



ALLIED  
PROPERTIES REIT

# Building on Our Foundation

2004 Annual Report



## CORPORATE PROFILE

Allied Properties Real Estate Investment Trust is the leading owner of Class I (“brick and beam”) office properties in downtown Toronto. In 2004 the REIT entered the Montreal market with the acquisition of a 200,000 square foot Class I property in Montreal’s International District, immediately north of Old Montreal.

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 the 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.

This 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 film groups and selected entertainment and retail uses.

The REIT is the premier provider of Class I space in Toronto and has established a solid position within the Montreal Class I market. The REIT continues to build on this platform, increasing its competitive advantage through the further consolidation of its large, fragmented and growing target markets. In 2004, the REIT acquired six properties and announced a seventh, increasing its gross leasable area by 70%. At year end the REIT’s portfolio comprised 22 predominantly Class I office properties with 1.7 million square feet of gross leasable area.

## FINANCIAL HIGHLIGHTS

	2004 <sup>1</sup>	2003 <sup>2</sup>	IPO <sup>3</sup>
Occupancy	99.2%	97.5%	96.9%
Rental revenue	34,565	17,945	18,139
Net rental income	22,537	12,142	11,547
Net income	7,867	6,434	5,654
Distributable income <sup>4</sup>	11,923	6,907	6,409
Net income per unit	0.87	1.05	0.94
Distributable income per unit	1.33	1.12	1.06
Distributions per unit	1.13	0.95	0.95

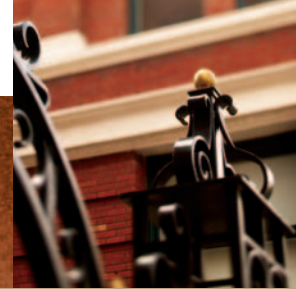
<sup>1</sup> For the year ended December 31, 2004

<sup>2</sup> For the 316-day period ended December 31, 2003

<sup>3</sup> The forecast included in the Prospectus dated February 6, 2003 pro-rated for the period of operations of the REIT from February 19, 2003 to December 31, 2003. These figures have been prepared by management and are unaudited.

<sup>4</sup> 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 15 for details.

# Allied Properties REIT Delivered



## ACQUISITIONS

- Acquired six properties for \$106 million
- Announced a seventh acquisition for \$16 million, which closed January 2005
- Increased portfolio size 70% to 1.7 million square feet
- Expanded into downtown Montreal
- Continued consolidation of target market in downtown Toronto

## OPERATIONS & FINANCING

- Increased occupancy rate to 99.2% from 97.5%
- Extended average mortgage term to maturity to 6.6 years from 5.5 years
- Reduced average weighted interest rate to 6.5% from 7.1%
- Raised \$59 million in equity

## RETURN TO UNITHOLDERS

- Increased distributions to annual rate of \$1.14/unit from \$1.10/unit
- From inception in 2003, delivered an average annual total return to unitholders of 31.5% without distribution reinvestment and 35.9% with distribution reinvestment

# Building on and Expanding Our Foundation



## I am very pleased to provide this annual report to unitholders of Allied Properties REIT.

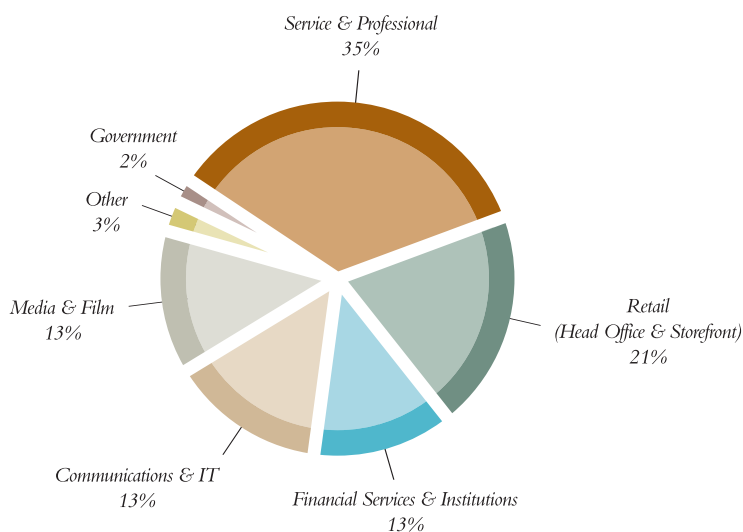
If 2003 was the year we laid our foundation for growth, 2004 was the year we started to build on and expand that foundation.

We began 2004 with 16 predominantly Class I properties in our initial target market, the vibrant areas to the east and west of Toronto's downtown core. Over the course of the year, we completed six acquisitions and announced a seventh which closed just after year-end. Six of the acquisitions were part of our ongoing strategy to consolidate ownership in our Toronto target market. The other expanded our geographic focus to include a second target market, the vibrant areas around Montreal's downtown core, particularly the International District and Old Montreal. Two of the acquisitions came through the development pipeline established by our Option Agreement with Allied Canadian Corporation, a leading developer of Class I properties.

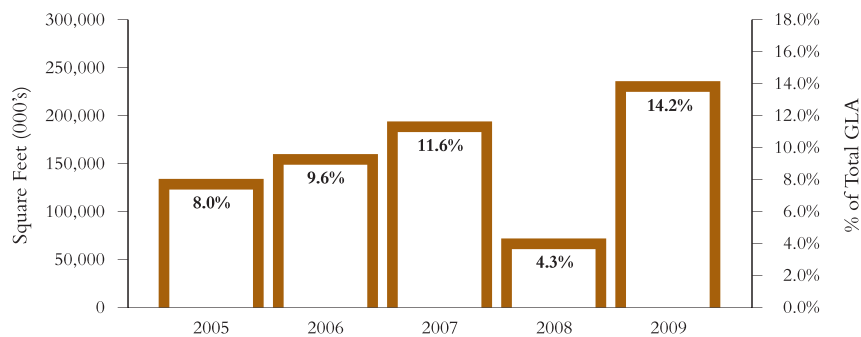
The acquisitions made or announced in 2004 totaled \$122 million, increased the size of our portfolio by 70% and increased our distributable income per unit. They also enhanced our key portfolio attributes, including our tenant mix and our lease maturity schedule, which are set out below on a pro-forma basis.

We financed our growth in 2004 with a carefully considered combination of debt and equity. We completed two bought deals, one in May for \$32.2 million at \$11.10 per unit and one just after year-end for \$24.7 million at \$13.00 per unit. An additional \$2.3 million in equity was raised through the exercise of options and participation in our DRIP. We also secured favourable first and second mortgage financing that increased the weighted average term to maturity of our mortgages to 6.62 years and reduced the weighted average interest rate on our mortgages to 6.51%.

**Tenant Mix**



Lease Maturity Schedule



### Continuing our Focus on Operations

Our overall portfolio strength was reflected in our 2004 operations. We began 2004 with a vacancy rate of 2.5% on 985,000 square feet and finished the year with a vacancy rate of less than 1% on 1.7 million square feet. Over the course of the year, we leased the remainder of the space that was vacant at the time of our IPO, renewed or replaced 93% of the space covered by leases that matured in 2004 and added high-value new tenancies to the portfolio.

Our distributable income per unit continued its steady increase in 2004, finishing the year at \$1.33 per unit. This enabled us to increase our monthly distributions in March of 2004 to \$0.095 per unit (\$1.14 per unit on annualized basis) and again in March of 2005 to \$0.0983 per unit (\$1.18 per unit on an annualized basis). It also enables us to achieve our monthly distributions at a pay-out ratio of 88.1% for the year and 83.6% for the second half of the year.

### Outlook for 2005

From its inception to the end of 2004, Allied Properties REIT delivered an average annual total return to unitholders<sup>1</sup> of 31.5% without distribution reinvestment and 35.9% with distribution reinvestment under our DRIP. Stable and growing monthly distributions are the bedrock on which a good total return rests. As we look to 2005, we are confident in our portfolio and in our ability to sustain a manageable rate of growth.

Our initial phase of growth came from the acquisition of Class I office properties in our Toronto target

market. We subsequently expanded our geographic focus to include Montreal, a 24-hour city with a large inventory of Class I properties. We intend to continue the consolidation process in our Toronto target market and to begin a similar process in our Montreal target market. In doing so, we will continue to focus on our competitive strengths – convenient locations, distinctive internal and external environments and significantly lower overall occupancy costs. And we will continue to work with existing and prospective tenants to remain a preferred provider of office space in our target markets.

We have the capacity to continue our successful acquisition strategy. Following the offering that closed just after year-end, our ratio of debt to Gross Book Value was 50.1%, affording us acquisition capacity of approximately \$70 million. Management intends to put this capacity to good use.

As we embark on 2005, I want to acknowledge our trustees and our management team. Their contributions have enabled Allied Properties REIT to deliver consistently on its promises of performance. I also want to thank our unitholders for their continued encouragement and interest in our business.

**Michael R. Emory**

President and Chief Executive Officer

<sup>1</sup> Calculated from February 20, 2003, the date of our IPO, based on the change in unit price plus cash distributions.

55,905 square feet

**217 Richmond Street West, Toronto**

The Gelber Building is a restored, six-storey, office/retail building. Located on the southwest corner of Richmond Street West and John Street, the property is comprised of 55,905 square feet of GLA. Built in the early 1900s, the building was extensively renovated for office and retail use in the 1980s.

55,814 square feet

**185 Spadina Avenue, Toronto**

185 Spadina Avenue is a restored, seven-storey, office building. Located on the east side of Spadina Avenue, just north of Queen Street West, the property is comprised of 55,814 square feet of GLA. Built in the early 1900s, the building was fully renovated in the late 1990s.



32,193 square feet

**50 Wellington Street East, Toronto**

50 Wellington Street East is a restored, five-storey, office/retail building. Located on the north side of Wellington Street East, just west of Church Street, the property is comprised of 32,193 square feet of GLA. Built in the early 1900s, the building was extensively renovated for office and retail use in the 1980s and again in the 1990s.



75,560 square feet



**The Castle Phase I – 53 Fraser Avenue, Toronto**

The Castle Phase I is the first phase of a restored, five-storey, Class I office/retail complex. Located on the east side of Fraser Avenue, just south of King Street West, the property is comprised of 75,560 square feet of GLA. Built in 1912 by E.W. Gillet Company for the production of Magic Baking Powder. Phase I of the complex was extensively renovated in 2001.

223,588 square feet

**The Queen Richmond Centre – 111 Queen Street East, Toronto**

The Queen Richmond Centre is an integrated complex of 11 restored, Class I office/retail buildings. Located on the south side of Queen Street East and the north side of Richmond Street East, just west of Jarvis Street, the complex is comprised of 223,588 square feet of GLA. Built in the late 1800s and early 1900s, the buildings comprising the complex were extensively renovated for office and retail use in 2001 and 2002.



206,134 square feet



**Edifice Viger – 425 Viger Avenue West, Montreal**

425 Viger Avenue West, is a restored 11-storey Class I office building, located on the north side of Viger Avenue West. Located immediately north of the new head office for the Caisse de Depot et Placement, in the International District, just north of Old Montreal. The property is comprised of 206,134 square feet of GLA. Originally built for the printing industry, the property was extensively renovated in 1981-82 and again in 1992-93.

## Quality of dialogue provides the most effective governance



As you will read in this annual report, 2004 was a solid year of performance for the REIT as we continue to build on the foundation we established with our IPO in February 2003.

Management met or exceeded expectations on several fronts – bottom line performance, growth both internally and by acquisition, significant increases in our capital and critical expansion into a new and exciting marketplace – Montreal.

Through the year interaction between the board of trustees and management was candid, open and useful. It is my view that the dialogue which occurred was both enlightening to the trustees in the discharge of their duties and helpful to management in accomplishing their business plan.

It is the quality of dialogue between management and those of us charged with oversight of the REIT's operations which provides the most effective regime of governance. For that I personally thank both our board of trustees and management.

Finally, I want to thank you, our unitholders for your ongoing support of our organization. I believe your confidence is well founded.

A handwritten signature in black ink, appearing to read "G.R. Cunningham".

**Gordon R. Cunningham**  
Chairman



## TRUSTEES AND MANAGEMENT

**Michael P. Bonneveld** Mr. Bonneveld is Director of Acquisitions of the REIT. He joined the REIT in June 2004, prior to which he was employed by Scotia Capital Inc., the investment banking division of Bank of Nova Scotia, where he was an Associate Director in the Corporate Finance – Real Estate Group. Mr. Bonneveld also spent four years with the consulting and valuation group of Jones Lang LeSalle, an international real estate consulting firm, in their Toronto office.

**Gerald R. Connor** Mr. Connor is Chairman of Cumberland Asset Management Corp., which currently manages assets in excess of \$1.3 billion for institutions and high net worth investors. Prior to founding Cumberland Asset Management Corp. 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 Asset Management Corp. 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 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 Corporation, positions he has held since 1995. Before joining Allied Canadian Corporation in 1992, Mr. Jacobs was employed by CB Richard Ellis, a leading national real estate brokerage firm.

**Marianne O'Leary** Ms. O'Leary is Vice President, Operations of the REIT. She is also Senior Vice President, Real Estate Operations of Allied Canadian Corporation, a position she has held since 1995. Prior to joining Allied Canadian 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 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**

Management's discussion and analysis of results of operations and financial condition ("MD&A") should be read in conjunction with the audited financial statements and notes thereto of Allied Properties Real Estate Investment Trust (the "REIT") as at December 31, 2004, and December 31, 2003. Unless otherwise indicated, dollar amounts in this MD&A are in thousands.

This MD&A contains forward-looking statements relating to the REIT's operations and the environment in which the REIT operates, which are based on expectations, estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to control or predict. Therefore, actual outcomes and results may differ materially from those expressed in these forward-looking statements. Readers, therefore, should not place undue reliance on any such forward-looking statements. Further, a forward-looking statement speaks only as of the date on which such statement is made. Management believes that the expectations reflected in forward-looking statements are based on reasonable assumptions but can give no guarantees or assurances that actual results will be consistent with these forward-looking statements.

Many factors could cause actual results to differ from the forward-looking statements in this MD&A. Important factors that could cause actual results to differ include, but are not limited to, the following:

- the results of our efforts to implement our acquisition strategies;
- the effect of economic conditions, including rising interest rates;
- our ability to generate sufficient cash flow from rental properties;
- our ability to maintain occupancy and to lease or release space at favourable rents on a timely basis;
- tenants' financial difficulties;
- changes in operating costs;
- the cost of our capital and debt;
- changes in our capital requirements and availability of financing;
- the actions of our competitors and our ability to respond to those actions; and
- environmental uncertainties and disasters and the ability to obtain adequate insurance coverage at reasonable cost.

These forward-looking statements are made as of March 9, 2005, and the REIT undertakes no obligation to update publicly any such statements to reflect new information or the occurrence of future events or circumstances.

March 9, 2005



## 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.

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 ("Initial Properties") in the downtown Toronto office market with approximately 820,000 square feet of space.

Effective October 1, 2003, the REIT acquired 99 Spadina Avenue, Toronto. On December 19, 2003, the REIT acquired 905 King Street West, Toronto. On February 28, 2004, the REIT acquired 217–225 Richmond Street West, Toronto. On April 1, 2004, the REIT acquired 185 Spadina Avenue, Toronto. On May 3, 2004, the REIT acquired 50 Wellington Street East, Toronto. Effective June 1, 2004, the REIT acquired The Queen Richmond Centre, 99–123 Queen Street East and 92–114 Richmond Street East, Toronto. Effective June 18, 2004, the REIT acquired Phase I of The Castle, 41 and 53 Fraser Avenue and 8 Pardee Avenue, Toronto. On November 29, 2004, the REIT acquired 425 Viger Avenue West, Montreal. Effective January 1, 2005, the REIT acquired 469 King Street West, Toronto. 99 Spadina Avenue, 905 King Street West, 217–225 Richmond Street West, 185 Spadina Avenue, 50 Wellington Street East, The Queen Richmond Centre, Phase I of The Castle and 425 Viger Avenue West are collectively referred to as the "Additional Properties".

The REIT financed the acquisition of the Additional Properties and 469 King Street West in part through a private placement of 900,000 units at \$11.15 per unit that closed on December 18, 2003, a public offering of 2.9 million units at \$11.10 per unit that closed on May 27, 2004, and a public offering of 1.9 million units at \$13.00 per unit that closed on January 4, 2005.

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 enjoys a first-mover advantage in the large-scale provision of Class I space in Toronto and intends to build on this advantage through ongoing consolidation of a large, fragmented and growing target market. Through this consolidation, the REIT will strive to realize ever greater operating efficiencies, to diversify further its tenant mix and to reduce further its exposure to any particular tenant. With the acquisition of 425 Viger Avenue West, the REIT initiated the expansion of its geographic focus to include downtown Montreal.

The REIT has the benefit of an option agreement ("Option Agreement") with Allied Canadian Corporation ("Developer"), a leading developer of Class I office properties in Toronto, 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. The REIT believes that there are sufficient acquisition opportunities available to it in its target market through the Option Agreement and from third-party owners to achieve its operating and growth objectives.

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, 2004, the REIT increased its monthly distributions by 3.6% to \$1.14 per unit on an annualized basis.

### *2. Distributable Income*

Increasing distributions can be achieved prudently by increasing Distributable Income. In 2003, the REIT forecast \$1.06 per unit in Distributable Income and achieved \$1.122 per unit. In 2004, Distributable Income was \$1.325 per unit, up 18% from the abbreviated comparable period in 2003.

### *3. 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 pay-out ratio, the ratio of actual distributions in a given period to Distributable Income in such period. In 2003, the REIT forecast a pay-out ratio of 90% and achieved a pay-out ratio of 85%. The pay-out ratio in the second half of 2004 was 83.6%.

### *4. Debt Ratio*

A conservative ratio of debt to Gross Book Value mitigates unitholder risk. In 2003, the REIT forecast a 56% ratio of debt to Gross Book Value and finished the year with a 51% ratio of debt to Gross Book Value. As at December 31, 2004, the ratio of debt to Gross Book Value was 56.3%. Following the closing of the public offering and the acquisition of 469 King Street West on January 4, 2005, the ratio of debt to Gross Book Value was 50.1%.

## **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. In 2003, the REIT renewed leases representing 44% of the area covered by maturing leases and re-leased another 40% of that area. In 2004, the REIT renewed leases representing 50% of the area covered by maturing leases and re-leased another 44% of that area. Two of the areas re-leased represent significant increases in rental rate and another two represent significant long-term improvements to the stability of the REIT's rental income.

### *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%.

### *3. Same Asset Net Operating Income*

The REIT strives to maintain or increase same asset net operating income over time. Ignoring the step rent revenue, the NOI from the Initial Properties was \$11,821 in 2004, \$2,050 higher than the abbreviated comparable period in 2003.

### *4. Leasing Costs*

The REIT monitors leasing costs carefully. In 2004, the REIT incurred \$2,518 in leasing cost with respect to vacant space or areas covered by maturing leases. \$1,459 of this amount was incurred in connection with the renewal or replacement of tenants occupying space covered by maturing leases. \$1,059 of this amount was incurred 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.

### *5. Capital Expenditures*

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2004, the REIT incurred \$1,978 in expenditures for capital improvements. \$427 of this amount involved maintenance capital expenditures. \$132 of this amount related to in-suite improvements made in connection with the renewal or replacement of tenants occupying space covered by maturing leases. \$1,419 of this amount related to base-building improvements made to 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**

As the REIT embarks on 2005, management remains confident in the REIT's portfolio and in the REIT's ability to sustain a manageable rate of growth.

The REIT intends to continue the consolidation process in its Toronto target market and to pursue Class I acquisition opportunities in its Montreal target market. In doing so, the REIT will continue to focus on its competitive strengths – convenient locations, distinctive internal and external environments and significantly lower overall occupancy costs. It will also continue to work with existing and prospective tenants to remain a preferred provider of office space in its target markets.

## **SUMMARY INFORMATION AND PERFORMANCE FOR THE YEAR ENDED DECEMBER 31, 2004**

Results for the year ended December 31, 2004 ("2004") are not directly comparable to the results for the 316-day period ended December 31, 2003 ("2003") for the following reasons:

- (i) 2004 is a 366-day period versus a 316-day period for 2003;
- (ii) the REIT's operations in 2003 did not include the Additional Properties other than 99 Spadina Avenue and 905 King Street West in the fourth quarter; and
- (iii) mandated changes in accounting policies apply for 2004, as more fully described in this MD&A.

Set out in Table 1 are the REIT's financial results for 2004 and 2003, the variance between the two and the variances attributable to the Initial Properties and to the Additional Properties.



**Table 1**

(In thousands except for per unit amounts)	2004	2003	Variance	Variance due to Initial Properties	Variance due to Additional Properties
Revenue from rental properties	\$ 34,565	\$ 17,945	\$ 16,620	\$ 3,905	\$ 12,715
Rental property operating cost	12,028	5,803	(6,225)	(1,089)	(5,136)
Net rental income	22,537	12,142	10,395	2,816	7,579
Financing expense	6,997	3,811	(3,186)	(363)	(2,823)
Depreciation and amortization	6,108	840	(5,268)	(2,217)	(3,051)
Income from operations	9,432	7,491	1,941	236	1,705
Trust expenses	1,565	1,057	(508)	(508)	—
Net income	7,867	6,434	1,433	(272)	1,705
Amortization on rental properties	4,209	789	3,420	1,981	1,439
Amortization on mortgage premium	(444)	(316)	(128)	17	(145)
Amortization of cost of acquired leases	820	—	820	—	820
Amortization of M-T-M acquired leases	(18)	—	(18)	—	(18)
Amortization of acquired tenant relationships	725	—	725	—	725
Step rent adjustments	(1,325)	—	(1,325)	(765)	(560)
Compensation expenses, long-term incentive plan	89	—	89	89	—
Distributable Income <sup>1</sup>	\$ 11,923	\$ 6,907	\$ 5,016	\$ 1,050	\$ 3,966
Distributable Income per unit (basic)	\$ 1.325	\$ 1.122	\$ 0.203		

<sup>1</sup> Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

Net income for the year ended December 31, 2004 increased by 22.3% to \$7,867 from \$6,434 for the period ended December 31, 2003, primarily due to the longer operating period in 2004 and the results of operations of the Additional Properties, offset by the impact of the changes in accounting policies applied in 2004 and increases in trust expenses. Basic net income per unit in 2004 was \$0.874 as compared to \$1.046 in 2003.

Basic Distributable Income in 2004 increased by 72.6% to \$11,923 from \$6,907 in 2003. Distributable Income per unit in 2004 was \$1.325 as compared to \$1.122 in 2003.

### Net Rental Income

Net rental income in 2004 increased by 85.6% to \$22,537 from \$12,142 in 2003 as follows:

- (i) \$765 due to new revenue recognition policies with respect to the REIT's Initial Properties;
- (ii) \$2,051 due to the longer operating period and improved performance in 2004 with respect to the Initial Properties; and
- (iii) \$7,579 due to the acquisition of the Additional Properties.

### 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 the assumed mortgages reduced financing expense by \$444 in 2004.

Financing expense in 2004 increased by 83.6% to \$6,997 from \$3,811 in 2003 as follows:

- (i) \$363 with respect to the Initial Properties due to a longer operating period in 2004, offset by slightly lower debt level; and
- (ii) \$2,823 with respect to the Additional Properties due to the mortgages assumed and debt utilized to finance the acquisitions.

### Depreciation and Amortization

Effective January 1, 2004, the REIT records depreciation on its buildings on a straight-line basis over their expected life. In 2003, the REIT recorded depreciation on its buildings on a 5%, 40-year sinking fund basis.

Depreciation recorded on buildings for in 2004 was \$4,209, \$3,420 higher than in 2003. \$1,981 of the increase relates to the Initial Properties and is mainly attributable to the change in accounting policy. \$1,439 of the increase is attributable to the Additional Properties in 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 expense is amortized on a straight-line basis over the term of the corresponding debt. For 2004 and 2003, amortization was:

**Table 2**

(In thousand of dollars)	2004	2003
Amortization of:		
Deferred leasing costs (tenant inducements and leasing commissions)	\$ 228	\$ 20
Fair value origination cost and tenant relationships for in-place leases on acquisition	1,545	—
Deferred financing cost	126	31
	<b>\$ 1,899</b>	<b>\$ 51</b>

### Trust Expenses

Trust expenses in 2004 of \$1,565 were \$508 higher than 2003, due to the longer operating period in 2004, an increase in management staff, increase in salaries, the non-cash expense associated with the long-term incentive plan and the costs associated with statutory reporting requirements. In addition, management of the Trust was eligible for and paid bonuses of \$60 in 2004, as certain targets established by the Governance and Compensation Committee were met. (Management was not eligible for a bonus in 2003 under any circumstances). Trust expenses includes those costs incurred by the REIT that are not directly attributable to a rental property and include such costs as officers' compensation, trustees fees, professional fees for legal and audit services, trustees and officers insurance premiums and general administrative expenses.

### Leasing Activity

As at December 31, 2003, 26,175 square feet of gross leasable area ("GLA") was vacant and leases for 146,748 square feet of GLA were scheduled to expire in 2004. During 2004, the REIT leased or renewed leases on 158,906 square feet of GLA.

The following sets out the GLA and leased area as at December 31, 2004.

**Table 3**

	Initial Properties	Additional Properties	Total
GLA (square feet)	825,748	814,931	1,640,679
Leased area (square feet)	812,311	814,931	1,627,242
Leased area as percentage of GLA	98.4%	100.0%	99.2%

### 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 providing tenant build-out allowances and tenant inducements and paying leasing commissions.

In 2004, expenditures for capital improvements were \$1,978. \$427 of this amount involved maintenance capital expenditures. \$132 of this amount related to in-suite improvements made in connection with the renewal or replacement of tenants occupying space covered by maturing leases. \$1,419 of this amount related to base-building improvements made to 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.

In 2004, expenditures for leasing costs were \$2,518. \$1,459 of this amount was incurred in connection with the renewal or replacement of tenants occupying space covered by maturing leases. \$1,059 of this amount was incurred 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.

### DISTRIBUTABLE INCOME

The REIT defines Distributable Income 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 expenses with respect to the long term incentive plan;
- (v) amortization of values ascribed in a building acquisition to in-place leases and customer relationships; and
- (vi) amortization of values ascribed in a building acquisition to above-market and below-market leases.



## Management's Discussion and Analysis

Distributable Income 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 Distributable Income to be a measure of its overall operating performance and is one of Management's key performance indicators. Set out in Table 1 and Table 4 are the calculations of Distributable Income, as defined above.

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 in Table 4 is this reconciliation.

**Table 4**

(In thousands except for unit and per unit amounts)	Q4 2004	Q4 2003	2004	2003
Cash from operating activities	\$ 5,613	\$ 3,296	\$ 13,678	\$ 7,001
Amortization, deferred leasing and financing cost	(139)	(17)	(354)	(51)
Change in non-cash operating items	(1,979)	(1,128)	(1,401)	(43)
Distributable Income <sup>1</sup>	\$ 3,495	\$ 2,151	\$ 11,923	\$ 6,907
Distributions	\$ 2,939	\$ 1,675	\$ 10,506	\$ 5,868
Distributions as a percentage of Distributable Income	84.1%	77.9%	88.1%	85.0%
Weighted average number of units outstanding (basic)	10,225,644	6,351,665	8,996,471	6,153,384
Weighted average number of units outstanding (diluted)	10,389,584	6,365,527	9,101,163	6,155,538
Distributable Income per unit (basic)	\$ 0.342	\$ 0.338	\$ 1.325	\$ 1.122
Distributable Income per unit (diluted)	\$ 0.336	\$ 0.338	\$ 1.310	\$ 1.122

<sup>1</sup> Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration of Trust.

Distributions in 2004 were \$10,506, which corresponds to a pay-out ratio of 88.1%, as compared to distributions in 2003 of \$5,868 and a corresponding pay-out ratio of 85.0%. The 2004 pay-out ratio is higher than normal as a result of the public offering of 2.9 million units, which closed on May 27, 2004, just prior to the record date for the May distribution. Without the extra distribution on the 2.9 million units, the pay-out ratio in 2004 would have been 85.8%.

## 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, which is widely used by the real estate industry. Set out in Table 5 is FFO, calculated in accordance with recommendations of CIPPREC.

**Table 5**

(In thousands)	Q4 2004	Q4 2003	2004	2003
Net income	\$ 1,998	\$ 1,999	\$ 7,867	\$ 6,434
Amortization on rental properties	1,194	246	4,209	789
Amortization of deferred leasing expenses	95	10	228	20
Amortization of values ascribed to the origination cost and tenant relationships for in-place leases acquired in a rental property acquisition	625	—	1,545	—
Funds from operations	\$ 3,912	\$ 2,255	\$ 13,849	\$ 7,243

**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, 2004, the REIT had mortgage debt of \$143,302, unitholders' equity of \$98,176 and bank debt (net of cash) of \$10,971.

The Declaration provides for a maximum debt level of 60% of the REIT's gross book value ("GBV") excluding convertible debentures (or 65% of GBV, including the entire principal pursuant to any convertible debentures outstanding). GBV is defined in the Declaration to mean, at any time, the book value of the assets of the REIT shown on the then most recent balance sheet of the REIT plus accumulated depreciation and amortization included therein or in the notes thereto. As at December 31, 2004, the REIT's debt to GBV was 56.3%, compared to 51.2% as at December 31, 2003.

**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.

In 2004, a total of 3,265,781 units were issued for equity contributions of \$34,748. Costs incurred to issue the units were \$1,866. Units were issued as follows:

- (i) 140,500 units were issued at \$10.00 per unit for \$1,405 pursuant to certain officers and trustees exercising options under the unit option plan;
- (ii) on May 27, 2004, 2,900,000 units were issued at \$11.10 per unit for \$32,190;
- (iii) on June 28, 2004, 110,000 units were issued pursuant to the long-term incentive plan at \$11.30 per unit for \$1,243;
- (iv) on December 22, 2004, 37,500 units were issued pursuant to the long-term incentive at \$13.17 per unit for \$494; and
- (v) 77,781 units were issued pursuant to the distribution re-investment plan at an average price of \$11.98 per unit for \$932.

The REIT adopted a unit option plan at the time of its IPO. As at December 31, 2003, 345,000 options were outstanding. In 2004 and 140,500 options were exercised and as at December 31, 2004, 204,500 options remain outstanding, of which 89,500 options have vested and 115,000 will vest on February 20, 2005. The options granted permit the trustees and officers to acquire units at an exercise price of \$10.00 per unit and expire on 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, of which 140,500 units had been issued by December 31, 2004. Subsequent to December 31, 2004, trustees and officers exercised 58,000 unit options.

## Management's Discussion and Analysis

In May 2004, the REIT adopted a long-term incentive plan (the "LTIP") whereby certain trustees and officers of the REIT (the "Participants") were offered the opportunity to participate in the LTIP. Under the LTIP, Participants subscribe for Units of the REIT at a market price payable as to 5% upon issuance of the units and the balance (the "LTIP Loan") over 10 years, bearing interest at 3%. The shares 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 LTIP Units are forwarded by the Custodian to the REIT and applied to reduce 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.

### Mortgages Payable

Mortgages payable as at December 31, 2004, consisted of mortgage debt of \$143,302 and premium on mortgages assumed (net of accumulated amortization) of \$1,048.

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.

**Table 6**

	Periodic Principal Payments (\$000)	Balance Due at Maturity (\$000)	Total Principal (\$000)	% of Total Principal	Interest Rate of Maturing Mortgages (%)
2005	\$ 3,587	\$ 1,850	\$ 5,437	3.79%	8.00%
2006	3,598	9,930	13,528	9.44%	7.33%
2007	3,475	19,404	22,879	15.97%	6.44%
2008	2,662	14,404	17,066	11.91%	5.95%
2009	2,584	8,735	11,319	7.90%	6.84%
Thereafter	13,006	60,067	73,073	50.99%	
	\$ 28,912	\$ 114,390	\$ 143,302		

Interest rates on mortgage indebtedness are between 5.20% and 8.10% with a weighted average interest rate of 6.53% and a weighted average term to maturity of 6.5 years. Each individual mortgage loan of the REIT is secured by a mortgage registered on title of a rental property and security agreements covering assignment of rents and personal property with respect to each property. The mortgage indebtedness has recourse to the assets of the REIT. The REIT attempts to stagger the maturity of the 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 and provides these assets as security to support bank credit facilities.

### Bank Credit Facilities

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

- (i) a \$5 million revolving credit facility bearing interest at bank prime plus 1.0%, which matures on February 28, 2006 (“Acquisition Credit Facility”); and
- (ii) a \$15 million revolving credit facility bearing interest at bank prime plus 1.0%, which matures on May 31, 2006 (“New Credit Facility”).

Subordinated mortgage charges and security agreements on three rental properties secure the Acquisition Credit Facility. First mortgage charges against three rental properties, subordinate mortgage charges against two other rental properties and security agreements on each of the five properties secure the New Credit Facility.

In 2004, the average borrowings under the credit facilities were \$4,582. As at December 31, 2004, the borrowings under the credit facilities were \$12,273.

### 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 expenses and distributions to Unitholders. The REIT’s Declaration requires it to declare distributions each year not less than the greater of (i) 75% of its Distributable Income 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 Distributable Income.

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 costs using cash flow from operations retained by the REIT and through available borrowing capacity under the New Credit Facility.

The Acquisition Credit Facility, the New Credit Facility, new mortgage indebtedness 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-to-GBV ratio, is \$25 million.

As at December 31, 2004, the REIT had future commitments as follows:

**Table 7**

(In thousands)	2004	2003
Leasing commissions	\$ 55	\$ 228
Tenant inducements	—	656
Building renovations	213	397
Operating costs	138	—
	<b>\$ 406</b>	<b>\$ 1,281</b>



## SUMMARY QUARTERLY INFORMATION AND PERFORMANCE

Set out in Table 10 is the summary of results for the most recently completed fiscal quarters and for the 41 day-period from the commencement of operations on February 19, 2003, to March 31, 2003.

**Table 8**

(In thousands except for per unit amounts)	October 1, to December 31, 2004	July 1 to September 30, 2004	April 1 to June 30, 2004	January 1, March 31, 2004	October 1, to December 31, 2003	July 1 to September 30, 2003	April 1 to June 30, 2003	February 19 to March 31, 2003
Revenue from								
rental properties	\$ 10,119	\$ 9,734	\$ 7,933	\$ 6,779	\$ 5,541	\$ 5,057	\$ 4,989	\$ 2,358
Rental property								
operating cost	3,664	3,369	2,656	2,339	1,776	1,610	1,579	838
Net rental income	6,455	6,365	5,277	4,440	3,765	3,447	3,410	1,520
Financing expense	2,117	1,957	1,618	1,305	1,200	1,086	1,060	465
Depreciation and amortization	1,958	1,855	1,354	941	263	241	234	102
Income								
from operations	2,380	2,553	2,305	2,194	2,302	2,120	2,116	953
Trust expenses	382	305	527	351	303	282	339	133
Net income	1,998	2,248	1,778	1,843	1,999	1,838	1,777	820
Amortization on								
rental properties	1,194	1,175	1,001	839	246	220	224	99
Amortization on								
mortgage premium	(103)	(113)	(120)	(108)	(94)	(74)	(100)	(48)
Amortization of cost								
of acquired leases	308	267	172	73	—	—	—	—
Amortization of M-T-M								
acquired leases	31	38	(34)	(53)	—	—	—	—
Amortization of								
acquired								
tenant relationships	317	291	117	—	—	—	—	—
Step rent adjustments	(276)	(375)	(361)	(313)	—	—	—	—
Compensation								
expense, long-								
term incentive plan	26	—	63	—	—	—	—	—
Distributable Income <sup>1</sup>	\$ 3,495	\$ 3,531	\$ 2,616	\$ 2,281	\$ 2,151	\$ 1,984	\$ 1,901	\$ 871
Net income								
per unit (basic)	\$ 0.195	\$ 0.220	\$ 0.212	\$ 0.253	\$ 0.315	\$ 0.303	\$ 0.293	\$ 0.136
Distributable Income								
per unit (basic)	\$ 0.342	\$ 0.346	\$ 0.312	\$ 0.320	\$ 0.338	\$ 0.326	\$ 0.313	\$ 0.144

<sup>1</sup> Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

## SUMMARY INFORMATION AND PERFORMANCE FOR THE QUARTER ENDED DECEMBER 31, 2004

Results for the quarter ended December 31, 2004 ("Q4 2004") are not directly comparable to the results for the quarter ended December 31, 2003 ("Q4 2003") for the following reasons:

- (i) the REIT's operations in Q4 2003 did not include the Additional Properties; and
- (ii) mandated changes in accounting policies apply for Q4 2004, as more fully described in this MD&A.

Set out in Table 9 are the REIT's financial results for Q4 2004 and Q4 2003, the variance between the two and the variances attributable to the Initial Properties and to the Additional Properties.

**Table 9**

(In thousands except for per unit amounts)	Q4 2004	Q4 2003	Variance	Variance Initial Properties	Variance Additional Properties
Revenue from rental properties	\$ 10,119	\$ 5,541	\$ 4,578	\$ 448	\$ 4,130
Rental property operating cost	3,664	1,776	(1,888)	(183)	(1,705)
Net rental income	6,455	3,765	2,690	265	2,425
Financing expense	2,117	1,200	(917)	67	(984)
Depreciation and amortization	1,958	263	(1,695)	(539)	(1,156)
Income from operations	2,380	2,302	78	(207)	285
Trust expenses	382	303	(79)	(79)	—
Net income	1,998	1,999	(1)	(286)	285
Amortization on rental properties	1,194	246	948	448	500
Amortization on mortgage premium	(103)	(94)	(9)	15	(24)
Amortization of cost of acquired leases	308	—	308	—	308
Amortization of M-T-M acquired leases	31	—	31	—	31
Amortization of acquired tenant relationships	317	—	317	—	317
Step rent adjustments	(276)	—	(276)	(117)	(159)
Trust expenses (non-cash)	26	—	26	26	—
Distributable Income <sup>1</sup>	\$ 3,495	\$ 2,151	\$ 1,344	\$ 86	\$ 1,258
Distributable Income per unit (basic)	\$ 0.342	\$ 0.338	\$ 0.004		

<sup>1</sup> Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

Net income in Q4 2004 decreased by \$1 as compared to Q4 2003. Basic net income per unit in Q4 2004 was \$0.195 as compared to \$0.315 in Q4 2003. The results of operations of the Additional Properties was offset by the impact of the changes in accounting policies, the increase in trust expenses and the amortization of deferred costs.

Distributable Income in Q4 2004 increased by 62.5% to \$3,495 from \$2,151 in Q4 2003. Basic Distributable Income per unit in Q4 2004 was \$0.342 as compared to \$0.338 in Q4 2003.

### Net Rental Income

Net rental income in Q4 2004 increased by 71.4% to \$6,455 from \$3,765 in Q4 2003, mainly due to acquisition of the Additional Properties and the new revenue recognition policies.

### 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 the assumed mortgages reduced financing expense by \$103, of which \$79 relates to mortgages assumed on the Initial Properties and \$24 relates to mortgages assumed on the Additional Properties.

Financing expense in Q4 2004 increased by 76.4% to \$2,117 from \$1,200 in Q4 2003 as follows:

- (i) a reduction of \$67 with respect to the Initial Properties due to a lower debt levels in Q4 2004; and
- (ii) \$983 due to the debt assumed and utilized to finance the acquisitions of the Additional Properties.

### Depreciation and Amortization

Effective January 1, 2004, the REIT records depreciation on its buildings on a straight-line basis over their expected life. In 2003, the REIT recorded depreciation on its buildings on a 5%, 40-year sinking fund basis.

Depreciation recorded on buildings for the Q4 2004 was \$1,194, \$948 higher than in Q4 2003. \$448 of the increase is directly attributable to the Initial Properties and \$500 of the increase is attributable to the Additional Properties in Q4 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 expense is amortized on a straight-line basis over the term of the corresponding debt. For Q4 2004 and Q4 2003 amortization was as follows:

**Table 10**

(In thousand of dollars)	Q4 2004	Q4 2003
Amortization of:		
Deferred leasing costs (tenant inducements and leasing commissions)	\$ 95	\$ 10
Fair value origination cost and tenant relationships for in-place leases on acquisition	625	—
Deferred financing cost	44	7
	<b>\$ 764</b>	<b>\$ 17</b>

## **Trust Expenses**

Trust expenses in Q4 2004 of \$382 were \$79 higher than Q4 2003, due to an increase in management staff and salaries. In addition, management of the Trust was eligible for a bonus in 2004 as certain targets established by the Governance and Compensation Committee were met. (Management was not eligible for a bonus in 2003 under any circumstances). Trust expenses includes those costs incurred by the REIT that are not directly attributable to a rental property and include such costs as officers' compensation, trustee fees, professional fees for legal and audit services, trustees and officers insurance premiums and general administrative expenses.

## **CRITICAL ACCOUNTING ESTIMATES**

The significant accounting policies used in preparing the REIT's audited 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 REIT also disclosed the fair value of mortgages in the notes to its financial statements. 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. There were no impairments recorded. 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.

## CHANGES TO ACCOUNTING POLICIES

The impact of recent pronouncements of the Canadian Institute of Chartered Accountants (the "CICA") on the REIT's accounting policies are set out in the REIT Management's Discussion and Analysis for the year ended December 31, 2003, and summarized below.

### Amortization of Rental Properties

Effective January 1, 2004, the sinking fund method of amortization is no longer in compliance with GAAP, with the result that, from the effective date, the REIT records depreciation on its buildings on a straight-line basis over their expected useful life.

### Revenue Recognition

Effective January 1, 2004, the REIT changed its method of recognizing rental revenues from leases with "stepped rent increases," where such increases were designed to account for inflation. In accordance with GAAP, rental revenue is recognized on a straight-line basis. The REIT applied this new policy on a prospective basis effective January 1, 2004.

### Accounting for Acquisitions of Rental Properties

Effective for transactions entered into after September 12, 2003, where operating leases are acquired in either an asset acquisition or a business combination, the purchase price is to be allocated to tangible assets (land, buildings and equipment) and identifiable intangibles.

The accounting treatment for intangibles is as follows:

- (i) the value of an above-market lease (lease that have a average rental rate in excess of the market rate at the time of acquisition) is recorded as an asset and amortized over the remaining term of the lease, which reduces rental revenue;
- (ii) the value of a below-market lease is recorded as a liability and amortized over the remaining term of the lease, which increases rental revenue; and
- (iii) the fair value of the origination cost associated with an in-place lease and the tenant relationship are recorded as assets and amortized over the remaining term of the lease, which increases amortization expense.

In the event an acquired lease is terminated prior to its contractual expiry date, the carrying amount of the intangibles with respect to that lease will be charged to rental revenue or amortization expense.

## RELATED PARTY TRANSACTIONS

The REIT has entered into an agreement (the "Property Management Agreement") with Allied Canadian Corporation ("Property Manager"), a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Property Manager.



Pursuant to the Property Management Agreement, the Property Manager is 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 to provide the REIT a fully equipped office and support staff. The initial term of the Property Management Agreement is five years to February 19, 2008 and renewable by the REIT for successive two year terms. Should the REIT decide not to renew the Property Management Agreement after the initial five-year term it is liable for the severance costs relating to the employees of the Property Manager dedicated to servicing any rental properties owned by the REIT.

Under the Property Management Agreement the REIT pays the following:

- (i) a management fee of 4% of rental revenue;
- (ii) a leasing fee of 15% of a third-party broker's fees if a broker originates a lease transaction;
- (iii) a leasing fee of 50% of the customary market brokerage fees if a third-party broker has not originated the lease transaction;
- (iv) a project management fee based on customary market fees for project management services for renovations, construction and reconstruction work on the rental properties;
- (v) the costs, plus applicable administrative charges, of staff supplied by the Property Manager to perform day-to-day maintenance and security functions for the rental properties;
- (vi) the costs, plus applicable administrative charges, of staff supplied by the Property Manager to perform duties that would typically be performed by on-site personnel;
- (vii) disbursements and out-of-pocket expenses related to services provided; and
- (viii) the costs incurred by the Property Manager to provide the REIT a fully equipped office and support staff.

Set out below are the fees paid or payable by the REIT to the Property Manager in connection with the provisions of its services for in 2004.

**Table 11**

(in thousands)	Recoverable Operating Expenses	Trust Expenses	Deferred Expenses	Rental Properties	Commit- ments	Total
Management fee	\$ 1,311	\$ —	\$ —	\$ —	\$ —	\$ 1,311
Maintenance	643	—	—	—	—	643
On-site personnel	214	—	—	—	—	214
Disbursements	32	5	—	—	—	37
Leasing fees	—	—	256	—	11	267
Project management fees	—	—	—	89	—	89
Office and support staff	—	60	—	—	—	60
	\$ 2,200	\$ 65	\$ 256	\$ 89	\$ 11	\$ 2,621

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 indemnity and the option expire six months after TechSpace's operations have stabilized. The REIT has 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.

## RISK AND UNCERTAINTIES

There are certain risk factors inherent in the investment and ownership of real estate. Such investments are capital intensive, and success depends on 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 largest metropolitan real estate market in Canada. This concentration enables Management to capitalize on certain economies of scale and competitive advantages that would not otherwise be available and contributes to mitigating the risk associated with the real estate ownership.

The REIT is also 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.

As at December 31, 2004, there were 121 tenants in the REIT's rental property portfolio and no single tenant accounted for more than 9.6% of the rental revenue for 2004. Table 12 is the REIT's tenant mix on the basis of percentage of rental revenue for 2004.

**Table 12**

Category	% of Rental Revenue 2004	% of Rental Revenue 2003
Service and professional	39	43
Retail (head office and storefront)	21	18
Telecommunications and information technology	16	17
Media and film	14	9
Financial services	4	4
Government	3	4
Other	3	5

99.2% of the space in the REIT's rental properties was leased as at December 31, 2004. Table 13 sets out the total leased square footage of the rental properties subject to lease expiry during the period ended December 31, 2009, assuming tenants do not exercise renewal options, and the percentage of leased leasable area.

**Table 13**

Year Ended	Square Feet	% of Leased Area
December 31, 2005	135,314	8
December 31, 2006	163,215	10
December 31, 2007	198,729	12
December 31, 2008	74,710	5
December 31, 2009	220,462	13

**SUBSEQUENT EVENTS**

On January 4, 2005, the REIT issued 1.9 million voting units at \$13.00 per unit pursuant to a public offering (the “Offering”), resulting in gross proceeds of \$24,700. Costs relating to the Offering, including underwriters’ fees, were \$1,265.

On January 4, 2005, the REIT acquired 469 King Street West, a rental property in Toronto, Ontario for \$16,000. The acquisition was financed with an assumed first mortgage of \$5,060, due July 1, 2015, bearing interest at 6.132%, the assumption of certain liabilities and the balance with cash.

## 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 financial statements were prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants and the Canadian Institute of Public and Private Real Estate Companies. The 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 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 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 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

**To the Unitholders of Allied Properties Real Estate Investment Trust**

We have audited the balance sheets of Allied Properties Real Estate Investment Trust as at December 31, 2004 and 2003 and the statements of earnings, unitholders' equity and cash flows for the year and period respectively 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 financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the year and period respectively then ended in accordance with Canadian generally accepted accounting principles.



BDO Dunwoody LLP  
Chartered Accountants

Toronto, Ontario  
February 2, 2005



## Balance Sheet

(in thousands)	December 31, 2004	December 31, 2003
<b>Assets</b>		
Rental properties (Note 4)	\$ 239,852	\$ 153,744
Deferred expenses (Note 5)	17,960	1,749
Other assets (Note 6)	9,023	1,271
Cash	—	305
	<b>\$ 266,835</b>	<b>\$ 157,069</b>
<b>Liabilities</b>		
Mortgages payable (Note 7)	\$ 144,350	\$ 82,096
Bank indebtedness (Note 7)	10,971	—
Accounts payable and other liabilities (Note 8)	12,351	6,387
Distributions payable	987	653
	<b>168,659</b>	<b>89,136</b>
<b>Unitholders' Equity</b> (Note 9)	<b>98,176</b>	<b>67,933</b>
	<b>\$ 266,835</b>	<b>\$ 157,069</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

# Statement of Unitholders' Equity

(in thousands)	Cumulative Capital	Cumulative Issue Costs	Cumulative Net Income	Cumulative Distributions	Total
From February 19, 2003 to December 31, 2003					
Net earnings	\$ —	\$ —	\$ 6,434	\$ —	\$ 6,434
Distributions	—	—	—	(5,868)	(5,868)
Initial public offering	50,000	(4,407)	—	—	45,593
Private placements	21,601	(455)	—	—	21,146
Distribution reinvestment plan	628	—	—	—	628
Unitholders' equity, December 31, 2003	\$ 72,229	\$ (4,862)	\$ 6,434	\$ (5,868)	\$ 67,933
<b>Year Ended December 31, 2004</b>					
<b>Net earnings</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 7,867</b>	<b>\$ —</b>	<b>\$ 7,867</b>
<b>Distributions</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(10,506)</b>	<b>(10,506)</b>
<b>Public offering</b>	<b>32,190</b>	<b>(1,841)</b>	<b>—</b>	<b>—</b>	<b>30,349</b>
<b>Distribution reinvestment plan</b>	<b>932</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>932</b>
<b>Unit options plan - options exercised</b>	<b>1,405</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>1,405</b>
<b>Long-term incentive plan (Note 12)</b>	<b>221</b>	<b>(25)</b>	<b>—</b>	<b>—</b>	<b>196</b>
<b>Unitholders' equity,</b>					
<b>December 31, 2004</b>	<b>\$ 106,977</b>	<b>\$ (6,728)</b>	<b>\$ 14,301</b>	<b>\$ (16,374)</b>	<b>\$ 98,176</b>

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

# Statement of Earnings

	Year Ended December 31, 2004	From February 19, 2003 to December 31, 2003
(in thousands, except per unit and unit amounts)		
Rental revenue	\$ 34,565	\$ 17,945
Operating costs	12,028	5,803
Amortization of rental properties	4,209	789
Amortization of deferred expenses	1,899	51
	18,136	6,643
Operating income from rental properties	16,429	11,302
Financing expense	6,997	3,811
Trust expenses	1,565	1,057
Net earnings	\$ 7,867	\$ 6,434
Net earnings per unit		
Basic	\$ 0.874	\$ 1.046
Fully diluted	\$ 0.864	\$ 1.045
Weighted average number of units		
Basic	8,996,471	6,153,384
Fully diluted	9,101,163	6,155,538

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

# Statement of Cash Flows

		From February 19, 2003 to December 31, 2003
	<b>Year Ended December 31, 2004</b>	
(in thousands)		
<b>CASH PROVIDED BY (USED IN):</b>		
<b>Operating activities</b>		
Net earnings	\$ 7,867	\$ 6,434
Items not affecting cash		
Amortization, rental properties	4,209	789
Amortization, deferred expenses	1,899	51
Step rent adjustments	(1,325)	—
Mark to market rent adjustments	(18)	—
Amortization, premium on assumed mortgages payable	(444)	(316)
Interest benefit granted under long-term incentive plan	89	—
	12,277	6,958
Change in other non-cash operating items	1,401	43
<b>Cash from operating activities</b>	<b>13,678</b>	<b>7,001</b>
<b>Investing activities</b>		
Net assets acquired (Note 2)	(97,553)	(54,974)
Capital expenditures, rental properties	(1,978)	(270)
Deferred leasing costs	(2,518)	(481)
<b>Cash used in investing activities</b>	<b>(102,049)</b>	<b>(55,725)</b>
<b>Financing activities</b>		
Repayment of mortgages payable	(6,201)	(1,383)
Proceeds from new mortgages payable	61,474	—
Deferred financing costs	(887)	(173)
Distributions	(9,240)	(4,588)
Proceeds of public offering (net of issue costs)	30,349	45,593
Proceeds of private placement (net of issue costs)	—	9,580
Proceeds from exercise of unit options	1,405	—
Proceeds from units issued under the LTIP (net of issue costs)	195	—
Net increase in short-term revolving debt (Note 7)	12,273	—
<b>Cash provided by financing activities</b>	<b>89,368</b>	<b>49,029</b>
<b>Increase in cash and cash equivalents</b>	<b>997</b>	<b>305</b>
<b>Cash and cash equivalents, beginning of period</b> (Note 7)	<b>305</b>	<b>—</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,302</b>	<b>\$ 305</b>
<b>Other cash flow information</b>		
Interest paid	\$ 7,111	\$ 3,702
<b>Supplemental disclosure of non-cash activities</b>		
Units issued pursuant to the distribution reinvestment plan	\$ 932	\$ 628

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

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

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, 2004 and the results of operations and cash flow for the year ended December 31, 2004. The comparative amounts presented in the statements of earnings, unitholders' equity and cash flow are for the period from February 19, 2003 to December 31, 2003.

## 2. ACQUISITIONS

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

	<b>Year Ended December 31, 2004</b>	Period From February 19, 2003 to December 31, 2003
Rental properties	\$ 86,264	\$ 152,480
Acquisition costs, including land transfer taxes	2,075	1,783
Other assets	553	1,045
Fair value of in-place leases	8,398	1,146
Fair value of above-market leases	4,463	—
Fair value of below-market leases	(1,379)	(883)
Fair value of tenant relationships	6,307	—
Mortgages payable	(7,425)	(83,795)
Accounts payable and accrued liabilities	(1,703)	(5,235)
Consideration paid for the net assets acquired	<b>\$ 97,553</b>	<b>\$ 66,541</b>
Consideration paid for the net assets acquired consisted of the following:		
Cash	\$ 97,553	\$ 54,974
Units issued to vendors	—	11,567
	<b>\$ 97,553</b>	<b>\$ 66,541</b>

## 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 and are also in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies, of which the REIT is a member.



#### **(b) 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.

#### **(c) 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.

#### **(d) 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.

Effective January 1, 2004, amortization on buildings is recorded on the straight-line basis over the useful life of the buildings, estimated at 40 years. The REIT adopted prospective application of this policy as a result of the application of CICA Section 1100. Prior to January 1, 2004, amortization on buildings was recorded on the sinking fund method to fully amortize the cost of the buildings over 40 years. The impact of this change in accounting policy was an increase to amortization on buildings of \$2,782 for the year ended December 31, 2004.

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. The REIT adopted prospective application of this policy with respect to acquisitions of rental properties that were initiated after September 12, 2003 in accordance with the guidance in CICA EIC 137 and EIC 140.

#### **(e) 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.

**(f) Revenue Recognition**

Rental revenue includes rents from tenants under leases, property tax and operating cost recoveries, parking income and incidental income. Effective January 1, 2004, rental revenue with respect to rents from tenants under leases is recognized ratably over the term of the lease. The REIT adopted prospective application of this policy as a result of the application of CICA Section 1100. Prior to January 1, 2004, rental revenue with respect to rents from tenants under leases was recognized based on contractual rents for the period. The impact of this change in accounting policy was an increase in rental revenue of \$1,378 for the year ended December 31, 2004.

**(g) Unit-based Compensation Plan**

Effective January 1, 2004, pursuant to amendments made to Handbook section 3870, the REIT commenced accounting 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. The amended recommendations were adopted on a retroactive basis, and the impact to earnings was not material.

**(h) Per Unit Calculations**

Basic earnings per unit is calculated by dividing net earnings by the weighted average number of units outstanding for the period, excluding those units issued under the Long Term Incentive Plan. 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.

**4. RENTAL PROPERTIES**

	Cost	Accumulated Amortization	Net Carrying Amount December 31, 2004	Net Carrying Amount December 31, 2003
Land	\$ 37,245	\$ –	\$ 37,245	\$ 24,187
Building, improvements and other costs	207,605	(4,998)	202,607	129,557
	<b>\$ 244,850</b>	<b>\$ (4,998)</b>	<b>\$ 239,852</b>	<b>\$ 153,744</b>

**5. DEFERRED EXPENSES**

Deferred expenses consist of costs incurred by the REIT, net of amortization of \$1,950 (2003 – \$51), with respect to obtaining debt financing, leasing costs incurred, the fair value attributed to in-place leases acquired and the fair value attributed to customer relationships with respect to rental property acquisitions. 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.

**6. OTHER ASSETS**

Other assets of \$9,023 (2003 – \$1,271) consist of above-market rents of leases acquired through rental property acquisitions of \$4,190 (2003 – \$nil), accounts receivable of \$2,116 (2003 – \$190), prepaid expenses of \$377 (2003 – \$38), cash deposits on account for a property pending property acquisition \$ nil (2003 – \$70) and escrow accounts held by mortgagees of \$2,340 (2003 – \$973).

## 7. MORTGAGES PAYABLE AND BANK INDEBTEDNESS

Substantially all of the REIT's assets have been pledged as security under the mortgages and other security agreements. Interest rates on the mortgages payable are between 5.20% and 8.10% with a weighted average of 6.53% (December 31, 2003 – 7.09%).

Mortgages payable at December 31, 2004 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Year ended December 31, 2005	\$ 3,587	\$ 1,850	\$ 5,437
Year ended December 31, 2006	3,598	9,930	13,528
Year ended December 31, 2007	3,475	19,404	22,879
Year ended December 31, 2008	2,662	14,404	17,066
Year ended December 31, 2009	2,584	8,735	11,319
Thereafter	13,006	60,067	73,073
	\$ 28,912	\$ 114,390	\$ 143,302
Premium on assumed mortgages (net of amortization)			1,048
			\$ 144,350

The REIT has a \$5,000 revolving credit facility with a Canadian chartered bank, which matures February 28, 2006 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 \$15,000 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 five rental properties and security agreements covering assignment of rents and personal property with respect to the six properties.

At December 31, 2004 the amount outstanding under the two credit facilities was \$12,273, which was fully repaid on January 4, 2005 with proceeds from the Public Offering described in Note 18, Subsequent Events. Bank indebtedness of \$10,971 includes amounts outstanding under the credit facilities net of cash of \$1,302.

## 8. ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payables and other liabilities consist of:

	December 31, 2004	December 31, 2003
General operating payables and tenant deposits	\$ 9,629	\$ 5,025
Below market rents of leases acquired through rental property acquisition (net of above market rents)	1,972	883
Accrued interest on mortgages payable	750	425
Deferred revenue	—	54
	\$ 12,351	\$ 6,387

## 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 May 27, 2004, the REIT issued 2.9 million voting units at \$11.10 per unit pursuant to a public offering (the "Offering"), resulting in gross proceeds of \$32,190. Costs relating to the Offering, including underwriters' fees, were \$1,841.

The number of units issued and outstanding is as follows:

	Units
Units outstanding, December 31, 2003	7,120,279
Units issued pursuant to Unit Option Plan (Note 11)	140,500
Units issued under the Dividend Reinvestment Plan	77,781
Units issued pursuant to the Offering	2,900,000
Units issued pursuant to the Long Term Incentive Plan (Note 12)	147,500
Units outstanding, December 31, 2004	10,386,060

## 10. NET EARNINGS PER UNIT

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

	Year Ended December 31, 2004	Period From February 19, 2003 to December 31, 2003
Basic	8,996,471	6,153,384
Dilutive – unit option plan	47,765	2,154
Dilutive – long-term incentive plan	56,927	–
Fully dilutive	9,101,163	6,155,538

## 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 and February 20, 2004 and 115,000 options vest on February 20, 2005.

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

Options	Weighted Average	
	Units	Exercise Price
Outstanding as at December 31, 2003	345,000	\$ 10.00
Exercised during the period ended December 31, 2004	140,500	\$ 10.00
Granted and outstanding as at December 31, 2004	204,500	\$ 10.00
Options exercisable as at December 31, 2004	89,500	\$ 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, 2004 147,500 Units were issued at a average purchase price of \$11.78 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 five years. For the year ended December 31, 2004, compensation cost of \$89, 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.

	Year Ended December 31, 2004
147,500 units issued under the LTIP	\$ 1,737
Compensation cost	89
	1,826
LTIP installment loans receivable	(1,650)
Interest on installment loan receivable	(18)
Distributions applied against installment loan receivable	63
	\$ 221

The REIT incurred costs of \$25 in connection with the LTIP which is included in unit issue costs.

## 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, 2004. The fair value of the mortgages payable is \$147,611 (2003 – \$83,735).

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, 2004 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 building renovations, leasing commissions and tenant inducements with respect to leasing activities and for repairs and operating costs. The commitments as at December 31, 2004 were \$406.

## 17. RELATED PARTY TRANSACTIONS

### (a) Property Management Agreement

Pursuant to the Property Management Agreement entered into by the REIT, Allied Canadian Corporation ("Allied Properties") has been appointed as the property manager for the rental properties owned by the REIT. Allied Properties is a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in Allied Properties. For its services as property manager, it is paid an annual fee equal to 4% of the gross revenues, is 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 year ended December 31, 2004 and the period from February 19, 2003 to December 31, 2003 were \$2,200 and \$1,165 respectively.

Pursuant to the Property Management Agreement, Allied Properties is entitled to a leasing fee. The fee is payable upon tenants having executed and delivered signed leases. Amounts paid and included in deferred expenses during the year ended December 31, 2004 and the period from February 19, 2003 to December 31, 2003 were \$256 and \$34, respectively.

Pursuant to the Property Management Agreement, Allied Properties is 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 year ended December 31, 2004 and the period from February 19, 2003 to December 31, 2003 were \$89 and \$11, respectively.

Pursuant to the Property Management Agreement, Allied Properties is to provide the REIT a fully equipped office and support staff and is entitled to recover its cost from the REIT. Amounts paid and included in trust expenses during the year ended December 31, 2004 and the period from February 19, 2003 to December 31, 2003 were \$65 and \$52, respectively.

Included in accounts payable and other liabilities is an amount of \$26 (2003 – \$6) related to the above noted services. Included in commitments and contingencies is an amount of \$11 (2003 – \$80) 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) Rental Revenues

Rental revenues included amounts received from related parties for the period ended December 31, 2004:

Related Party	Nature of Revenue	Year Ended December 31, 2004	Period From February 19, 2003 to December 31, 2003
Vendors of properties	Head Lease	\$ 257	\$ 284
Techspace Canada Inc.	Guarantee	162	–
Techspace Canada Inc.	Lease	–	643
Vendors of properties	Bridge Covenants	59	602
		\$ 478	\$ 1,529

#### 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 \$667, which is held in an escrow account by Allied Properties. 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 indemnity and the option expire six months after TechSpace’s operations have stabilized. The REIT has 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.

**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.

**18. SUBSEQUENT EVENTS**

On January 4, 2005, the REIT issued 1.9 million voting units at \$13.00 per unit pursuant to a public offering (the “Offering”), resulting in gross proceeds of \$24,700. Costs relating to the Offering, including underwriters’ fees, were \$1,265.

On January 4, 2005, the REIT acquired 469 King Street West, a rental property in Toronto, Ontario for \$16,000. The acquisition was financed with an assumed first mortgage of \$5,060, due July 1, 2015, bearing interest at 6.132%, the assumption of certain liabilities and the balance with cash.

## CORPORATE OFFICES

**Allied Properties  
Real Estate Investment Trust**  
469 King Street West  
Fourth Floor  
Toronto, ON  
M5V 1K4

## LISTING

**Toronto Stock Exchange**  
(TSX) AP.UN

## ANNUAL MEETING

Monday May 9, 2005

## AUDITORS

**BDO Dunwoody LLP**  
32<sup>nd</sup> Floor, Royal Bank Plaza  
P.O. Box 32  
Toronto, ON  
M5J 2J8

## COUNSEL

**Aird & Berlis LLP**  
BCE Place  
Suite 1800, Box 754  
181 Bay Street  
Toronto, ON  
M5J 2T9

## REGISTRAR AND TRANSFER AGENT

**CIBC Mellon Trust Company**  
320 Bay Street  
P.O. Box 1  
Toronto, ON  
M5H 4A6

## INVESTOR RELATIONS CONTACT

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

**Allied Properties  
Real Estate Investment Trust**  
469 King Street West  
Fourth Floor  
Toronto, ON  
M5V 1K4

Tel: 416.977.9002  
Fax: 416.977.9053  
Web: [www.alliedpropertiesreit.com](http://www.alliedpropertiesreit.com)



**ALLIED**  
PROPERTIES REIT

**Allied Properties Real Estate Investment Trust**

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Toronto, ON, M5V 1K4

[www.alliedpropertiesreit.com](http://www.alliedpropertiesreit.com)