>	<b>\$ 150,324</b>	<b>\$ 198,048</b>		

Interest rates on the mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 6.03%. The weighted average term of the mortgage debt is 7.27 years.

Each individual mortgage loan of the REIT is secured by a mortgage registered on title of a rental property and by security agreements covering assignment of rents and personal property with respect to such property. The mortgage debt provides the holder with recourse to the assets of the REIT.

The REIT attempts to stagger the maturity of its mortgages and to have mortgages maturing each year to be in a position to upward finance the principal amount of maturing mortgages. Additionally, the REIT attempts to maintain 15 to 20% of its rental properties free from traditional long-term mortgage financing with a view to providing these assets as security for bank credit facilities.

**BANK CREDIT FACILITIES**

The REIT has credit facilities with two Canadian chartered banks as follows:

- (i) a \$5,000 revolving credit facility bearing interest at bank prime plus 1.0%, which matures on February 28, 2007; and
- (ii) a \$25,000 revolving credit facility bearing interest at bank prime plus 1.0%, which matures on May 31, 2006.

The credit facilities are secured by subordinated mortgage charges, first mortgage charges and security agreements on certain of the REIT's rental properties.

In the year ended December 31, 2005, the average borrowings under the credit facilities were \$3,208. As at December 31, 2005, the borrowings under the credit facilities were \$14,119.

**Liquidity and Commitments**

Net operating income generated from the rental properties is the primary source of liquidity to fund the REIT's financing expense, trust expense and distributions to unitholders. The Declaration requires the REIT to declare distributions each year not less than the greater of (i) 75% of its DI or (ii) an amount to ensure that the REIT will not be subject to tax on its income and capital gains. The REIT intends to pay distributions of approximately 85% to 90% of DI.

The REIT expects that increased financing on maturing mortgages will provide sufficient cash flow to fund mortgage repayments. The REIT plans to fund anticipated ongoing commitments, obligations, capital expenditures and leasing expenditures using cash flow from operations retained by the REIT and through available borrowing capacity under the credit facilities.

The credit facilities, new mortgage financing and the access to the public equity markets will provide the necessary capital the REIT requires for acquisitions. The REIT's acquisition capacity, meaning the ability of the REIT to acquire rental properties using un-utilized borrowing capacity while not exceeding the 60% Debt Ratio, is \$90,000.

As at December 31, 2005, the REIT had future commitments as set out below.

(in thousands)	December 31, 2005
Leasing commissions	\$ 829
Tenant inducements	200
Building renovations	626
Expenses	349
<b>Total</b>	<b>\$ 2,004</b>

### Summary Information and Performance for the Quarter ended December 31, 2005

The following sets out summary information and financial results for the quarter ended December 31, 2005, and the comparable quarter in 2004 and the change between the two.

(in thousands except for per unit and % amounts)	Q4 2005	Q4 2004	Change	% Change
Revenue from rental properties	\$ 14,291	\$ 10,119	\$ 4,172	41.2%
Rental property operating cost	5,145	3,664	1,481	40.4%
Net rental income	9,146	6,455	2,691	41.7%
Real estate service income	78	—	78	
Financing expense				
Interest	2,893	2,220	673	30.3%
Amortization – Mortgage premium	(182)	(103)	(79)	76.7%
Depreciation and amortization				
Rental properties	1,692	1,194	498	41.7%
Deferred leasing costs	184	95	89	93.7%
Origination cost and acquired tenant relationships	1,943	626	1,317	210.4%
Acquired contracts and customer relationships	24	—	24	
Deferred financing cost	66	43	23	53.5%
Computer and office equipment	10	—	10	
Income from operations	2,594	2,380	214	9.0%
Trust expense	631	382	249	65.2%
Property management internalization expense	—	—	—	
Net income	1,963	1,998	(35)	(1.8%)
Amortization				
Rental properties	1,692	1,194	498	41.7%
Mortgage premium	(182)	(103)	(79)	76.7%
Acquired leases	633	308	325	105.5%
M-T-M acquired leases	181	31	150	483.9%
Acquired tenant relationships	1,311	317	994	313.6%
Acquired contracts and customer relationships	24	—	24	
Step-rent adjustments	(339)	(276)	(63)	22.8%
Property management internalization expense	—	—	—	
LTIP compensation expense	—	26	(26)	(100.0%)
DI	\$ 5,283	\$ 3,495	\$ 1,788	51.2%
Weighted average units outstanding (basic)	15,350	10,226	5,124	50.1%
Weighted average units outstanding (diluted)	15,606	10,389	5,217	50.2%
Distributions	4,578	2,939	1,639	55.8%
DI per unit (basic)	\$ 0.344	\$ 0.342	\$ 0.002	0.7%
DI per unit (diluted)	\$ 0.339	\$ 0.336	\$ 0.003	0.6%
DI pay-out ratio	86.7%	84.1%	2.6%	
FFO	5,782	3,913	1,869	51.7%
FFO per unit (basic)	\$ 0.377	\$ 0.383	\$ (0.006)	(1.6%)
FFO per unit (diluted)	\$ 0.370	\$ 0.377	\$ (0.007)	(1.8%)
FFO pay-out ratio	79.2%	75.1%	2.0%	

## MANAGEMENT'S DISCUSSION AND ANALYSIS

(in thousands except for per unit and % amounts)	Q4 2005	Q4 2004	Change	% Change
AFFO	<b>4,999</b>	3,206	1,793	55.9%
AFFO per unit (basic)	<b>\$ 0.326</b>	\$ 0.314	\$ 0.012	3.9%
AFFO per unit (diluted)	<b>\$ 0.320</b>	\$ 0.309	\$ 0.011	3.8%
AFFO pay-out ratio	<b>91.6%</b>	91.7%	0.1%	
Net operating income	<b>8,988</b>	6,210	2,778	44.7%
Same-asset net operating income	<b>6,109</b>	5,945	164	2.8%
Total assets	<b>\$ 384,424</b>	\$ 237,786	\$ 146,638	61.7%
Total debt (excludes premium on assumed debt)	<b>\$ 210,093</b>	\$ 126,666	\$ 83,427	65.9%
Debt to GBV	<b>51.04%</b>	52.30%	(1.26%)	
Total GLA (s.f., excluding properties under dev.)	<b>2,266</b>	1,640	626	38.2%
Leased GLA (s.f., excluding properties under dev.)	<b>2,197</b>	1,627	570	35.0%
Leased GLA (% total GLA)	<b>97.0%</b>	99.2%	(2.2%)	

Net income for the quarter ended December 31, 2005, was \$1,963, as compared to net income of \$1,998 in the quarter ended December 31, 2004. Net income per unit (basic) for the quarter was \$0.128, as compared to net income per unit (basic) of \$0.195 in the comparable quarter.

DI for the quarter ended December 31, 2005, increased by 51.2% to \$5,283 from \$3,495 for the quarter ended December 31, 2004. DI per unit (basic) for the quarter was \$0.344, as compared to \$0.342 in the comparable quarter.

### NET RENTAL INCOME

Net rental income for the quarter ended December 31, 2005, increased by 44.1% to \$9,299 from \$6,455 in the quarter ended December 31, 2004, as follows:

- (i) \$87 due to the increase in same-asset net rental income from properties owned for the entire quarter and the entire comparable quarter;
- (ii) \$2,325 due to net rental income from properties not owned for the entire quarter and the entire comparable quarter; and
- (iii) \$279 due to the internalization of the property management function effective July 1, 2005.

Net rental income per occupied square foot for the quarter ended December 31, 2005, was \$4.50 (\$18.00 annualized), as compared to \$4.25 (\$17.00 annualized) in the quarter ended December 31, 2004.

### REAL ESTATE SERVICE INCOME

The Property Manager provided real estate services to third-party owners of commercial real estate from an effective date of July 1, 2005. For the quarter ended December 31, 2005, real estate services income was \$78.

#### PROPERTY MANAGEMENT ACQUISITION BENEFIT

The economic benefit to the REIT of the Property Management Acquisition for the quarter ended December 31, 2005, is summarized in the following table:

(in thousands)		Q4 2005
Increase in net rental income	\$	279
Real estate service income		78
Reduction in leasing expenditures payable as leasing fees		50
Reduction in capital expenditures payable as project management fees		17
Total	\$	424

This is consistent with Management's expectations for the quarter.

#### FINANCING EXPENSE

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on assumed mortgages reduced financing expense by \$182 in the quarter ended December 31, 2005.

Financing expense for the quarter ended December 31, 2005, increased by 28.0% to \$2,711 from \$2,117 in the quarter ended December 31, 2004, due to the increase in financing expense associated with additional properties acquired in 2004 and in the year ended December 31, 2005.

#### DEPRECIATION AND AMORTIZATION

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the quarter ended December 31, 2005, increased by 41.7% to \$1,692 from \$1,194 in the quarter ended December 31, 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in-place leases acquired on acquisition of a rental property on a straight-line basis over the term of the corresponding lease. Deferred financing cost is amortized on a straight-line basis over the term of the corresponding debt.

#### TRUST EXPENSE

Trust expense includes cost incurred by the REIT that is not directly attributable to rental property, such as officers' compensation, trustees' fees, professional fees for legal and audit services, trustees' and officers' insurance premiums and general administrative expenses.

Trust expense for the quarter ended December 31, 2005, increased by 65.2% to \$631 from \$382 in the quarter ended December 31, 2004, due to an increase in executive management staff, salary levels and year-end bonuses.

MANAGEMENT'S DISCUSSION AND ANALYSIS

**Summary Quarterly Information and Performance**

The following sets out summary information and financial results for the most recently completed fiscal quarters.

(in thousands except for per unit and % amounts)	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004
Revenue from rental properties	\$ 14,291	\$ 12,822	\$ 12,260	\$ 11,797	\$ 10,119	\$ 9,734	\$ 7,933	\$ 6,779
Rental property operating cost	5,145	4,442	4,480	4,197	3,664	3,369	2,656	2,339
Net rental income	9,146	8,380	7,780	7,600	6,455	6,365	5,277	4,440
Real estate service income	78	84	—	—	—	—	—	—
Financing expense	2,711	2,360	2,218	2,269	2,117	1,957	1,618	1,305
Depreciation and amortization	3,919	3,075	2,910	2,336	1,958	1,855	1,354	941
Income from operations	2,594	3,029	2,652	2,995	2,380	2,553	2,305	2,194
Trust expense	631	404	469	497	382	305	527	351
Property management internalization expense	—	7,877	—	—	—	—	—	—
Net income (loss)	1,963	(5,252)	2,183	2,498	1,998	2,248	1,778	1,843
Amortization								
Rental properties	1,692	1,549	1,461	1,369	1,194	1,175	1,001	839
Mortgage premium	(182)	(145)	(99)	(104)	(103)	(113)	(120)	(108)
Acquired leases	633	535	501	413	308	267	172	73
M-T-M acquired leases	181	—	24	24	31	38	(34)	(53)
Acquired tenant relationships	1,311	720	761	393	317	291	117	—
Acquired contracts and customer relationships	24	24	—	—	—	—	—	—
Step-rent adjustments	(339)	(287)	(350)	(405)	(276)	(375)	(361)	(313)
Property management internalization expense	—	7,877	—	—	—	—	—	—
LTIP compensation expense	—	—	—	109	26	—	63	—
DI	\$ 5,283	\$ 5,021	\$ 4,481	\$ 4,297	\$ 3,495	\$ 3,531	\$ 2,616	\$ 2,281
Weighted average units outstanding (basic)	15,350	14,471	14,036	12,118	10,226	10,200	8,396	7,138
Weighted average units outstanding (diluted)	15,606	14,727	14,289	12,329	10,389	10,348	8,427	7,174
DI per unit (basic)	\$ 0.344	\$ 0.347	\$ 0.319	\$ 0.355	\$ 0.342	\$ 0.346	\$ 0.312	\$ 0.320
DI per unit (diluted)	\$ 0.339	\$ 0.341	\$ 0.314	\$ 0.348	\$ 0.336	\$ 0.341	\$ 0.310	\$ 0.318
Distributions	4,578	4,317	4,295	3,557	2,939	2,933	2,638	1,996
DI pay-out ratio	86.7%	86.0%	95.8%	82.7%	84.1%	83.1%	100.8%	87.5%
FFO	5,782	5,616	5,045	4,786	3,912	4,062	3,103	2,772
FFO per unit (basic)	\$ 0.377	\$ 0.388	\$ 0.359	\$ 0.395	\$ 0.383	\$ 0.398	\$ 0.370	\$ 0.388
FFO per unit (diluted)	\$ 0.370	\$ 0.381	\$ 0.353	\$ 0.388	\$ 0.377	\$ 0.393	\$ 0.368	\$ 0.386
Net operating income	8,988	8,093	7,454	7,219	6,210	6,028	4,882	4,074
Net income (loss) per unit (basic)	\$ 0.128	\$ (0.363)	\$ 0.156	\$ 0.206	\$ 0.195	\$ 0.220	\$ 0.212	\$ 0.258
Net income (loss) per unit (diluted)	\$ 0.126	\$ (0.363)	\$ 0.153	\$ 0.203	\$ 0.192	\$ 0.217	\$ 0.211	\$ 0.257

(in thousands except for per unit and % amounts)	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004
Total assets	\$384,538	\$321,659	\$309,822	\$284,741	\$ 266,835	\$ 237,786	\$ 236,330	\$ 165,809
Total debt	\$210,093	\$163,182	\$144,596	\$147,418	\$ 154,273	\$ 125,514	\$ 125,247	\$ 87,207
Total debt to GBV	51.0%	47.7%	44.8%	50.0%	56.3%	52.1%	52.3%	52.7%
Total GLA (sq. ft)	2,266	1,985	1,925	1,703	1,641	1,430	1,428	1,042
Leased GLA (sq. ft.)	2,197	1,933	1,885	1,687	1,627	1,410	1,407	1,017
Leased Area (%GLA)	97.0%	97.4%	97.3%	99.1%	99.2%	98.6%	98.5%	97.6%

### Critical Accounting Estimates

The significant accounting policies used in preparing the REIT's financial statements are described in Note 3 to those statements. The following is a discussion of Management's estimates that are most important to the presentation of the REIT's results of operations and financial condition and are most subjective as a result of matters that are inherently uncertain.

#### FAIR VALUE OF ASSUMED MORTGAGES PAYABLE AND FAIR VALUE OF MORTGAGES PAYABLE

Most of the mortgage indebtedness of the REIT was assumed in conjunction with rental property acquisitions. GAAP requires that the mortgages payable assumed on acquisition of properties be recorded at fair value. The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using market rates for debt of similar terms and credit risks. Market rates for debt are based on the yield of Canadian government bonds with similar maturity dates plus a credit spread based on Management's experience in obtaining financing and the current market conditions.

#### IMPAIRMENT OF ASSETS

The REIT is required to write down to fair value any long-life assets that are determined to have been permanently impaired. The REIT's long-life assets consist of rental properties. The REIT's policy is to assess any potential impairment by making a comparison of the current and projected operating cash flow of a rental property over its remaining useful life, on an un-discounted basis, to the carrying amount of the rental property. If such carrying amount was in excess of the projected operating cash flow of the rental property, impairment in value would be recognized to adjust the carrying amount to its estimated fair market value. Current operating cash flows are based on leases in place and projected operating cash flows are based on Management's estimates of future rental rates. Prior to acquiring a rental property, the REIT commissions an appraisal and conducts due-diligence to satisfy itself that the acquisition price is representative of fair market value.

#### DEPRECIATION

A significant portion of the purchase price of rental properties is allocated to buildings. The depreciation recorded on buildings is based on the straight-line basis over their expected useful life. The allocation of purchase price to buildings and the estimated useful life are based on Management's estimates and, if these estimates prove incorrect, the depreciation will not be appropriately recorded.

### Related Party Transactions

At the time of its IPO, the REIT entered into an agreement ("Property Management Agreement") with the Developer, a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Developer.

Pursuant to the Property Management Agreement, the Developer was responsible for the overall management and operations of the REIT's rental properties, all aspects of the leasing of the rental properties owned by the REIT and the provision of fully equipped office space and support staff. The initial term of the Property Management Agreement was five years to February 19, 2008, and renewable by the REIT for successive two year terms.

The REIT completed the Property Management Acquisition on July 4, 2005, with an effective date of July 1, 2005. Immediately prior to the effective date of the Property Management Acquisition, the Developer ceased to provide services to the REIT under the Property Management Agreement.

Set out below are the fees paid by the REIT to the Developer in connection with the provision of services under the Property Management Agreement for the period ended June 30, 2005, the day prior to the effective date of the closing of the Property Management Acquisition.

(in thousands)	Recoverable Operating Expense	Trust Expense	Deferred Expense	Rental Properties	Commitments	Total
Management fee	\$ 895	\$ -	\$ -	\$ -	\$ -	\$ 895
Maintenance	510	-	-	-	-	510
On-site personnel	153	-	-	-	-	153
Disbursements	13	3	-	-	-	16
Leasing fees	-	-	72	-	55	127
Project management fees	-	-	-	10	-	10
Office and support staff	-	30	-	-	-	30
<b>Total</b>	<b>\$ 1,571</b>	<b>\$ 33</b>	<b>\$ 72</b>	<b>\$ 10</b>	<b>\$ 55</b>	<b>\$ 1,741</b>

At the time of the REIT's IPO, a subsidiary of the Developer leased 29,102 square feet of office space from the REIT pursuant to a lease expiring on September 30, 2010. Effective July 1, 2005, the REIT entered into a direct lease of this space with Loblaw's Properties Limited for a term ending October 31, 2010, on the condition that the original indemnity of the Developer protecting the REIT from any revenue shortfall (on a cash basis) from the original lease remain in full force and effect.

### Risk and Uncertainties

There are certain risk factors inherent in the investment and ownership of real estate. Real estate investments are capital intensive, and success from real estate investments depends upon maintaining occupancy levels and rental income flows to generate acceptable returns. These success factors are dependent on general economic conditions and local real estate markets, demand for leased premises and competition from other available properties.

The REIT's portfolio is focused on a particular asset class in the two largest metropolitan real estate markets in Canada. This concentration enables management to capitalize on certain economies of scale and competitive advantages that would not otherwise be available.

### FINANCING AND INTEREST RATE RISK

The REIT is subject to risk associated with debt financing. The availability of debt to re-finance existing and maturing loans and the cost of servicing such debt will influence the success of the REIT. In order to minimize risk associated with debt financing, the REIT will attempt to re-finance maturing loans with long-term fixed-rate debt and to stagger the maturities over time.



Interest rates on the REIT's mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 6.03%. The weighted average term of the REIT's mortgage debt is 7.27 years. As at December 31, 2005, the borrowings under the REIT's credit facilities were \$14,119.

#### CREDIT RISK

The REIT is subject to credit risk. Credit risk arises from the possibility that tenants may not be able to fulfill their lease obligations. The REIT will strive to mitigate this risk by maintaining a diversified tenant-mix and limiting exposure to any single tenant. As at December 31, 2005, there were 275 tenants in the REIT's portfolio.

The following sets out the REIT's tenant-mix on the basis of percentage of rental revenue for the year ended December 31, 2005, and the year ended December 31, 2004.

Category	<b>% of Rental Revenue 2005</b>	% of Rental Revenue 2004
Service and professional	<b>34</b>	39
Retail (head office and storefront)	<b>20</b>	22
Telecommunications and information technology	<b>15</b>	16
Media and entertainment	<b>13</b>	13
Financial services	<b>12</b>	4
Government	<b>2</b>	3
Other	<b>4</b>	3

The following sets out the percentage of rental revenue from the REIT's top-10 tenants by rental revenue for the year ended December 31, 2005, as well as the percentage of rental revenue from those tenants for the year ended December 31, 2004.

Tenant	<b>% of Rental Revenue 2005</b>	% of Rental Revenue 2004
Desjardins	<b>7.9</b>	0.9
Cossette Communications	<b>6.0</b>	9.1
MTS Allstream	<b>4.3</b>	5.3
Publicis Toronto	<b>3.2</b>	3.1
St. Joseph Media	<b>3.2</b>	2.6
Algorithmics	<b>2.7</b>	3.2
Indigo Books & Music	<b>2.4</b>	4.3
Nelvana	<b>2.3</b>	1.9
Blast Radius	<b>2.3</b>	3.4
DWL	<b>2.2</b>	2.7

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### LEASE ROLL-OVER RISK

The REIT is subject to lease roll-over risk. Lease roll-over risk arises from the possibility that the REIT may experience difficulty renewing or replacing tenants occupying space covered by leases that mature. The REIT strives to stagger its lease maturity schedule so that it is not faced with a disproportionately large level of lease maturity in a given year.

97.0% of the GLA in the REIT's portfolio was leased as at December 31, 2005 (not including 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, properties under development). The following sets out the total GLA of the leases that mature during the period from January 1, 2006, to December 31, 2010, assuming tenants do not exercise renewal options, and the percentage of total GLA represented by the maturing leases.

Year Ended	Square Feet	% of Total GLA
December 31, 2006	252,103	10.9
December 31, 2007	305,999	13.2
December 31, 2008	180,062	7.8
December 31, 2009	355,653	10.4
December 31, 2010	240,614	5.4

Leases representing 50% of the GLA that matures in 2006 were renewed by December 31, 2005.

The weighted average term to maturity of the REIT's leases is five years.

### ENVIRONMENTAL RISK

As an owner of real property, the REIT is subject to various federal, provincial and municipal laws relating to environmental matters. Such laws provide that the REIT could be liable for the costs of removal of certain hazardous substances and remediation of certain hazardous locations. The failure to remove or remediate such substances or locations, if any, could adversely affect the REIT's ability to sell such real estate or to borrow using such real estate as collateral and could potentially also result in claims against the REIT. The REIT is not aware of any material non-compliance with environmental laws at any of the properties in its portfolio. The REIT is also not aware of any pending or threatened investigations or actions by environmental regulatory authorities in connection with any of the properties in its portfolio or any pending or threatened claims relating to environmental conditions at the properties in its portfolio.

### Subsequent Events

On January 20, 2006, the REIT placed a first mortgage on 208-210 Adelaide Street West, Toronto, 200 Adelaide Street West, Toronto and 116 Simcoe Street, Toronto, in the principal amount of \$9 million for a term of 10 year at an annual interest rate of 5.16%.

On January 20, 2006, the REIT placed a first mortgage on 579 Richmond Street West, Toronto, and 141 Bathurst Street, Toronto, in the principal amount of \$6.5 million for a term of 10 year at an annual interest rate of 5.16%.

On February 2, 2006, the REIT announced an agreement to acquire 4436-4450 Saint-Laurent Boulevard, a Class I office property located in downtown Montreal, and 5,500 square feet of adjacent land that forms the southwest corner of Saint-Laurent and Boulevard Mount-Royal for an aggregate purchase price of \$11.2 million. The acquisition is scheduled to close on or about March 31, 2006.

### Property Table

The following lists the properties owned by the REIT at December 31, 2005:

Property	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Vacant	Vacancy Rate
Toronto Total	1,548,192	345,610	1,893,802	81.58%	42,849	10,278	53,127	2.81%
King West Total	162,056	26,394	188,450	8.12%	19,045	2,112	21,157	11.23%
Phase I, The Castle	59,002	16,562	75,564		–	–	–	0.00%
905 King Street West	103,054	9,832	112,886		19,045	2,112	21,157	18.74%
King West Central Total	538,839	119,617	658,456	28.36%	7,061	3,764	10,825	1.64%
468 King Street West	65,039	–	65,039		–	–	–	0.00%
425–439 King Street West	74,053	25,134	99,187		–	–	–	0.00%
445–455 King Street West	27,565	23,048	50,613		–	–	–	0.00%
469 King Street West	62,594	11,250	73,844		–	–	–	0.00%
500–522 King Street West	94,945	27,705	122,650		–	2,064	2,064	1.68%
602–606 King Street West	37,299	23,113	60,412		–	1,700	1,700	2.81%
420 Wellington Street West	33,813	3,137	36,950		–	–	–	0.00%
425 Adelaide Street West	74,008	4,104	78,112		3,008	–	3,008	3.85%
579 Richmond Street West	29,311	–	29,311		2,568	–	2,568	8.76%
141 Bathurst Street	10,521	–	10,521		–	–	–	0.00%
662 King Street West	29,691	2,126	31,817		1,485	–	1,485	4.67%
Entertainment District Total	405,342	103,516	508,858	21.92%	–	4,402	4,402	0.87%
116 Simcoe Street	13,819	–	13,819		–	–	–	0.00%
200 Adelaide Street West	28,024	–	28,024		–	–	–	0.00%
208–210 Adelaide Street West	12,330	–	12,330		–	–	–	0.00%
312 Adelaide Street West	63,904	7,891	71,795		–	4,402	4,402	6.13%
331–333 Adelaide Street West	20,951	3,209	24,160		–	–	–	0.00%
358–360 Adelaide Street West	35,986	18,263	54,249		–	–	–	0.00%
134 Peter Street	29,218	19,804	49,022		–	–	–	0.00%
82 Peter Street	38,623	8,287	46,910		–	–	–	0.00%
388 King Street West	32,529	11,765	44,294		–	–	–	0.00%
99 Spadina Avenue	39,267	12,613	51,880		–	–	–	0.00%
185 Spadina Avenue	55,814	–	55,814		–	–	–	0.00%
217–225 Richmond Street West	34,877	21,684	56,561		–	–	–	0.00%
Downtown Total	44,870	5,794	50,664	2.18%	6,659	–	6,659	13.14%
67 Richmond Street West	44,870	5,794	50,664		6,659	–	6,659	13.14%
St. Lawrence Market Total	71,754	41,390	113,144	4.87%	7,108	–	7,108	6.28%
35–39 Front Street East	30,811	16,606	47,417		–	–	–	0.00%
41–45 Front Street East	19,799	13,735	33,534		–	–	–	0.00%
50 Wellington Street East	21,144	11,049	32,193		7,108	–	7,108	22.08%
Queen Richmond Total	270,106	48,899	319,005	13.74%	2,976	–	2,976	0.93%
Queen Richmond Centre	175,000	48,899	223,899		2,976	–	2,976	1.33%
230 Richmond Street East	62,514	–	62,514		–	–	–	0.00%
489 Queen Street East	32,592	–	32,592		–	–	–	0.00%
Properties Under Development	55,225	–	55,225	2.38%				
100 Lombard Street	44,600	–	44,600					
145 Berkeley Street	10,625	–	10,625					
Montreal Total	370,111	18,284	388,395	16.73%	15,539	–	15,539	4.00%
425 Viger Avenue West	205,314	820	206,134		–	–	–	0.00%
3575 Saint-Laurent Boulevard	164,797	17,464	182,261		15,539	–	15,539	8.53%
Winnipeg Total	34,495	4,815	39,310	1.69%	–	–	–	0.00%
115 Bannatyne Avenue	34,495	4,815	39,310		–	–	–	0.00%
Total	1,952,798	368,709	2,321,507	100.00%	58,388	10,278	68,666	3.03%

## MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The management of Allied Properties Real Estate Investment Trust (the "REIT") is responsible for the integrity and fairness of the financial information presented in this Annual Report. These consolidated financial statements were prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants. The consolidated financial statements, where necessary, include amounts, which are based on best estimates and judgement of management. Financial information appearing throughout this Annual Report is consistent with that shown in accompanying financial statements.

Management has developed and maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition, and liabilities are recognized.

The Board of Trustees oversees management's responsibility for financial reporting through an Audit Committee, which is composed entirely of outside trustees. The Audit Committee reviews the consolidated financial statements with both management and the independent auditors before such statements are approved by the Board of Trustees and submitted to Unitholders of the REIT.

BDO Dunwoody LLP, the independent auditors of the REIT, have examined the consolidated financial statements of the REIT in accordance with Canadian generally accepted auditing standards to enable them to express to the Unitholders their opinion on the consolidated financial statements. The Auditors of the REIT had full and free access to, and meet periodically with the Audit Committee.



**Michael R. Emory**  
President and Chief Executive Officer



**Tom Wenner, CA**  
Chief Financial Officer

## AUDITORS' REPORT

### TO THE UNITHOLDERS OF ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST

We have audited the consolidated balance sheets of Allied Properties Real Estate Investment Trust as at December 31, 2005 and 2004 and the consolidated statements of earnings, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



BDO Dunwoody LLP  
Chartered Accountants

Toronto, Ontario  
February 10, 2006

## CONSOLIDATED BALANCE SHEET

(in thousands)	December 31, 2005	December 31, 2004
<b>Assets</b>		
Rental properties (Note 4)	\$ 336,606	\$ 239,852
Properties under development	6,564	-
Deferred expenses (Note 5)	28,027	17,960
Other assets (Note 6)	13,341	9,023
	<b>\$ 384,538</b>	<b>\$ 266,835</b>
<b>LIABILITIES</b>		
Mortgages payable (Note 7)	\$ 198,876	\$ 144,350
Bank indebtedness (Note 7)	12,045	10,971
Accounts payable and other liabilities (Note 8)	15,258	12,351
Distributions payable	1,575	987
	<b>227,754</b>	<b>168,659</b>
<b>UNITHOLDERS' EQUITY (Note 9)</b>	<b>156,784</b>	<b>98,176</b>
	<b>\$ 384,538</b>	<b>\$ 266,835</b>

The accompanying notes are an integral part of these financial statements.

Approved by the Board of Trustees



**Gordon Cunningham**  
Trustee



**Michael R. Emory**  
Trustee

## CONSOLIDATED STATEMENT OF UNITHOLDERS' EQUITY

(in thousands)	Cumulative Capital	Cumulative Issue Costs	Cumulative Net Income	Cumulative Distributions	Total
Unitholders' equity, December 31, 2003	\$ 72,229	\$ (4,862)	\$ 6,434	\$ (5,868)	\$ 67,933
<b>YEAR ENDED DECEMBER 31, 2004</b>					
Net income	—	—	7,867	—	7,867
Distributions	—	—	—	(10,506)	(10,506)
Public offering	32,190	(1,841)	—	—	30,349
Distribution reinvestment plan	932	—	—	—	932
Unit options plan – options exercised	1,405	—	—	—	1,405
Long-term incentive plan	221	(25)	—	—	196
Unitholders' equity, December 31, 2004	\$ 106,977	\$ (6,728)	\$ 14,301	\$ (16,374)	\$ 98,176
<b>YEAR ENDED DECEMBER 31, 2005</b>					
Net income	\$ —	\$ —	\$ 1,392	\$ —	\$ 1,392
Distributions	—	—	—	(16,761)	(16,761)
Public offering	74,950	(3,754)	—	—	71,196
Distribution reinvestment plan	1,224	—	—	—	1,224
Unit option plan – options exercised (Note 11)	1,230	—	—	—	1,230
Long-term incentive plan (Note 12)	327	—	—	—	327
Unitholders' equity, December 31, 2005	\$ 184,708	\$ (10,482)	\$ 15,693	\$ (33,135)	\$ 156,784

The accompanying notes are an integral part of these financial statements.

## CONSOLIDATED STATEMENT OF EARNINGS

(in thousands, except unit and per unit amounts)	Year Ended December 31, 2005	Year Ended December 31, 2004
<b>Revenues</b>		
Rental properties	\$ 51,170	\$ 34,565
Real estate services	422	—
	<b>51,592</b>	<b>34,565</b>
<b>Expenses</b>		
Rental property operating	18,264	12,028
Real estate services	260	—
Financing	9,558	6,997
Trust	2,001	1,565
Amortization of rental properties	6,071	4,209
Amortization of deferred expenses	6,153	1,899
Amortization of computer and office equipment	16	—
Internalization of property management (Note 2(b))	7,877	—
	<b>50,200</b>	<b>26,698</b>
Net income for the year	\$ 1,392	\$ 7,867
<b>Net income per unit</b>		
Basic	\$ 0.099	\$ 0.874
Fully diluted	\$ 0.098	\$ 0.864
<b>Weighted average number of units (Note 10)</b>		
Basic	14,004,054	8,996,471
Fully diluted	14,249,424	9,101,163

The accompanying notes are an integral part of these financial statements.



## CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands)	Year Ended December 31, 2005	Year Ended December 31, 2004
Cash Provided by (Used in):		
<b>Operating activities</b>		
Net income	\$ 1,392	\$ 7,867
Items not affecting cash		
Amortization of rental properties	6,071	4,209
Amortization of computer and office equipment	16	–
Amortization of deferred expenses	6,153	1,899
Step rent adjustments	(1,381)	(1,325)
Mark to market rent adjustments	229	(18)
Amortization, premium on assumed mortgages	(530)	(444)
Interest benefit granted under long-term incentive plan	109	89
	12,059	12,277
Change in other non-cash operating items	(4,200)	1,401
<b>Cash from operating activities</b>	<b>7,859</b>	<b>13,678</b>
<b>Investing activities</b>		
Rental properties acquired, net of non-cash consideration (Note 2 (a))	(92,756)	(97,553)
Properties under development acquired	(6,505)	–
Identifiable assets acquired, net of non-cash consideration (Note 2 (b))	(967)	–
Capital expenditures, rental properties and other assets	(1,390)	(1,978)
Capital expenditures, properties under development	(59)	–
Deferred recoverable expenses	(16)	–
Deferred leasing costs	(1,970)	(2,518)
<b>Cash used in investing activities</b>	<b>(103,663)</b>	<b>(102,049)</b>
<b>Financing activities</b>		
Repayment of mortgages payable	(22,432)	(6,201)
Proceeds from new mortgages payable	59,900	61,474
Deferred financing costs	(542)	(887)
Distributions	(14,949)	(9,240)
Proceeds of public offering (net of issue costs)	71,196	30,349
Proceeds from exercise of unit options	1,230	1,405
Proceeds from units issued under the LTIP (net of issue costs) (Note 12)	327	195
Net increase in short-term revolving credit facilities	1,580	12,273
<b>Cash provided by financing activities</b>	<b>96,310</b>	<b>89,368</b>
<b>Increase in cash and cash equivalents</b>	<b>506</b>	<b>997</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>1,302</b>	<b>305</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 1,808</b>	<b>\$ 1,302</b>
<b>Other cash flow information</b>		
Interest paid	\$ 9,947	\$ 7,111
<b>Supplemental disclosure of non-cash activities</b>		
Units issued pursuant to the distribution reinvestment plan	\$ 1,224	\$ 932

The accompanying notes are an integral part of these financial statements.

## CONSOLIDATED NOTES TO FINANCIAL STATEMENTS

(In thousands of dollars except per unit and unit amounts)

December 31, 2005 and December 31, 2004

### 1. The Trust

Allied Properties Real Estate Investment Trust (the "REIT") is an unincorporated closed-end real estate investment trust created pursuant to the Declaration of Trust dated October 25, 2002, subsequently amended and restated on February 6, 2003. The REIT is governed by the laws of the Province of Ontario and began operations on February 19, 2003. The units of the Trust are traded on the Toronto Stock Exchange.

These financial statements present the financial position of the REIT as at December 31, 2005 and the results of operations and cash flow for the year ended December 31, 2005.

### 2. Acquisitions

#### (a) RENTAL PROPERTIES

Net assets with respect to rental properties acquired were as follows (using the purchase method of accounting):

	Year Ended December 31, 2005	Year Ended December 31, 2004
Rental properties	\$ 101,566	\$ 88,339
Other assets	131	553
Fair value of in-place leases and tenant relationships	12,730	14,705
Fair value of above-market leases	2,764	4,463
Fair value of below-market leases	(1,795)	(1,379)
Mortgages payable	(17,591)	(7,425)
Accounts payable and accrued liabilities	(5,049)	(1,703)
Cash consideration paid for the net assets acquired	\$ 92,756	\$ 97,553

The REIT allocates the purchase price of an acquired rental property on a preliminary basis, to the identified assets and liabilities acquired based on their estimated fair values at the time of acquisition. The purchase prices allocations are considered preliminary until the REIT has obtained the necessary information to complete its allocations.

#### (b) PROPERTY MANAGEMENT BUSINESS

Effective July 1, 2005, the REIT acquired, through wholly owned subsidiaries set out in Note 3 (b), the property management business from Allied Canadian Development Corporation for a cash purchase price of \$8,500 and additional consideration of up to \$900, contingent on the achievement of profitability criteria of the property management business for the year ended December 31, 2006, plus legal advisory and other costs.

The REIT accounted for the acquisition in accordance with EIC 138 "Internalization of the Management Function in Royalty and Income Trust.

The following costs incurred are in connection with the internalization of the management function and have been recorded as an expense in the consolidated statement of earnings for the year ended December 31, 2005:

	<b>Year Ended December 31, 2005</b>
Property management contract termination fee	\$ 7,533
Legal, advisory and other costs	344
Internalization of property management	<u>\$ 7,877</u>

Identifiable assets acquired have been recorded at the fair values as follows:

Computer and office equipment	\$ 77
Intangible assets – contracts and customer relationships	<u>959</u>
	<b>1,036</b>
Assumption of capital lease obligations	<u>(69)</u>
Total cash paid for identifiable assets	<u>\$ 967</u>

Upon the settlement of the contingent consideration, management will determine the allocation between property management contract termination fee and contracts and customer relationships.

### **3. Summary of Significant Accounting Policies**

#### (a) BASIS OF PRESENTATION

The REIT's financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

#### (b) BASIS OF CONSOLIDATION

The REIT's consolidated financial statements include the accounts of the REIT's subsidiaries as follows:

Entity	<b>Interest Held on December 31, 2005</b>	Interest Held on December 31, 2004	Accounting Method
Allied Properties Management Limited Partnership	<b>100%</b>	0%	Consolidation
Allied Properties Management Trust	<b>100%</b>	0%	Consolidation
Allied Properties Management GP Limited	<b>100%</b>	0%	Consolidation

#### (c) USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

#### (d) CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, balances with banks and short-term deposits with original maturities of three months or less.

(e) RENTAL PROPERTIES

Rental properties include land, buildings, improvements and acquisition costs that are capitalized as part of the cost of rental properties.

Rental properties are stated at the lower of cost less accumulated amortization and fair value. If conditions indicate the carrying amount may not be recoverable, the REIT determines if an impairment exists and a write-down to fair value is needed by comparing the carrying amount to the net recoverable amount. The net recoverable amount represents the undiscounted estimated future cash flow expected to be received from the ongoing use of the properties together with the residual value of the properties.

Amortization on buildings is recorded on the straight-line basis over the useful life of the buildings, estimated at 40 years.

Upon the acquisition of rental properties, the REIT evaluates all in-place tenant lease agreements to determine if the leases are at, below or above market rates. If a lease is determined to be above or below market rates, a corresponding asset or liability is recorded and amortized into income over the life of the lease. Also at the time of acquisition, an asset representing the fair value of the costs of the leasing commissions and tenant inducements that the REIT would have otherwise incurred if it had originated each lease agreement acquired is recorded and amortized over the lease's remaining life. Furthermore, an asset representing the fair value, if any, of the relationship with a customer or tenant is created upon the acquisition of the property.

(f) COMPUTER AND OFFICE EQUIPMENT

Depreciation on computer and office equipment is recorded on a straight-line basis over estimated useful lives of three years.

(g) DISTRIBUTION REINVESTMENT PLAN (DRIP)

The REIT has instituted a DRIP whereby Canadian unitholders may elect to have their distributions automatically reinvested in additional units. Unitholders who so elect will receive a further distribution of units equal in value to 5% of each distribution that was reinvested. No commissions, service charges or brokerage fees are payable by participants in connection with the DRIP.

(h) REVENUE RECOGNITION

Rental revenue includes rents from tenants under leases, property tax and operating cost recoveries, parking income and incidental income. Rental revenue with respect to rents from tenants under leases is recognized rateably over the term of the lease. Real estate services revenue is recorded on an accrual basis as services are provided.

(i) UNIT-BASED COMPENSATION PLAN

The REIT accounts for employee unit-based options by measuring the compensation cost for options granted on or after January 1, 2002 under the fair value-based method using a Black-Scholes option pricing model.

(j) PER UNIT CALCULATIONS

Basic earnings per unit is calculated by dividing net earnings by the weighted average number of units outstanding for the year, excluding those units issued under the Long Term Incentive Plan, which are not fully paid up. The calculations of earnings per unit on a diluted basis consider the potential exercise of outstanding unit purchase options, if dilutive, and are calculated using the treasury stock method. The calculation of earnings per unit on a diluted basis includes those units issued under the Long Term Incentive Plan, which are not fully paid up.

(k) CONTRACTS AND CUSTOMER RELATIONSHIPS

Contracts and customer relationships included in deferred expenses consists of the values assigned to property management clients upon initial acquisition and are amortized on a straight-line basis over their estimated useful lives of 10 years.

(l) COMPARATIVE AMOUNTS

The comparative amounts presented in the consolidated financial statements have been restated to conform to the current year's presentation.

#### 4. Rental Properties

	Cost	Accumulated Amortization	Net Carrying Amount December 31, 2005	Net Carrying Amount December 31, 2004
Land	\$ 64,375	\$ —	\$ 64,375	\$ 37,245
Building, improvements and other costs	283,300	11,069	272,231	202,607
	<b>\$ 347,675</b>	<b>\$ 11,069</b>	<b>\$ 336,606</b>	<b>\$ 239,852</b>

#### 5. Deferred Expenses

Deferred expenses consist of costs incurred by the REIT, net of accumulated amortization of \$8,103 (December 31, 2004 – \$1,950), with respect to obtaining debt financing, leasing costs incurred, the fair value attributed to in-place leases acquired, the fair value attributed to customer relationships with respect to rental property acquisitions and amounts recorded on the acquisition of the property manager – contracts and customer relationships. Amortization is recorded on a straight-line basis over the term of the respective credit facility and over the remaining term of the respective leases to which the costs or fair value relate.

	Cost	Accumulated Amortization	Net Carrying Amount December 31, 2005	Net Carrying Amount December 31, 2004
Tenant inducements and leasing costs incurred through leasing activities	\$ 4,970	\$ 871	\$ 4,099	\$ 2,750
Deferred financing costs	1,603	373	1,230	904
Amounts ascribed to leasing costs and tenant relationships on rental properties acquired	28,582	6,811	21,771	14,306
Amounts recorded on the acquisition of the property manager – contracts and customer relationships	959	48	911	—
Recoverable expenditures	16	—	16	—
	<b>\$ 36,130</b>	<b>\$ 8,103</b>	<b>\$ 28,027</b>	<b>\$ 17,960</b>

## 6. Other Assets

Other assets consist of:

	December 31, 2005	December 31, 2004
Above-market rents of leases acquired through rental property acquisitions net of amortization of \$1,404 (December 31, 2004 – \$385)	\$ 5,881	\$ 4,190
Accounts receivable	4,435	2,116
Prepaid expenses	163	377
Escrow accounts held by mortgagees	2,746	2,340
Computer and office equipment, net of amortization of \$15	79	–
Leasehold improvements, net of amortization of \$1	37	–
	<b>\$ 13,341</b>	<b>\$ 9,023</b>

## 7. Mortgages Payable and Bank Indebtedness

Substantially all of the REIT's assets have been pledged as security under the related mortgages and other security agreements. Interest rates on the mortgages payable are between 4.94% and 8.10 % with a weighted average rate of 6.03% (December 31, 2004 – 6.53%).

Mortgages payable at December 31, 2005 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Year ended December 31, 2006	\$ 5,309	\$ –	\$ 5,309
Year ended December 31, 2007	5,449	19,408	24,857
Year ended December 31, 2008	4,735	14,404	19,139
Year ended December 31, 2009	4,779	8,735	13,514
Year ended December 31, 2010	4,991	1,926	6,917
Thereafter	22,461	105,851	128,312
	<b>\$ 47,724</b>	<b>\$ 150,324</b>	<b>\$ 198,048</b>
Premium on assumed mortgages (net of amortization of \$632)			828
			<b>\$ 198,876</b>

The REIT has a \$5,000 revolving credit facility with a Canadian chartered bank, which matures February 28, 2007 and bears interest at bank prime rate plus 1.0%, which is secured by second and third mortgage charges on three rental properties.

The REIT has a \$25,000 revolving credit facility with another Canadian chartered bank, which matures May 31, 2006 and bears interest at bank prime rate plus 1.0%. Security for the facility consists of first and second mortgage charges on seven rental properties and security agreements covering assignment of rents and personal property with respect to the six properties.

At December 31, 2005 the amount outstanding under the credit facilities was \$12,045, net of cash of \$1,808 (December 31, 2004 \$10,971, net of cash of \$1,302).

## 8. Accounts Payable and Other Liabilities

Accounts payables and other liabilities consist of:

	December 31, 2005	December 31, 2004
General operating payables and tenant deposits	\$ 11,233	\$ 9,629
Below market rents of leases acquired through rental property acquisition – net of amortization of \$1,193 (2004 – \$402)	3,057	1,972
Accrued interest	916	750
Capital lease obligations	52	–
	<b>\$ 15,258</b>	<b>\$ 12,351</b>

## 9. Unitholders' Equity

The REIT is authorized to issue an unlimited number of trust units, each of which represents a unitholder's proportionate undivided beneficial interest in the REIT. No unitholder has or is deemed to have any right of ownership in any of the assets of the REIT.

On January 4, 2005, the REIT issued 1.9 million voting units at \$13.00 per unit pursuant to a public offering, resulting in gross proceeds of \$24,700. On April 18, 2005, the REIT issued 2.15 million voting units at \$14.00 per unit pursuant to a public offering, resulting in gross proceeds of \$30,100. On November 1, 2005, the REIT completed an issuance of 1.3 million voting units at \$15.50 per unit pursuant to a public offering, resulting in gross proceeds of \$20,150.

The number of units issued and outstanding is as follows:

	Units
Units outstanding, December 31, 2004	10,386,060
Units issued pursuant to Unit Option Plan (Note 11)	123,000
Units issued under the Distribution Reinvestment Plan	83,649
Units issued pursuant to the Offerings	5,350,000
Units issued pursuant to the Long Term Incentive Plan (Note 12)	76,224
Units outstanding, December 31, 2005	16,018,933

## 10. Weighted Average Units

The weighted average units outstanding of the purposes for calculating net earnings per unit are as follows:

	Year Ended December 31, 2005	Year Ended December 31, 2004
Basic	14,004,054	8,996,471
Unit option plan	38,144	47,765
Long-term incentive plan	207,226	56,927
Fully diluted	14,249,424	9,101,163

## **11. Unit Option Plan**

The REIT adopted a Unit Option Plan providing for the issuance, from time to time, at the discretion of the trustees, of options to purchase Units for cash. Participation in the Unit Option Plan is restricted to the trustees and the officers of the REIT. The Unit Option Plan complies with the requirements of the Toronto Stock Exchange. The exercise price of any option granted will not be less than the closing market price of the units on the day preceding the date of grant. The options may have a maximum term of ten years from the date of grant. The maximum number of Units reserved for issuance pursuant to the Unit Option Plan is 345,000 units.

On February 20, 2003, 345,000 options were granted to trustees and officers with an exercise price of \$10.00 and expiring on February 19, 2008. 115,000 options vested on each of February 20, 2003, February 20, 2004 and February 20, 2005.

A summary of the status of the Unit Option Plan is as follows:

Options	Units	Weighted Average Exercise Price
Granted and outstanding as at December 31, 2004	204,500	\$ 10.00
Exercised between January 1 and June 30, 2005	123,000	\$ 10.00
Exercised between July 1 and December 31, 2005	–	\$ 10.00
Granted and outstanding as at December 31, 2005	81,500	\$ 10.00
Options exercisable as at December 31, 2005	81,500	\$ 10.00

## **12. Long-Term Incentive Plan**

Officers and trustees of the REIT have been granted the right to participate in a LTIP, whereby the participants may subscribe for units for a purchase price equal to the weighted average trading price of the units for five trading days preceding the date of the grant. The purchase price is payable (“installment loan receivable”), over a term not exceeding 10 years, bears 3% interest on any outstanding balance and has full recourse to the participant. The units issued under the LTIP are held by a custodian for the benefit of the Participants, until the purchase price has been paid in full. Cash distributions paid in respect of the units issued under the LTIP are applied to the installment loan receivable.

An aggregate of 259,390 units are reserved for issuance, pursuant to the LTIP and, during the year ended December 31, 2005, 76,224 Units were issued at a purchase price of \$13.46 per unit.



The fair value of the LTIP is the estimated present value of the 1.5% imputed interest benefit and an assumed market rate of return of 4.5%, over an estimated expected term of ten years. For the year ended December 31, 2005, compensation cost of \$109, attributable to the LTIP, was charged against earnings with a corresponding amount included in unitholders' equity as units issued. The LTIP installment loans receivable are recognized as deductions from units issued. Distributions received under the LTIP are charged to unitholders' equity while interest received under the LTIP is credited to distributions.

	<b>Cumulative as at December 31, 2005</b>	<b>Year Ended December 31, 2005</b>	Year Ended December 31, 2004
Units issued under the LTIP			
Number of units issued	<b>223,724</b>	<b>76,224</b>	147,500
Units issued	<b>\$ 2,763</b>	<b>\$ 1,026</b>	\$ 1,737
Compensation cost	<b>198</b>	<b>109</b>	89
	<b>2,961</b>	<b>1,135</b>	1,826
LTIP installment loans receivable	<b>(2,624)</b>	<b>(974)</b>	(1,650)
Interest on installment loan receivable	<b>(91)</b>	<b>(73)</b>	(18)
Distributions applied against installment loan receivable	<b>303</b>	<b>240</b>	63
	<b>\$ 548</b>	<b>\$ 327</b>	\$ 221

### **13. Income Taxes**

The REIT is taxed as a "Mutual Fund Trust" for income tax purposes. The REIT is required by its Declaration of Trust to distribute or designate all of its taxable income to unitholders and to deduct such distributions or designation for income tax purposes. Accordingly, no provision for income taxes has been made. Income tax obligations relating to distributions of the REIT are the obligations of the unitholders.

### **14. Financial Instruments**

The fair value of the REIT's financial assets and liabilities with current maturities approximate their recorded values as at December 31, 2005. The fair value of the mortgages payable is \$201,890 (2004 – \$148,033)

In the normal course of its business, the REIT is exposed to a number of financial risks that can affect its operating performance. These risks and the actions taken to manage them are noted below. The REIT does not have foreign exchange risks as it holds only Canadian dollar denominated assets and liabilities.

#### (a) INTEREST RATE RISK

All of the REIT's mortgages payable at December 31, 2005 are at fixed interest rates and are not exposed to changes in interest rates. Bank indebtedness is at floating rate interest rates and is exposed to changes in interest rates. As fixed rate debt matures and as the REIT utilizes additional floating rate debt under the revolving credit facilities, the REIT will be further exposed to changes in interest rates. As part of its risk management program, The REIT endeavors to maintain an appropriate mix of fixed rate and floating rate debt and to stagger the maturities of its debt.

#### (b) CREDIT RISK

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The REIT's credit risk is limited to the recorded amount of tenant receivables.

The REIT does not acquire, hold or issue derivative financial instruments for hedging or trading purposes.

## **15. Segmented Disclosure**

Substantially all of the REIT's assets are in, and its revenue is derived from, the downtown Toronto office market.

## **16. Commitments and Contingencies**

The REIT has entered into commitments for acquisitions, building renovations, leasing commissions and tenant inducements with respect to leasing activities and for repairs and operating costs. The commitments as at December 31, 2005 and December 31, 2004 were \$1,161 and \$406, respectively.

## **17. Related Party Transactions**

### (a) PROPERTY MANAGEMENT AGREEMENT

Prior to July 1, 2005 the REIT was bound by the Property Management Agreement the REIT had entered into with Allied Canadian Development Corporation ("Developer"). The Developer was appointed as the property manager for the rental properties owned by the REIT. The Developer is a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Developer. For its services as property manager, it was paid an annual fee equal to 4% of the gross revenues, was entitled to recover the cost incurred by it in substituting on-site managers at rental properties, the costs of its maintenance staff to perform regular maintenance at the rental properties and its out-of pocket expenses related to services provided. Amounts paid and included in rental operating cost during the years ended December 31, 2005 and December 31, 2004 were \$1,571 and \$2,200 respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a leasing fee. The fee was payable upon tenants having executed and delivered signed leases. Amounts paid and included in deferred expenses during the years ended December 31, 2005 and December 31, 2004 were \$72 and \$256 respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a project management fee based on customary market fees for project management services in connection with renovations, construction and reconstruction work on the rental properties. Amounts paid and included in rental properties during the years ended December 31, 2005 and December 31, 2004 were \$10 and \$89 respectively.

Pursuant to the Property Management Agreement, the Developer provided the REIT a fully equipped office and support staff and was entitled to recover its cost from the REIT. Amounts paid and included in trust expenses during the years ended December 31, 2005 and December 31, 2004 were \$38 and \$65 respectively.

Included in accounts payable and other liabilities is an amount of \$31 (December 31, 2004 – \$26) related to the above noted services. Included in commitments and contingencies is an amount of \$45 (December 31, 2004 – \$11) related to the above noted services.

These transactions are in the normal course of operations and were measured at the exchange amount agreed upon by the parties.

### (b) REAL ESTATE SERVICES

As a result of the acquisition of the property management business on July 1, 2005 as disclosed in Note 2 (b), the REIT engages in third party property management services, including services provided for properties in which certain trustees of the REIT have an ownership interest. For the year ended December 31, 2005 real estate service revenue earned from these properties was \$205, which was fully paid in the period. These transactions are in the normal course of operations and were measured at the exchange amount set out in agreement between the respective property owners and the Property Manager, prior to the REIT acquiring the business. The REIT assumed the terms of these agreements.

### (c) RENTAL REVENUES

Rental revenues included amounts received from related parties for the Year Ended December 31, 2005:

Related Party	Nature of Revenue	Year Ended December 31, 2005	Year Ended December 31, 2004
Vendors of properties	Head Lease	\$ 165	\$ 257
Property Manager	Lease	151	–
Techspace Canada Inc.	Guarantee	61	162
Techspace Canada Inc.	Lease	178	–
Vendors of properties	Bridge Covenants	360	59
		<b>\$ 915</b>	<b>\$ 478</b>

#### *Head Lease:*

Certain vendors entered into a lease dated February 20, 2003 for 16,686 square feet of office space for a five year term, expiring on February 19, 2008, (the “Head Lease”). The Head Lease has been amended such that the term with respect to 2,747 square feet expired on May 31, 2004 and the term with respect to 5,596 square feet expired on July 31, 2004. The REIT has entered into lease agreements with new tenants for the 2,747 square feet and the 5,596 square feet for terms, which expire subsequent to February 20, 2008. The obligations of the vendors under the Head Lease are secured by cash of \$539, which is held in an escrow account by the Property Manager. These vendors are under common control of certain trustees of the REIT.

#### *Guarantee and Lease:*

TechSpace Canada Inc. (“TechSpace”), a subsidiary of the Property Manager, leased 29,102 square feet of office space from the REIT on commercial terms. The lease was to expire on September 30, 2010. The Property Manager indemnified the REIT in respect of all of TechSpace’s obligations under the lease. The REIT entered into a lease directly with a new tenant effective January 1, 2004 for the 29,102 square feet. The indemnity from the Property Manager remains in place to protect the REIT from any revenue shortfall (on a cash basis) from the original TechSpace lease. This lease was terminated on April 30, 2005 and a new lease has been entered into with a current tenant of the REIT for a term of July 1, 2005 to April 30, 2008. The indemnity remains in effect to September 30, 2010.

#### *Bridge Covenants:*

Certain vendors of the rental properties provided bridge covenants (collectively the “Bridge Covenants”) to the REIT in respect of certain office space leased to third party, non related tenants. These Bridge Covenants provide the REIT with an income stream to coincide with rent-free periods that the vendors provided to the tenants, prior to the REIT acquiring the rental properties. These vendors are under common control of certain trustees of the REIT.

### (d) RENTAL PROPERTY ACQUISITIONS

Effective January 1, 2005 and July 1, 2005 the REIT acquired from certain vendors that are under common control of certain Trustees of the REIT, 469 King Street West and 602 King Street West for purchase prices of \$16.0 million and \$11.27 million respectively. The purchase prices net of standard adjustments were paid in cash and the REIT assumed a first mortgage loan of \$5.06 million with respect to 469 King Street West. The purchase price was determined by an independent appraisal.

## **18. Subsequent Events**

On January 20, 2006, the REIT placed a first mortgage on 208-210 Adelaide Street West, Toronto, 200 Adelaide Street West, Toronto and 116 Simcoe Street, Toronto, in the principal amount of \$9 million for a term of 10 years at an annual interest rate of 5.16%.

On January 20, 2006, the REIT placed a first mortgage on 579 Richmond Street West, Toronto, and 141 Bathurst Street, Toronto, in the principal amount of \$6.5 million for a term of 10 years at an annual interest rate of 5.16%.

On February 2, 2006, the REIT announced an agreement to acquire 4436-4450 Saint-Laurent Boulevard, a Class I office property located in downtown Montreal, and 5,500 square feet of adjacent land that forms the southwest corner of Saint-Laurent and Boulevard Mount-Royal for an aggregate purchase price of \$11.2 million. The acquisition is scheduled to close on or about March 31, 2006.

## UNITHOLDER INFORMATION

### CORPORATE OFFICES

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### LISTING

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(TSX) AP.UN

### ANNUAL MEETING

Thursday, May 4, 2006

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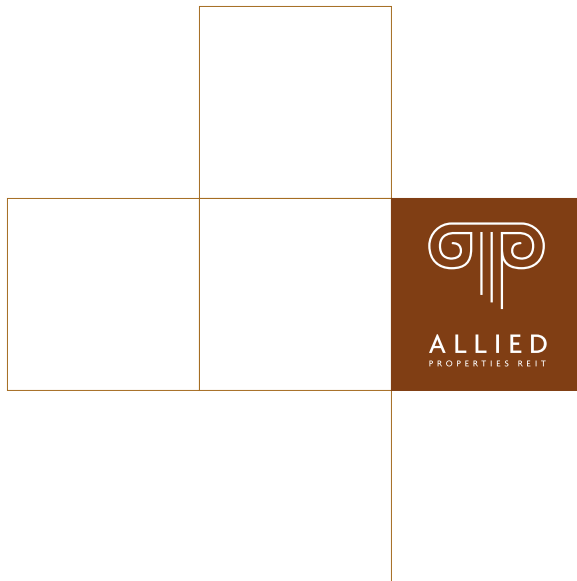
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