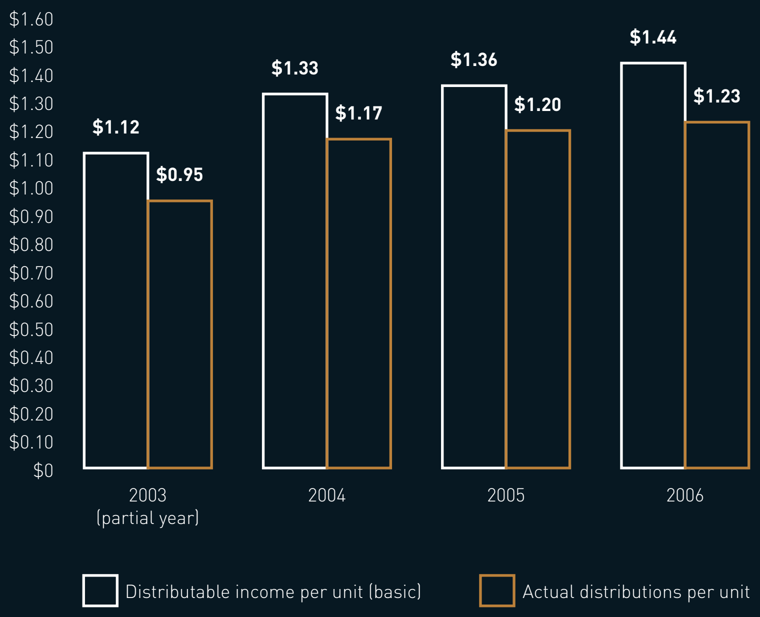

ALLIED
PROPERTIES REIT
building on our experience
Annual Report 2006

Financial highlights

(In thousands, except for % and per unit amounts)	2006 [1]	2005 [2]
Occupancy	**96.3%**	97.0%
Rental revenue	**64,229**	51,170
Net rental income	**41,048**	32,906
Net income	**7,717**	1,392
Distributable income [3]	**23,982**	19,082
Distributable income per unit (basic)	**1.442**	1.363
Distributable income per unit (diluted)	**1.414**	1.339
Distributable income pay-out ratio	**85.3%**	87.9%

1. For the year ended December 31, 2006.
2. For the year ended December 31, 2005.
3. Distributable income is not a financial measure defined by Canadian GAAP. See the REIT's MD&A for a description of this measure and its reconciliation to net income.

Distributable income per unit (basic) and actual distributions per unit since IPO



Allied Properties Real Estate Investment Trust is a leading owner and manager of Class I office properties in Canada. Class I office properties are created through the adaptive re-use of light industrial structures in urban areas. They typically feature high ceilings, abundant natural light, exposed structural frames, 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.

The Class I value proposition includes:

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

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

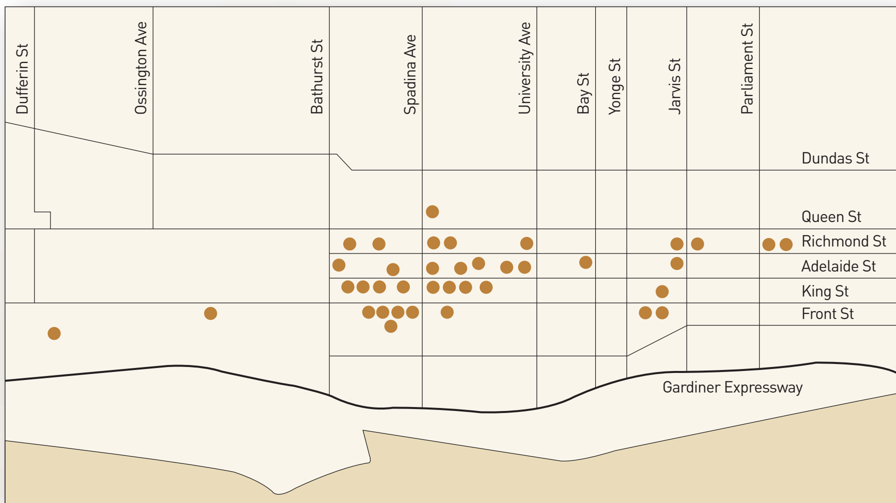
The REIT operates in four target markets: the urban areas of Toronto, Montreal, Winnipeg and Quebec City. The REIT intends to continue the process of consolidating ownership in its target markets with a view to achieving ever-greater competitive advantage in those target markets.

Our portfolio grew by 48% in 2006 to 56 properties with 3,441,216 square feet of GLA. By year-end, the Toronto component was 2,076,976 square feet, the Montreal component 775,014 square feet, the Winnipeg component 405,356 square feet and the Quebec City component 183,870 square feet.

Toronto target market

+183,174 square feet

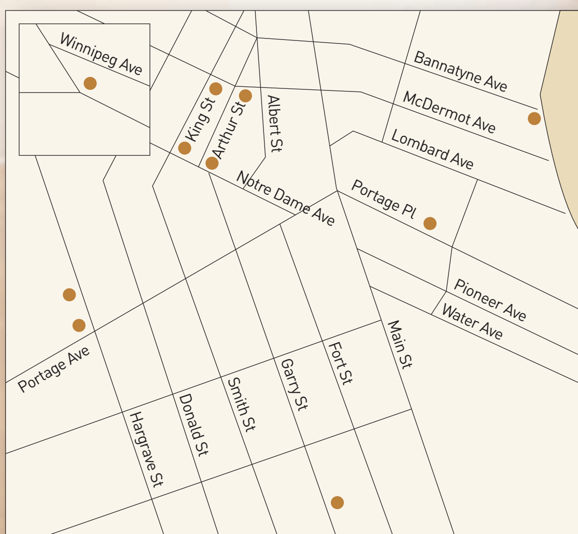
This target market includes the areas to the east and west of Toronto's downtown core, specifically Downtown East, Downtown West and King West. By year-end, it contained 13.2 million square feet of office space, approximately half of which was Class I space. The Toronto component of our portfolio is approximately 16% of the total office space in this target market, giving us a very strong operating platform with considerable room for growth.



Winnipeg target market

+366,046 square feet

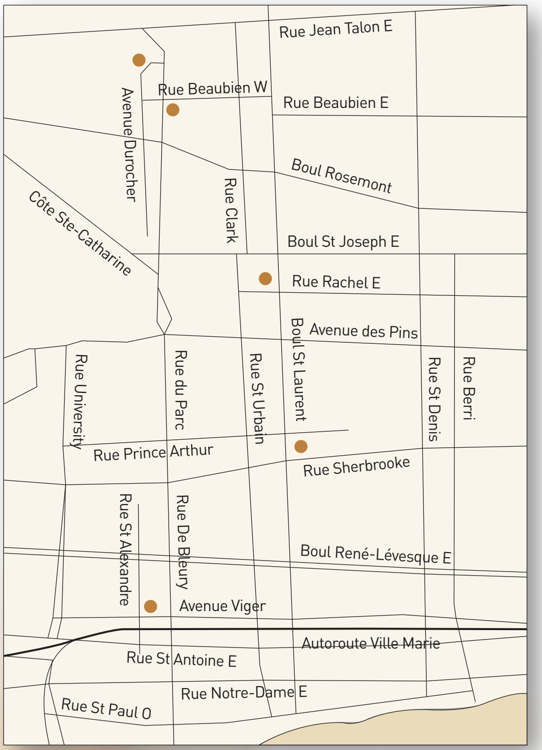
This target market includes the Exchange District, a 30-block area just to the north of Portage and Main. By year-end, it contained 1.8 million square feet of office space, most of which was Class I space. The Winnipeg component of our portfolio is approximately 22.5% of the total office space in this target market, giving us a solid operating and investment foothold with considerable room for growth.



Montreal target market

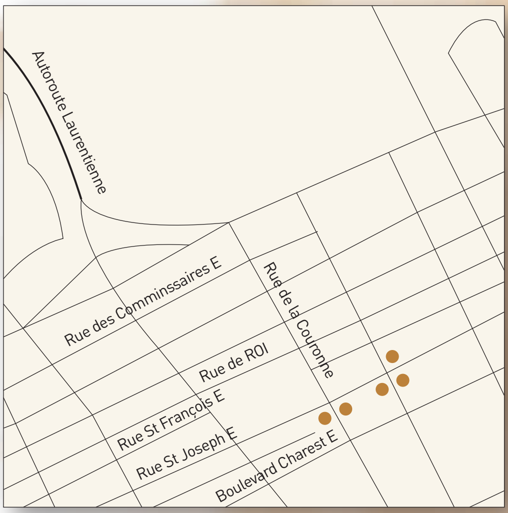
+386,619 square feet

This target market includes Downtown East, Old Montreal and Mile End. By year-end, it contained 17.7 million square feet of office space, approximately half of which was Class I space. The Montreal component of our portfolio is approximately 4.4% of the total office space in this target market, giving us a solid operating and investment foothold with considerable room for growth.



Quebec City target market

+183,870 square feet



This target market includes the Saint Roch office node, a downtown neighbourhood near the old city that has undergone extensive revitalization in the past five years. By year-end, it contained 1.5 million square feet of office space, most of which was Class I space. The Quebec City component of our portfolio is approximately 12.3% of the total office space in this target market, giving us a solid operating and investment foothold with considerable room for growth.

The interior of Les Bossus at 622 Saint Joseph Street East, Quebec City.

letter to unitholders

building on our experience

Fellow Unitholders of Allied Properties REIT

What an exciting and profitable time to be building a real estate business! Operating fundamentals in our markets are strong, and the cost of capital remains extraordinarily low. In an environment like this, finding good acquisitions is the biggest challenge, and I'm pleased to report that we met that challenge successfully in 2006.

Acquisitions

We began the year with 37 mostly Class I office properties in our Toronto, Montreal and Winnipeg target markets. Over the next 12 months, we completed 19 acquisitions for $115 million, increasing the size of our portfolio by 48% to 3.4 million square feet.

Five acquisitions helped solidify our position as the leading operator of Class I office space in Toronto. Within our operating sphere, we have the ability to provide our tenants the widest range of occupancy solutions, the greatest amount of flexibility and the most extensive property-related services. These competitive advantages contribute to lower vacancy rates, higher rents and lower turnover when our leases mature.

Three acquisitions strengthened our foothold in Montreal, bringing that part of our portfolio to over three-quarters of a million square feet of Class I office space. A portfolio acquisition of five properties established

"Within our operating sphere, we have the ability to provide our tenants the widest range of occupancy solutions, the greatest amount of flexibility and the most extensive property-related services."

Michael R. Emory
President and Chief Executive Officer

a fourth target market for us, the burgeoning Saint Roch office node in Quebec City. Another portfolio acquisition of six properties solidified our foothold in Winnipeg, particularly in the evolving Exchange District. Our goal in these three target markets is to achieve competitive advantages comparable to the ones we have in Toronto.

Our development pipeline with Allied Canadian Development Corporation was again productive, contributing three of the five Toronto acquisitions. Allied Canadian Development has two remaining properties in the development pipeline, both of which are nearing completion.

Properties Under Development

As you know, Class I office properties are created through the redevelopment of light industrial structures in urban areas. This involves comprehensive renovation of the buildings, as well as re-leasing to office tenants.

Until November of 2005, all of the Class I properties we acquired had gone through the full redevelopment process before we acquired them. Since then, we've acquired five smaller Class I properties that were only partially redeveloped at the time of acquisition. One was largely renovated, but only 20% occupied. We've since leased it up. The other four were partially renovated and entirely or significantly vacant. We're now working toward completing the redevelopment of these properties. Also, in early 2006, we acquired a Class I property in Montreal with an ancillary piece of land. We're planning to develop approximately 22,000 square feet of office and retail space on this land.

We refer to these as properties under development. They do at least three things for us: they broaden our range of acquisition opportunities; they enable us to work for higher investment returns than we could achieve by simply buying

QRC South
103 Richmond Street East, Toronto

Here's a concrete example of why properties under development excite us. When we acquired it in late 2005, 103 Richmond Street East in Toronto was one grim property. It was shabby inside and out, and half-hearted efforts at renovation in the past had only made matters worse. Not surprisingly, the occupancy level was low, around 40%. We saw opportunity for two reasons. One, the property had most of the important Class I attributes. Two, the property was immediately south of one of our largest and best Class I properties in Toronto, The Queen-Richmond Centre, known as QRC. We decided to reposition the property as an annex to QRC and to rename it QRC South. This meant we had to renovate it to a high standard, so we promptly restored the façade to resemble the exterior of QRC, and we upgraded the infrastructure, the common areas and the vacant space. Our Executive VP, Wayne Jacobs, then initiated and led the re-leasing effort. With the help of the brokerage community, Wayne is close to securing an anchor office tenant for the fourth floor. Within approximately 18 months from acquisition, we will have transformed the property into a solid, Class I office property yielding a higher investment return than we could have achieved if we'd bought it after the redevelopment was completed.

The façade of QRC South with QRC reflected in the windows.

finished properties; and they allow us to take advantage of the proven expertise of our management team. Because they represent higher risk than buying finished properties, we'll make sure properties under development don't become too large a component of our overall portfolio. At the end of 2006, the cost of the our properties under development was $17 million, 3.1% of our gross book value at the time.

Property Management

You'll recall that we bought Allied Canadian Development's property management business in mid-2005. This business involves the provision of property management and related services on a fee-for-service basis. Not only did it round-out our operating platform and deepen our management team, it gave us the ability to develop additional service-based sources of income as we continue to grow.

The price we paid for the business was based on estimated earnings of $1.9 million in 2006. By the end of the year, the business generated earnings of nearly $2.5 million, well above estimate, meaning we acquired a good business on advantageous financial terms.

The importance of good property management can't be overstated. We buy properties that generate predictable income streams, which represent our return on investment. The ultimate aim of property management is to protect and enhance these income streams. This means maintaining the physical integrity of the properties and delivering value to our tenants continuously. It may not be glamourous, and it's certainly not easy, but it's critical to our success as a real estate business.

"By transforming underutilized properties, we're able to take advantage of our real estate expertise profitably."

Wayne L. Jacobs
Executive Vice President

Growth

Growth is inherent in our consolidation strategy. Consolidation is what allows us to provide our tenants a wider range of occupancy solutions, greater flexibility and more extensive property-related services, which in turn contribute to lower vacancy rates, higher rents and lower turnover when our leases mature. There are many other benefits that flow from managed growth.

Consider our key portfolio attributes.

- Our tenant-mix is more diversified than ever. As a percentage of gross revenue in 2006, financial-service tenants increased from 6% to 11% and media tenants from 9% to 14% since our IPO. Service and professional tenants declined from 41% to 35% and retail tenants from 21% to 18% in the same period.
- Our top-10 tenants are well established Canadian businesses. Together, they represented 30% of our gross revenue in 2006, compared to the 49% represented by a different group of top-10 tenants at the time of our IPO.
- Our lease maturity schedule remains moderate. At the end of 2006, our leases matured at an average rate of 12.4% per year going forward five years, compared to 13% at the time of our IPO.

Consider also our cost of capital.

- In 2005 and 2006, we raised nearly $150 million in equity through five bought-deals, the first at $13 per unit and the most recent at $20.50 per unit. Through these offerings, we locked-in a progressively lower cost of equity, for the most part concurrently with specific acquisitions.

"At the end of the day, our job is to assist our tenants in building their businesses."

Marianne O'Leary
Senior Vice President,
Real Estate Operations

BBDO's new premises at The Balfour Building in Montreal.

→ In the same period, we raised over $100 million in debt through multiple 10-year mortgage financings. These financings reduced the weighted average interest rate on our mortgages to 5.9%, compared to 6.9% at the time of our IPO.

Throughout it all, we've maintained a conservative balance sheet. Our debt ratio at the end of 2006 was 48.2%, compared to 55.8% at the time of our IPO.

Our VP and CFO, Tom Wenner, keeps careful watch over our key portfolio attributes and cost of capital. To the extent possible, Tom strives to fix our cost of equity and cost of debt concurrently with our acquisitions, thereby locking-in key components of our return on investment.

The Bottom Line

Stable and growing monthly distributions are the hallmark of success in our business. In March of 2006, we increased our monthly distribution by 3.4% to $1.22 per unit (annualized). By the end of 2006, we increased distributable income (diluted) by 5.6% to $1.41 per unit, bringing our pay-out ratio in 2006 to a conservative 85.3%.

Unit price appreciation also represents success. Our units closed the year at $23.25, bringing your total return[1] for 2006 to 46.8%.

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

The Balfour Building
3575 Saint Laurent Boulevard, Montreal

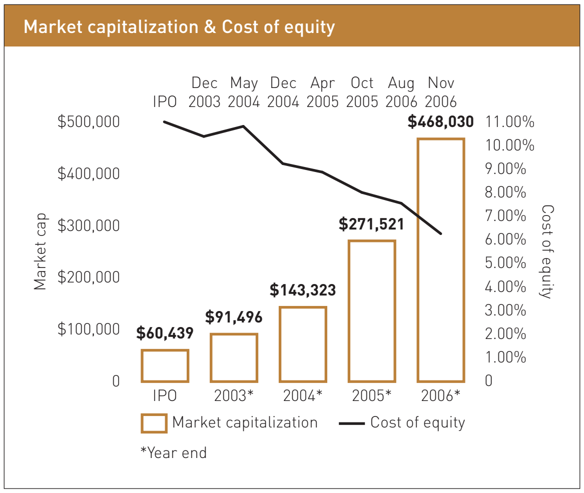
Here's a concrete example of why property management is so important to us. In 2005, we acquired the Balfour Building, a large Class I property in Montreal. At the time, it was occupied by over 80 tenants, many of them using very small amounts of space on a short-term basis. Our intention at the time was to rationalize the use of space in the building, increase the percentage of long-term leases and boost the income stream. In 2006, we leased all of the second and part of the third floor (approximately 31,000 square feet in total) to a leading global marketing firm for a term of 10 years. In order to accommodate the new tenant, we had to relocate numerous small tenants and complete extensive reconfiguration of the second and third floors within a very tight time-frame. Our Senior VP, Real Estate Operations, Marianne O'Leary, oversaw the entire process with our property management team in Montreal. Marianne and the Montreal team got it all done on time and on budget, and the tenant moved in on September 1, right on schedule. The property is now nearing full occupancy with a smaller number of larger tenants occupying space under longer-term leases and generating a higher income stream.

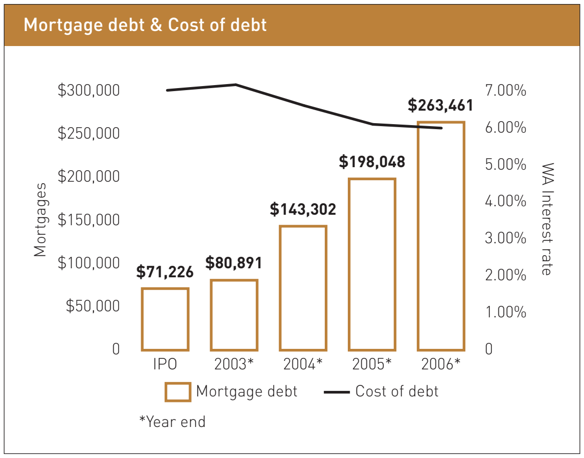
"Our mission is to build a great Canadian real estate business, one that serves your interests consistently and well over time."

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

	2003*	2004	2005	**2006**
Distributable income	$ 6.9 million	$ 11.9 million	$ 19.0 million	**$24.0 million**
Distributable income per unit (diluted)	$ 1.122	$ 1.310	$ 1.339	**$ 1.414**
Annual distribution level per unit at year-end	$ 1.10	$ 1.14	$ 1.18	**$ 1.22**
Pay-out ratio	85.0%	88.1%	87.8%	**85.3%**
Total return	40.7%	17.6%	32.3%	**46.8%**

* partial year from February 20, 2003.






The ground floor corridor of QRC South.

Outlook

As I've said before, our mission is to build a great Canadian real estate business, one that serves your interests consistently and well over time. I'm confident that we have the platform, the portfolio and the people to do it. Our management team and our trustees have the necessary experience, and we're building on that experience relentlessly.

Our strategy is to continue to consolidate the ownership of Class I office properties in our Toronto, Montreal, Quebec City and Winnipeg target markets with a view to achieving ever-greater competitive advantages in each of these markets. We look forward to keeping you apprised of our progress.

Thanks

Our management team again gave it their all in 2006, and our trustees were as consistently supportive throughout the year as they were demanding, all of which enabled Allied Properties REIT to make real progress in building its business. To our management team and trustees, I express sincere thanks. And to you, my fellow unitholders, I extend an equal measure of gratitude for your ongoing support and encouragement.

Michael R. Emory
President and Chief Executive Officer

“We strive to fix our cost of capital as close to the time of acquisition as possible and for as long a period of time as possible. To us, this is an important element of stability.”

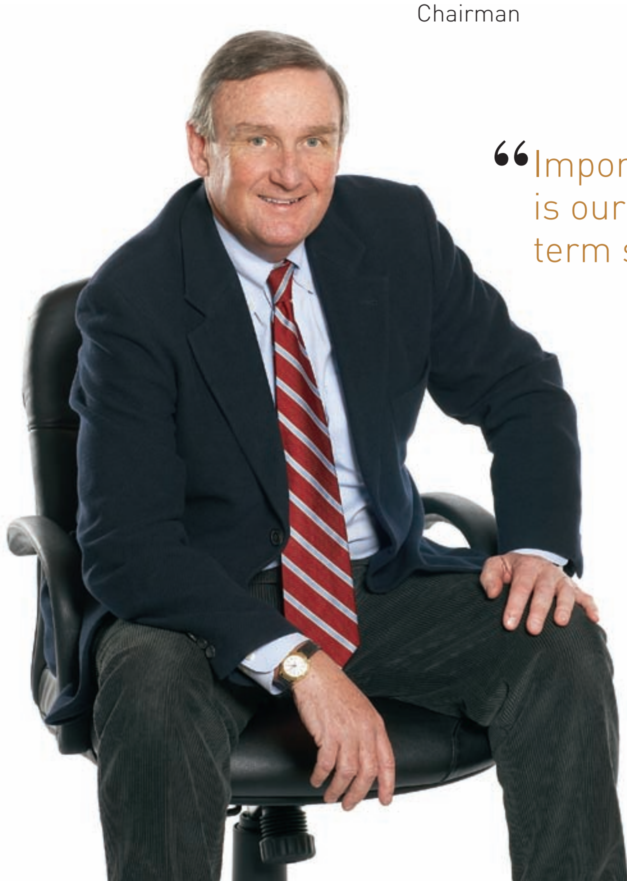
Tom Wenner
Vice President and
Chief Financial Officer

from the chairman

building a great real estate business

As you have now read, 2006 was another very good year for Allied Properties. Since going public in February 2003, both management and the trustees have focused our attention on one theme- building a stable and successful business. That theme overlays everything we do at Allied, whether acquiring new properties, expanding into new markets, internalizing our property management function or managing our existing portfolio. Building a stable and successful business requires talented and dedicated people, which we are most fortunate to have. I express my gratitude to all Allied people including, in particular Michael Emory, for their hard work and for the success they achieved in 2006. We are also fortunate to have an engaged and dedicated board of trustees who provide constructive guidance to management, ensure a strong and comprehensive governance regime and focus along with all Allied people in continuing to build this unique franchise.

Gordon R. Cunningham
Chairman



"Importantly for our unitholders of course is our ability to provide them with long-term stable returns."

Gordon R. Cunningham
Chairman

management's discussion & analysis

PART I

Forward-Looking Disclaimer

The terms "Allied Properties", "the REIT", "we", "us" and "our" in the following Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") refer to Allied Properties Real Estate Investment Trust and its consolidated financial position and results of operations for the year ended December 31, 2006. This MD&A should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2006, and for the year ended December 31, 2005. Historical results and percentage relationships contained in our consolidated financial statements and MD&A, including trends which might appear, should not be taken as indicative of our future results, operations or performance. Unless otherwise indicated, dollar amounts in this MD&A are in thousands.

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

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

All forward-looking statements in this MD&A are qualified by this forward-looking disclaimer. These statements are made as of March 7, 2007, and, except as required by applicable law, we undertake no obligation to update publicly or revise any such statements to reflect new information or the occurrence of future events or circumstances.

management's discussion & analysis

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.

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.

Property Portfolio

The REIT completed its Initial Public Offering ("IPO") on February 20, 2003. The REIT used the net proceeds of the IPO to acquire a portfolio of 14 predominantly Class I office properties in downtown Toronto with 820,000 square feet of gross leasable area ("GLA"). By the end of 2005, the REIT had acquired another 20 office properties in downtown Toronto, 19 of them Class I office properties, bringing its total GLA in that market to just under two million square feet. The REIT had also acquired two Class I office properties in downtown Montreal and one in downtown Winnipeg, bringing its total portfolio at the end of 2005 to 37 properties with 2.32 million square feet of GLA.

The REIT made the following acquisitions in 2006, bringing the portfolio to 56 properties with 3.4 million square feet of GLA:

Class I Office Property	Acquired	Office GLA	Retail GLA	Total GLA	Parking Spaces
4446 Saint Laurent Boulevard, Montreal	April 5, 2006	72,613	10,000	82,613	0
364 Richmond Street West, Toronto	May 2, 2006	21,300	17,300	38,600	0
257 Adelaide Street West, Toronto	June 28, 2006	40,050	5,843	45,893	0
400 Atlantic Avenue, Montreal	July 14, 2006	86,034	0	86,034	26
390 Charest Boulevard East, Quebec City	September 8, 2006	66,771	6,348	73,119	56
410 Charest Boulevard East, Quebec City	September 8, 2006	0	24,937	24,937	0
430 Charest Boulevard East, Quebec City	September 8, 2006	44,051	13,285	57,336	0
622 Saint Joseph Street East, Quebec City	September 8, 2006	3,620	3,300	6,920	0
633 Saint Joseph Street East, Quebec City	September 8, 2006	15,558	6,000	21,558	0
6290-6306 Avenue du Parc, Montreal	December 1, 2006	217,022	950	217,972	90
King-Brant Parking, Toronto*	December 1, 2006	0	0	0	208
441-443 King Street West, Toronto*	December 1, 2006	6,820	3,065	9,885	0
Phase II, The Castle, Toronto*	December 1, 2006	71,035	17,761	88,796	9
54-70 Arthur Street, Winnipeg	December 1, 2006	110,918	10,500	121,418	98
250 McDermot Avenue, Winnipeg	December 1, 2006	41,446	10,200	51,646	40
138 Portage Avenue East, Winnipeg	December 1, 2006	43,960	0	43,960	22
309 Hargrave Street, Winnipeg	December 1, 2006	21,460	1,400	22,860	52
165 Garry Street, Winnipeg	December 1, 2006	4,400	10,362	14,762	0
1500 Notre Dame Avenue, Winnipeg	December 1, 2006	111,400	0	111,400	85
Total		978,458	141,251	1,119,709	686

*offered to, and accepted by, the REIT pursuant to the Option Agreement between the REIT and Allied Canadian Development Corporation

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's portfolio accommodates a diverse base of tenants. At the end of 2006, business-service and professional tenants represented 35% of the REIT's gross revenue, retail tenants 18%, telecommunications and IT tenants 16%, media and entertainment tenants 14%, financial-service tenants 11%, government tenants 3% and other tenants 3%.

The REIT is a leading provider of Class I office and ancillary retail space in Canada and intends to build on this advantage by continuing to make coherent office property acquisitions in its target markets. In doing so, the REIT will strive to enhance on an ongoing basis the quantity and quality of its net rental revenue.

Four Toronto properties – QRC South (103 Richmond Street East), 257 Adelaide Street West, 47 Fraser Avenue and 47A Fraser Avenue – and one Montreal property – the land adjacent to 4446 Saint Laurent Boulevard – are properties under development ("Properties Under Development" or "PUD"). They are undergoing the development or redevelopment necessary to function as high quality, income-producing, Class I office properties.

The REIT has an option agreement ("Option Agreement") with Allied Canadian Development Corporation ("Developer"), a leading developer of Class I office properties, pursuant to which the Developer must offer to sell to the REIT at fair market value all developed or redeveloped office properties upon substantial completion. Six of the properties in the REIT's portfolio were acquired pursuant to the Option Agreement. Three of the properties acquired by the REIT in 2006 were acquired pursuant to the Option Agreement. The Developer has two remaining properties subject to the provisions of the Option Agreement. Both properties are nearing substantial completion.

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

	IPO	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	**Dec. 31, 2006**
GLA (square feet)	820,120	984,856	1,636,343	2,321,507	**3,415,279**
% leased	96.9	97.5	99.2	97.0*	**96.3***

*not including Properties Under Development

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

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	**Dec. 31, 2006**
Distribution level per unit annualized	$ 1.10	$ 1.14	$ 1.18	**$ 1.22**
Total return with reinvestment through DRIP	40.7%	17.6%	32.3%	**46.8%**
Total return without reinvestment	38.0%	16.2%	31.3%	**44.3%**

Property Management

Effective July 1, 2005, the REIT's wholly owned subsidiary, Allied Properties Management Limited Partnership ("Property Manager"), completed the acquisition of the property management business of the Developer. In addition to providing property management and related services in connection with the REIT's portfolio, the Property Manager provides property management and related services to third-party property owners on a fee-for-service basis.

management's discussion & analysis

Performance Indicators

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

Financial Indicators

1. Distributions

The REIT is focused on increasing distributions to its unitholders on a regular and prudent basis. During its first 12 months of operations, the REIT made regular monthly distributions of $1.10 per unit on an annualized basis. In March of 2004, the REIT increased its monthly distributions by 3.6% to $1.14 per unit on an annualized basis. In March of 2005, the REIT increased its monthly distributions by 3.5% to $1.18 per unit on an annualized basis. In March of 2006, the REIT increased its monthly distributions by 3.4% to $1.22 per unit on an annualized basis.

2. Distributable Income

Increasing distributions can be achieved prudently by increasing Distributable Income ("DI"), as defined in the Declaration. See "Distributable Income" below. In 2005, DI per unit (diluted) was $1.339. In 2006, DI per unit (diluted) was $1.414, up 5.6% from 2005.

3. DI Pay-Out Ratio

To ensure it retains sufficient cash to meet its capital improvement and leasing objectives, the REIT will strive to maintain an appropriate DI pay-out ratio, the ratio of actual distributions to DI in a given period. In 2005, the REIT achieved a DI pay-out ratio of 87.9%. In 2006, the REIT achieved a DI pay-out ratio of 85.3%.

4. Adjusted Funds From Operations

Increasing distributions cannot be achieved prudently without reference to adjusted funds from operations ("AFFO"), as this financial indicator takes account of regular maintenance capital expenditures and regular leasing expenditures while ignoring the impact of non-cash revenue. See "Adjusted Funds from Operations" below. In 2005, AFFO per unit (diluted) was $1.221. In 2006, AFFO per unit (diluted) was $1.239, up 1.5% from 2005.

5. AFFO Pay-Out Ratio

To ensure it retains sufficient cash to meet its capital improvement and leasing objectives, the REIT will strive to maintain an appropriate AFFO pay-out ratio, the ratio of actual distributions to AFFO in a given period. In 2005, the REIT achieved an AFFO pay-out ratio of 96.3%. In 2006, the REIT achieved an AFFO pay-out ratio of 97.3%.

6. Debt Ratio

Gross Book Value ("GBV") is defined as the book value of the assets of the REIT shown on the most recent balance sheet plus accumulated depreciation and amortization and an amount equal to the property management internalization expense recorded by the REIT. A conservative ratio of debt to GBV ("Debt Ratio") mitigates unitholder risk. At the end of 2005, the Debt Ratio was 51.0%. As the end of 2006, the Debt Ratio was 48.2%.

Operating Indicators

1. Tenant Retention and Replacement

The REIT places a high value on tenant retention, as the cost of retention is typically lower than the cost of securing new tenancies. If retention is neither possible nor desirable, the REIT will strive for high-quality replacement tenants. Leases representing 274,437 square feet of GLA matured in 2006. By the end of 2006, the REIT had renewed leases representing 147,348 square feet of this GLA and re-leased another 92,126 square feet of this GLA, representing 87.3% of the GLA covered by the maturing leases.

2. Occupancy

The REIT strives to maintain consistently high levels of occupancy. At the end of 2005, the REIT's leased area was 97.0% (not including Properties Under Development). At the end of 2006, the REIT's leased area was 96.3% (not including Properties Under Development). The year-over-year decline in occupancy stems largely from the acquisitions made by the REIT on December 1, 2006, which included 47,809 square feet of vacant space. Management regards this vacant space as an opportunity to increase rental revenue over time.

3. Same-Asset Net Operating Income

The REIT strives to maintain or increase same-asset net operating income ("NOI") over time. See "Net Operating Income" below. Same-asset refers to those properties that were owned and operated by the REIT for the entire period in question and for the same period in the prior year. Ignoring the step-rent revenue and the amortization of the fair value assigned to above-market and below-market rents with respect to acquired properties (the mark-to-market rent adjustment), same-asset NOI was $30,290 in 2006, up 4.4% from 2005.

4. Leasing Expenditures

The REIT monitors leasing expenditures carefully. 277,583 square feet of the GLA leased in 2006 involved new leases or lease-renewals that commenced in the year. $2,982 in leasing expenditures relate to this space, representing $10.74 per leased square foot.

5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2006, the REIT incurred $1,147 in regular maintenance capital expenditures, representing $0.46 per square foot of the average size of REIT's portfolio over the course of 2006.

Summary

The following table summarizes the key financial and operating performance indicators for 2006 and 2005, as well as the change between the two.

	2006	2005	Change
Year-end distribution level per unit annualized	$ **1.22**	$ 1.18	$ 0.04
DI per unit (diluted)	$ **1.414**	$ 1.339	$ 0.075
DI pay-out ratio	**85.3%**	87.9%	(2.6%)
AFFO per unit (diluted)	$ **1.239**	$ 1.221	$ 0.018
AFFO pay-out ratio	**97.3%**	96.3%	1.0%
Debt Ratio	**48.2%**	51.0%	(2.8%)
Renewal/replacement % of leases maturing in year	**87.3%**	77.0%	10.3%
Year-end leased area (not including PUD)	**96.3%**	97.0%	(0.7%)
Same-asset NOI	$ **30,290**	$ 29,016	$ 1,274
Leasing expenditures	$ **2,982**	$ 1,620	$ 1,362
Leasing expenditures per leased square foot	$ **10.74**	$ 8.43	$ 2.31
Maintenance capital expenditures	$ **1,147**	$ 1,118	$ 29
Maintenance capital expenditures per portfolio square foot	$ **0.46**	$ 0.59	$ (0.13)

Business Environment and Outlook

The REIT operates in four target markets – downtown Toronto, downtown and midtown Montreal, downtown Winnipeg and downtown Quebec City. The following is a brief description of the REIT's target markets:

1. Downtown Toronto

This target market includes 13.2 million square feet of office inventory in three sub-markets, Downtown East (2.1 million square feet), Downtown West (9.2 million square feet) and King West (1.9 million square feet). Approximately half of the office inventory in this target market falls within the Class I category. The downtown Toronto office market strengthened in 2006, with the overall vacancy rate declining to 6.1% at the end of the year and the Downtown East, Downtown West and King West sub-markets finishing the year with vacancy rates of 5.1%, 5.6% and 12.0%, respectively.[1]

2. Downtown and Midtown Montreal

This target market includes 17.7 million square feet of office inventory in three sub-markets, Downtown East (7.5 million square feet), Old Montreal (7.7 million square feet) and Mile End (2.5 million square feet). Approximately half of the office inventory in this target market falls within the Class I category. The downtown Montreal office market was stable in 2006, with the overall vacancy rate declining to 9.7% at the end of the year and the Downtown East and Old Montreal sub-markets finishing the year with vacancy rates of 5.2% and 8.8%, respectively.[2]

3. Downtown Winnipeg

This target market includes 1.8 million square feet of office inventory, principally in the Exchange District. Most of the office inventory in the Winnipeg target market falls within the Class I category. The Winnipeg office market was stable in 2006, with the overall vacancy rate declining to 7.1% at the end of the year.[3] While Class I office space is not tracked separately in Winnipeg, Colliers International observed that "certain users will continue to be attracted to [space in the Exchange District] by its 'brick and beam ambience' and lower occupancy costs".[4]

4. Downtown Quebec City

This target market includes 1.5 million square feet of office inventory in the St. Roch office node. Most of the office inventory in this target market falls within the Class I category. The Quebec City office market strengthened in 2005, with the overall vacancy rate declining to 4.0%.[5] The strengthening continued in 2006, with the overall vacancy rate declining to 3.7% by mid-year.[6]

Demand for office space in the REIT's target markets is stable or strengthening. The state of the REIT's target markets, the quality of the REIT's portfolio and the capabilities of the REIT's personnel afford Management a reasonable basis for confidence in the REIT's near-term performance. The REIT intends to continue the acquisition of Class I and other office properties in its target markets.

1. Cushman & Wakefield LePage, *Fourth Quarter 2006 Statistical Summary, Toronto Office Market*.
2. Cushman & Wakefield LePage, *Fourth Quarter 2006 Statistical Summary, Montreal Office Market*.
3. Colliers International, *Winnipeg Year End Office Report, December 2006*.
4. Colliers International, *Winnipeg Year End Office Report, December 2006*.
5. Altus Helyar, *Greater Quebec City Office Market Study, May 2006*.
6. Altus Helyar, *Greater Quebec City Office Market Study, May 2006*.

PART II

Summary Information and Performance for the Year Ended December 31, 2006

The following sets out summary information and financial results for the year ended December 31, 2006, and the comparable year and the change between the two.

(In thousands except for per unit and % amounts)	2006	2005	Change	% Change
Revenue from rental properties	64,229	51,170	13,059	25.5%
Rental property operating cost	23,181	18,264	4,917	26.9%
Net rental income	41,048	32,906	8,142	24.7%
Real estate service income	436	162	274	169.1%
Financing expense				
Interest	13,109	10,088	3,021	29.9%
Amortization – Mortgage premium	(283)	(530)	247	(46.6%)
Depreciation and amortization				
Rental properties	7,628	6,071	1,557	25.6%
Deferred leasing cost and tenant improvements	1,253	622	631	101.4%
Origination cost and acquired tenant relationships	8,413	5,267	3,146	59.7%
Acquired contracts and customer relationships	96	48	48	100.0%
Deferred financing cost	242	216	26	12.0%
Computer and office equipment	32	16	16	100.0%
Income from operations	10,994	11,270	(276)	(2.4%)
Trust expense	2,377	2,001	376	18.8%
Property management internalization expense	900	7,877	(6,977)	(88.6%)
Net income (loss)	7,717	1,392	6,325	454.4%
Amortization				
Rental properties	7,628	6,071	1,557	25.6%
Mortgage premium	(283)	(530)	247	(46.6%)
Acquired leases	2,719	2,082	637	30.6%
M-T-M acquired leases	162	229	(67)	(29.3%)
Acquired tenant relationships	5,694	3,185	2,509	78.8%
Acquired contracts and customer relationships	96	48	48	100.0%
Step-rent adjustments	(921)	(1,381)	460	(33.3%)
Property management internalization expense	900	7,877	(6,977)	(88.6%)
LTIP compensation expense	270	109	161	147.7%
DI	23,982	19,082	4,900	25.7%
Weighted average units outstanding (basic)	16,632	14,004	2,628	18.8%
Weighted average units outstanding (diluted)	16,964	14,249	2,715	19.1%
Distributions	20,457	16,761	3,696	22.1%
DI per unit (basic)	$ 1.442	$ 1.363	$ 0.079	5.8%
DI per unit (diluted)	$ 1.414	$ 1.339	$ 0.075	5.6%
DI pay-out ratio	85.3%	87.9%	(2.6%)	
FFO	25,911	21,229	4,682	22.1%
FFO per unit (basic)	$ 1.558	$ 1.516	$ 0.042	2.8%
FFO per unit (diluted)	$ 1.527	$ 1.490	$ 0.037	2.5%
FFO pay-out ratio	79.0%	79.0%	–	
AFFO	21,024	17,398	3,626	20.8%
AFFO per unit (basic)	$ 1.264	$ 1.242	$ 0.022	1.8%
AFFO per unit (diluted)	$ 1.239	$ 1.221	$ 0.018	1.5%
AFFO pay-out ratio	97.3%	96.3%	0.6%	
NOI	40,289	31,754	8,535	26.9%
Same-asset net operating income	30,290	29,016	1,274	4.4%
Total assets	$ 502,509	$ 384,538	$ 117,971	30.7%
Total debt (excludes premium on assumed debt)	$ 263,464	$ 210,093	$ 53,371	25.4%
Debt to GBV	48.2%	51.0%	(2.8%)	
Total GLA (s.f., excluding PUD)	3,321	2,266	1,055	46.6%
Leased GLA (s.f., excluding PUD)	3,197	2,197	1,000	45.5%
Leased GLA (% total GLA)	96.3%	97.0%	(0.7%)	

Net income for the year ended December 31, 2006, was $7,717, as compared to $1,392 in the year ended December 31, 2005. Net income per unit (diluted) for the year was $0.455, as compared to net income per unit (diluted) of $0.098 in the comparable year. The net income for the year ended December 31, 2005, was affected by the expense of $7,877 recorded in connection with the internalization of property management on July 1, 2005. The net income for the year ended December 31, 2006, was affected by the expense of $900 recorded in connection with the internalization of property management.

DI for the year ended December 31, 2006, increased by 25.7% to $23,982 from $19,082 for the year ended December 31, 2005. DI per unit (diluted) for the year was $1.414, as compared to DI per unit (diluted) of $1.339 in the comparable year.

Net Rental Income

Net rental income for the year ended December 31, 2006, increased by 24.7% to $41,048 from $32,906 in the year ended December 31, 2005, as follows:

(i) $7,475 due to net rental income from properties not owned for the entire period and the entire comparable period;

(ii) $831 due to the internalization of the property management function; and

(iii) offset by $165 due to the decrease in same-asset net rental income from properties owned for the entire period and the entire comparable period (which includes the period-over-period decrease in step-rent adjustments).

Of the $41,048 of net rental income for the year, $752 of operating cost recoveries is in dispute with a tenant. Based on the advice of legal counsel, Management is of the view that there is no merit to the tenant's position and is diligently pursuing the matter.

Net rental income per occupied square foot for the year ended December 31, 2006, was $16.37, as compared to $17.72 in the year ended December 31, 2005. The year-over-year decline is reflective of the fact that the REIT acquired more property in target markets with lower net rental rates than its Toronto target market.

Real Estate Service Income

The Property Manager provides real estate services to third-party property owners. Real estate service income for the year ended December 31, 2006, was $436, as compared to $162 in the year ended December 31, 2005. As the Property Manager commenced providing real estate services to third-party property owners on July 1, 2005, the real estate service income for the year ended December 31, 2005, covered a six-month period only.

Property Management Internalization

The economic benefit of the property management internalization for the year ended December 31, 2006, is summarized in the following table:

(In thousands)	2006
Increase in net rental income	$ 1,538
Real estate service income	436
Net reduction in leasing expenditures payable as leasing fees	218
Net reduction in capital expenditures payable as project management fees	264
Total	$ 2,456

This exceeded Management's expectations for the year and materially exceeded the threshold established for the final payment by the REIT of $900 in connection with the internalization of property management.

Financing Expense

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on assumed mortgages reduced financing expense by $283 in the year ended December 31, 2006.

Financing expense for the year ended December 31, 2006, increased by 34.2% to $12,826 from $9,558 in the year ended December 31, 2005, due to the increase in financing expense associated with additional properties acquired in 2005 and 2006.

Depreciation and Amortization

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the year ended December 31, 2006, increased by 25.6% to $7,628 from $6,071 in the year ended December 31, 2005.

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

Trust Expense

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

Trust expense for the year ended December 31, 2006, increased by 18.8% to $2,377 from $2,001 in the year ended December 31, 2005, due to increased salary, bonus and occupancy costs and increased LTIP expense under the REIT's long-term incentive plan ("LTIP").

Leasing Activity

Leasing activity as at December 31, 2006, is summarized in the following table:

	Vacant or Maturing	Leased End of Year	% Leased End of Year	Vacant End of Year*
Vacant GLA on January 1, 2006*	68,666	47,303	68.9%	21,363
Vacant GLA on acquisition in 2006*	60,041	10,194	17.0%	49,847
GLA accessed through rationalization	37,969	19,706	51.9%	18,263
GLA that matured in 2006	274,437	239,474	87.3%	34,963
Total	441,113	316,677	71.8%	124,436

* not including Properties Under Development

68,666 square feet of GLA were vacant at the beginning of 2006. By year-end, the REIT had leased 47,303 square feet of this originally vacant GLA, leaving 21,363 square feet vacant.

In 2006, the REIT acquired properties with 60,041 square feet of vacant GLA, not including Properties Under Development, of which 10,194 square feet was leased by year-end.

In 2006, the REIT gained access to 19,706 square feet of GLA in the Balfour Building in Montreal, which it reconfigured and retrofitted to accommodate a high-value new tenancy for occupancy on September 1, 2006. The REIT also gained access late in the year to 18,263 square feet of GLA formerly used as a nightclub at 358-360 Adelaide Street West. The REIT is reconfiguring and retrofitting this space for office use, which Management expects to be more profitable going forward.

Leases for 274,437 square feet of GLA matured in 2006. By year-end, the REIT had renewed or replaced leases representing 239,474 square feet of the GLA that matured in the year, leaving 34,963 square feet vacant.

With respect to the maturing leases renewed or replaced in 2006 (239,474 square feet of GLA), the REIT achieved rental rates

(i) above in-place rental rates with respect to 67% of this GLA and

(ii) equal to in-place rental rates with respect to the balance of this GLA.

Capital Expenditures

The REIT's portfolio requires ongoing maintenance capital expenditures and leasing expenditures. Leasing expenditures include the cost of in-suite or base-building improvements made in connection with the leasing of vacant space or the renewal or replacement of tenants occupying space covered by maturing leases, as well as improvement allowances and commissions paid in connection with the leasing of vacant space and the renewal or replacement of tenants occupying space covered by maturing leases.

In the year ended December 31, 2006, the REIT incurred or committed to (i) $1,147 in regular maintenance capital expenditures ($0.46 per portfolio square foot) and (ii) $2,982 in leasing expenditures ($10.47 per leased square foot) in connection with new leases or lease-renewals that commenced in the year. In addition, the REIT incurred (i) $1,452 in capital expenditures in connection with a comprehensive cladding restoration program at 425 Viger Avenue West in Montreal, the need for which was recognized at the time of acquisition and the cost of which was partially reflected in a reduction to the purchase price, and (ii) $2,602 in revenue-enhancing capital and leasing expenditures in connection space that was significantly reconfigured and retrofitted to accommodate high-value new tenancies.

$365 of the salary expense incurred by the REIT in the year ended December 31, 2006, was capitalized in connection with capital improvements to the REIT's rental properties and Properties Under Development. This amount was equivalent to approximately 5% of the associated construction costs.

Properties Under Development

Management believes that the Properties Under Development represent risk-appropriate opportunities to enhance DI per unit and create value for unitholders. Management also believes that the Properties Under Development represent an opportunity to capitalize more fully on the experience and expertise of the REIT's personnel.

The REIT acquired 145 Berkeley Street, Toronto, in November of 2005 at a cost of approximately $125 per square foot. At that time, 80% of the GLA in the property was vacant. The REIT has since leased all the vacant space in the property. From October 1, 2006, onward, the property ceased to be treated as a Property Under Development and was treated as a rental property for accounting purposes.

The REIT acquired QRC South in November of 2005 at a cost of approximately $95 per square foot. The property is a brick-and-beam structure that extends south from Richmond Street East through to Lombard Street and has entrances from both streets connected along the north-south axis by an open corridor. The REIT has repositioned the property as an annex to The Queen Richmond Centre, a Class I office complex acquired by the REIT in 2004 and known as QRC. (QRC is a brick-and-beam complex that extends south from Queen Street East through to Richmond Street East and has entrances from both streets connected along the north-south axis by an open corridor.) The construction phase of the repositioning at QRC South is complete, and the re-leasing phase is well underway.

The REIT acquired 257 Adelaide Street West, Toronto, in June of 2006 at a cost of approximately $127 per square foot. At that time, less than 60% of the GLA in the property was occupied. The construction phase of the upgrade of the property is largely complete, and the re-leasing phase has commenced.

The REIT acquired approximately 5,500 square feet of land adjacent to 4446 Saint Laurent Boulevard, Montreal, in April of 2006 at a cost of $118 per square foot. The REIT has evaluated the potential development of a 22,000 square foot building on the land to accommodate office and ancillary retail users and concluded that it is feasible. The REIT is now working toward securing an anchor tenant for the development.

The REIT acquired 47 and 47A Fraser Avenue, Toronto (two satellite buildings at The Castle in Liberty Village) at a cost of approximately $145 per square foot. The upgrade of the two properties will be performed in conjunction with, and customized to, the re-leasing effort, which is underway.

Properties Under Development are stated at the lower of cost and net recoverable value. Cost includes the cost of acquisition, other direct cost, realty tax, other operating expense and applicable financing expense during the development period, less the amount of operating revenue during the development period. The principal factors in determining when the redevelopment-period ends are (i) the achievement of positive cash flow after applicable interest expense and (ii) the passage of a predetermined period of time. Other criteria may be considered in determining when a redevelopment-period ends if warranted by circumstances relating to the relevant Property Under Development.

As at December 31, 2006, the cost of the REIT's Properties Under Development was $17,074, which was equivalent to 3.1% of the REIT's GBV.

Distributable Income

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

(i) depreciation on rental properties;
(ii) amortization of the premiums or discounts on assumed mortgages;
(iii) non-cash rental revenue recorded to recognize rental income rateably over the life of each lease;
(iv) non-cash compensation expense with respect to the LTIP;
(v) amortization of values ascribed in a building acquisition to in-place leases and tenant relationships;
(vi) amortization of values ascribed in a building acquisition to above-market and below-market leases;
(vii) amortization of values ascribed in the property management internalization to acquired contracts and customer relationships; and
(viii) property management internalization expense.

DI is a non-GAAP financial measure used by some Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. DI does not have any standardized meaning prescribed by GAAP. As computed by the REIT, DI may differ from similar computations reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers DI to be a useful measure of cash available for distributions. The following reconciles cash flow from operations, as presented in the consolidated financial statements, to DI.

(In thousands)	2006	2005
Cash flow from operations	$ 26,088	$ 7,859
Amortization of deferred leasing cost, tenant improvements and financing cost	(1,495)	(838)
Amortization of computer and office equipment	(32)	(16)
Amortization, tenant inducements	(26)	–
Change in non-cash operating items	(1,453)	4,200
Property management internalization expense	900	7,877
DI	$ 23,982	$ 19,082

Distributions for the year ended December 31, 2006, were $20,457, representing a DI pay-out ratio of 85.3%, as compared to distributions for the year ended December 31, 2005, of $16,761, representing a DI pay-out ratio of 87.9%.

Funds From Operations

Funds From Operations ("FFO") is a non-GAAP financial measure used by most Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. While FFO does not have any standardized meaning prescribed by GAAP, the Real Property Association of Canada ("REALpac") established a standardized definition of FFO in its White Paper on Funds From Operations dated November 30, 2004. Essentially, the REALpac definition is net income with most non-cash expenses added back. Management believes that this definition is followed by most Canadian real estate investment trusts and that it is a useful measure of cash available for distributions. The following reconciles net income, as presented in the consolidated financial statements, with FFO, as calculated in accordance with recommendations of the REALpac definition.

(In thousands)	2006	2005
Net income	$ 7,717	$ 1,392
Amortization on rental properties	7,628	6,071
Amortization of deferred leasing cost and tenant improvements	1,253	622
Amortization of origination cost and acquired tenant relationships	8,413	5,267
Property management internalization expense	900	7,877
FFO	$ 25,911	$ 21,229

management's discussion & analysis

Distributions for the year ended December 31, 2006, represented an FFO pay-out ratio of 79.0%, as compared to distributions for the year ended December 31, 2005, which represented an FFO pay-out ratio of 79.0%.

Adjusted Funds From Operations

AFFO is a non-GAAP financial measure used by most Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. AFFO does not have any standardized meaning prescribed by GAAP. As computed by the REIT, AFFO may differ from similar computations reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers AFFO to be a useful measure of cash available for distributions. The principal advantage of AFFO is that it starts from the standardized definition of FFO and takes account of maintenance capital expenditures and regular leasing expenditures while ignoring the impact of non-cash revenue. Because maintenance capital expenditures and regular leasing expenditures are not incurred evenly throughout a fiscal year, there can be volatility in AFFO on a quarterly basis. The following reconciles net income, as presented in the consolidated financial statements, with AFFO, calculated in accordance with what Management believes to be industry practice.

(In thousands)	2006	2005
FFO	$ 25,911	$ 21,229
Step-rent adjustments	(920)	(1,381)
M-T-M acquired leases	162	288
Leasing expenditures	(2,982)	(1,620)
Maintenance capital expenditures	(1,147)	(1,118)
AFFO	$ 21,024	$ 17,398

Distributions for the year ended December 31, 2006, represented an AFFO pay-out ratio of 97.3%, as compared to distributions for the year ended December 31, 2005, which represented an AFFO pay-out ratio of 96.3%.

Net Operating Income

NOI 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. NOI does not have any standardized meaning prescribed by GAAP. As computed by the REIT, NOI may differ from similar computations reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers NOI to be a useful measure of performance for rental properties. The following reconciles net rental income, as presented in the consolidated financial statements, to NOI.

(In thousands)	2006	2005
Revenue from rental properties	$ 64,229	$ 51,170
Rental property operating cost	23,181	18,264
Net rental income	41,048	32,906
M-T-M acquired leases	162	229
Step-rent adjustments	(920)	(1,381)
NOI	$ 40,290	$ 31,754

PART III

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 two Canadian chartered banks and (iii) equity. As at December 31, 2006, the REIT had mortgage debt of $264,286 and unitholders' equity of $215,704.

Unitholders' Equity

As at December 31, 2005, the REIT had a market capitalization of approximately $271,521 based on a closing unit price of $16.95 on the Toronto Stock Exchange. As at December 31, 2006, the REIT had a market capitalization of approximately $468,029 based on a closing unit price of $23.25 on the Toronto Stock Exchange.

In the year ended December 31, 2006, the REIT issued a total of 4,111,380 units for equity contributions of $74,416. Costs incurred to issue the units were $3,497. Units were issued as follows:

(i) 26,000 units at $10.00 per unit for $260 to certain officers and trustees who exercised options under the REIT's Unit Option Plan;

(ii) 137,069 units at $17.21 for $2,359 to certain officers and trustees under the LTIP;

(iii) 1.9 million units at $17.00 per unit for $32,300 pursuant to a bought deal that closed on September 5, 2006;

(iv) 2 million units at $20.50 per unit for $41,000 pursuant to a bought deal that closed on December 1, 2006; and

(v) 48,311 units under its distribution re-investment plan at an average price of $17.73 per unit for $856.

The REIT adopted a Unit Option Plan at the time of its IPO and granted at that time options to the trustees and officers of the REIT to acquire 345,000 units at an exercise price of $10.00 per unit prior to February 19, 2008. In 2004, the maximum number of units reserved for the Unit Option Plan was reduced from 604,390 units to 345,000 units. In 2004, 2005 and the year ended December 31, 2006, the trustees and officers of the REIT exercised 289,500 options in accordance with their terms. As at December 31, 2006, 55,500 options were outstanding, all of which had vested.

In May of 2004, the REIT adopted the LTIP whereby trustees and officers of the REIT ("Participants") may from time to time, at the discretion of the Trustees and subject to regulatory approval, subscribe for units at a market price established in accordance with the provisions of the LTIP. The price for the units is payable as to 5% upon issuance and as to the balance ("LTIP Loan") over 10 years with interest on the LTIP Loan at an annual rate established in accordance with the provisions of the LTIP. The units issued pursuant to the LTIP are registered in the name of a Custodian on behalf of the Participants who are the beneficial owners. The units are pledged to the REIT as security for payment of the LTIP Loan, and all distributions paid on the units are forwarded by the Custodian to the REIT and applied first on account of interest on the LTIP Loan and then to reduce the outstanding balance of the LTIP Loan. The maximum number of units authorized for issuance under the LTIP is equal to 5% of the issued and outstanding units from time to time.

Mortgages Payable

Mortgages payable as at December 31, 2006, consisted of mortgage debt of $263,461 and premium on mortgages assumed (net of accumulated amortization) of $825.

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

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

	Periodic Principal Payments	Balance Due at Maturity	Total Principal	% of Total Principal	Weighted Average Interest Rate of Maturing Mortgages
2007	$ 6,979	$ 19,433	$ 26,412	10.0%	6.44%
2008	6,810	6,437	13,247	5.0%	6.50%
2009	6,698	14,022	20,720	7.9%	6.40%
2010	6,772	4,478	11,250	4.3%	5.35%
2011	6,938	8,496	15,434	5.8%	6.57%
Thereafter	26,476	149,922	176,398	67.0%	5.70%
Total	$ 60,673	$ 202,788	$ 263,461		

Interest rates on the mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 5.9%. The weighted average term of the mortgage debt is 7.2 years.

Each individual mortgage loan of the REIT is secured by a mortgage registered on title of a rental property and by security agreements covering assignment of rents and personal property with respect to such property. The mortgage debt provides the holder with recourse to the assets of the REIT. The REIT attempts to stagger the maturity of its mortgages and to have mortgages maturing each year to be in a position to upward finance the principal amount of maturing mortgages as needed. Additionally, the REIT attempts to maintain 15% to 20% of its rental properties free from traditional long-term mortgage financing with a view to providing these assets as security for bank credit facilities.

Bank Credit Facilities

The REIT has a $25,000 revolving credit facility with a Canadian chartered bank bearing interest at bank prime plus 1.0% and maturing on May 31, 2007, as well as a $5,000 revolving credit facility with another Canadian chartered bank bearing interest at bank prime plus 1.0% and maturing on May 31, 2007. Each credit facility is secured by a combination of mortgage charges and security agreements on certain of the REIT's rental properties. In the year ended December 31, 2006, the average borrowings under the credit facilities were $8,331. As at December 31, 2006, the borrowings under the credit facilities were nil.

Liquidity and Commitments

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

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

The credit facilities, new mortgage financing and the access to the public equity markets will provide the necessary capital the REIT requires for acquisitions. The REIT's acquisition capacity, meaning its ability to use un-utilized borrowing capacity while not exceeding the 60% Debt Ratio, is $160,000.

As at December 31, 2006, the REIT had future commitments as set out below.

(In thousands)	December 31, 2006
Leasing commissions	$ 139
Tenant improvements	453
Building renovations and maintenance capital expenditures	356
Revenue-enhancing leasing expenditure	1,232
Properties Under Development	166
Expenses	199
Total	$ 2,545

PART IV

Summary Information and Performance for the Quarter Ended December 31, 2006

The following sets out summary information and financial results for the quarter ended December 31, 2006, and the comparable quarter in 2005 and the change between the two.

(In thousands except for per unit and % amounts)	Q4 2006	Q4 2005	Change	% Change
Revenue from rental properties	17,871	14,291	3,580	25.1%
Rental property operating cost	6,775	5,145	1,630	31.7%
Net rental income	11,096	9,146	1,950	21.3%
Real estate service income	113	78	35	44.9%
Financing expense				
Interest	3,493	2,893	600	20.7%
Amortization – Mortgage premium	(98)	(182)	84	(46.2%)
Depreciation and amortization				
Rental properties	2,107	1,692	415	24.5%
Deferred leasing cost and tenant improvements	390	184	206	112.0%
Origination cost and acquired tenant relationships	2,675	1,943	732	37.7%
Acquired contracts and customer relationships	24	24	–	0.0%
Deferred financing cost	60	66	(6)	(9.1%)
Computer and office equipment	8	10	(2)	(20.0%)
Income from operations	2,550	2,594	(44)	(1.7%)
Trust expense	597	631	(34)	(5.4%)
Property management internalization expense	900	–	900	
Net income (loss)	1,053	1,963	(910)	(46.4%)
Amortization				
Rental properties	2,107	1,692	415	24.5%
Mortgage premium	(98)	(182)	84	(46.2%)
Acquired leases	770	633	137	21.6%
M-T-M acquired leases	67	181	(114)	(63.0%)
Acquired tenant relationships	1,904	1,311	593	45.2%
Acquired contracts and customer relationships	24	24	–	0.0%
Step-rent adjustments	(165)	(339)	174	(51.3%)
Property management internalization expense	900	–	900	
LTIP compensation expense	–	–	–	–
DI	6,562	5,283	1,279	24.2%

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(In thousands except for per unit and % amounts)	Q4 2006	Q4 2005	Change	% Change
Weighted average units outstanding (basic)	18,445	15,350	3,095	20.2%
Weighted average units outstanding (diluted)	18,824	15,606	3,218	20.6%
Distributions	5,696	4,578	1,118	24.4%
DI per unit (basic)	$ 0.356	$ 0.344	$ 0.012	3.4%
DI per unit (diluted)	$ 0.349	$ 0.339	$ 0.010	3.0%
DI pay-out ratio	86.8%	86.7%	0.1%	
FFO	7,125	5,782	1,343	23.2%
FFO per unit (basic)	$ 0.386	$ 0.377	$ 0.009	2.6%
FFO per unit (diluted)	$ 0.379	$ 0.370	$ 0.009	2.2%
FFO pay-out ratio	79.9%	79.2%	0.7%	
AFFO	5,928	5,124	804	15.7%
AFFO per unit (basic)	$ 0.321	$ 0.334	$ (0.013)	(3.9%)
AFFO per unit (diluted)	$ 0.315	$ 0.328	$ (0.013)	(4.0%)
AFFO pay-out ratio	96.1%	89.4%	6.7%	
NOI	10,998	8,988	2,010	22.4%
Same-asset net operating income	8,439	8,252	187	2.3%
Total assets	$ 502,509	$ 384,538	$ 117,971	30.7%
Total debt (excludes premium on assumed debt)	$ 263,464	$ 210,093	$ 53,371	25.4%
Debt Ratio	48.2%	51.0%	(2.8%)	
Total GLA (s.f., excluding PUD)	3,321	2,266	1,055	46.6%
Leased GLA (s.f., excluding PUD)	3,197	2,197	1,000	45.5%
Leased GLA (% total GLA)	96.3%	97.0%	(0.7%)	

Net income for the quarter ended December 31, 2006, was $1,053, as compared to net income $1,963 in the quarter ended December 31, 2005. The net income for the quarter ended December 31, 2006, was affected by the expense of $900 recorded in connection with the internalization of property management. Net income per unit (diluted) for the quarter was $0.056, as compared to net income per unit (diluted) of $0.128 in the comparable quarter.

DI for the quarter ended December 31, 2006, increased by 24.2% to $6,562 from $5,283 for the quarter ended December 31, 2005. DI per unit (diluted) for the quarter was $0.349, as compared to DI per unit (diluted) of $0.339 in the comparable quarter.

Net Rental Income

Net rental income for the quarter ended December 31, 2006, increased by 21.3% to $11,096 from $9,146 in the quarter ended December 31, 2005, as follows:

(i) $1,981 due to net rental income from properties not owned for the entire quarter and the entire comparable quarter;

(ii) $85 due to the internalization of the property management function; and

(iii) offset by $116 due to the decrease in same-asset net rental income from properties owned for the entire quarter and the entire comparable quarter (which includes the quarter-over-quarter decrease in step-rent adjustments).

Net rental income per occupied square foot for the quarter ended December 31, 2006, was $4.11 ($16.44 annualized), as compared to $4.50 ($18.00 annualized) in the quarter ended December 31, 2005. The quarter-over-quarter decline is reflective of the fact that the REIT acquired more property in target markets with lower net rental rates than its Toronto target market.

Real Estate Service Income

The Property Manager provides real estate services to third-party property owners. Real estate service income for the quarter ended December 31, 2006, was $113, as compared to $78 in the quarter ended December 31, 2005.

Property Management Internalization

The economic benefit of the property management internalization for the quarter ended December 31, 2006, is summarized in the following table:

(In thousands)	Q4 2006
Increase in net rental income	$ 272
Real estate service income	113
Reduction in leasing expenditures payable as leasing fees	10
Reduction in capital expenditures payable as project management fees	127
Total	$ 522

This exceeded Management's expectations for the quarter.

Financing Expense

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on assumed mortgages reduced financing expense by $98 in the quarter ended December 31, 2006.

Financing expense for the quarter ended December 31, 2006, increased by 25.2% to $3,395 from $2,711 in the quarter ended December 31, 2005, due to the increase in financing expense associated with additional properties acquired in 2005 and 2006.

Depreciation and Amortization

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the quarter ended December 31, 2006, increased by 24.5% to $2,107 from $1,692 in the quarter ended December 31, 2005.

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

Trust Expense

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

Trust expense for the quarter ended December 31, 2006, decreased by 5.4% to $597 from $631 in the quarter ended December 31, 2005.

PART V

Summary Quarterly Information and Performance

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

(In thousands except for per unit and % amounts)	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Revenue from rental properties	17,871	15,948	15,467	14,943	14,291	12,822	12,260	11,797
Rental property operating cost	6,775	5,478	5,385	5,543	5,145	4,442	4,480	4,197

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(In thousands except for per unit and % amounts)	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Net rental income	11,096	10,470	10,082	9,400	9,146	8,380	7,780	7,600
Real estate service income	113	110	103	110	78	84	–	–
Financing expense	3,395	3,262	3,188	2,981	2,711	2,360	2,218	2,269
Depreciation and amortization	5,264	4,366	4,047	3,987	3,919	3,075	2,910	2,336
Income from operations	2,550	2,952	2,950	2,542	2,594	3,029	2,652	2,995
Trust expense	597	495	767	518	631	404	469	497
PM internalization expense	900	–	–	–	–	7,877		
Net income (loss)	1,053	2,457	2,183	2,024	1,963	(5,252)	2,183	2,498
Amortization								
Rental properties	2,107	1,908	1,837	1,776	1,692	1,549	1,461	1,369
Mortgage premium	(98)	(89)	(54)	(42)	(182)	(145)	(99)	(104)
Acquired leases	770	678	635	636	633	535	501	413
M-T-M acquired leases	67	(61)	68	88	181	–	24	24
Acquired tenant relationships	1,904	1,355	1,191	1,244	1,311	720	761	393
Acquired contracts and customer relationships	24	24	24	24	24	24	–	–
Step-rent adjustments	(165)	(192)	(209)	(355)	(339)	(287)	(350)	(405)
Property management internalization expense	900	–	–	–	–	7,877	–	–
LTIP compensation expense	–	–	270	–	–	–	–	109
DI	6,562	6,080	5,945	5,395	5,283	5,021	4,481	4,297
Weighted average units (basic)	18,445	16,397	15,848	15,809	15,350	14,471	14,036	12,118
Weighted average units (diluted)	18,824	16,772	16,166	16,064	15,606	14,727	14,289	12,329
Distributions	5,696	5,102	4,891	4,768	4,578	4,317	4,295	3,557
DI per unit (basic)	$ 0.356	$ 0.371	$ 0.375	$ 0.341	$ 0.344	$ 0.347	$ 0.319	$ 0.355
DI per unit (diluted)	$ 0.349	$ 0.363	$ 0.368	$ 0.336	$ 0.339	$ 0.341	$ 0.314	$ 0.348
DI pay-out ratio	86.8%	83.9%	82.3%	88.4%	86.7%	86.0%	95.8%	82.8%
FFO	7,125	6,734	6,139	5,913	5,782	5,616	5,045	4,786
FFO per unit (basic)	$ 0.386	$ 0.411	$ 0.387	$ 0.374	$ 0.377	$ 0.388	$ 0.359	$ 0.395
FFO per unit (diluted)	$ 0.379	$ 0.402	$ 0.380	$ 0.368	$ 0.370	$ 0.381	$ 0.353	$ 0.388
NOI	10,998	10,217	9,941	9,133	8,988	8,093	7,454	7,219
Net income (loss) per unit (basic)	$ 0.057	$ 0.147	$ 0.138	$ 0.128	$ 0.128	$ (0.363)	$ 0.156	$ 0.206
Net income (loss) per unit (diluted)	$ 0.056	$ 0.144	$ 0.135	$ 0.126	$ 0.126	$ (0.363)	$ 0.153	$ 0.203
Total assets	$ 502,509	$ 443,945	$ 405,827	$ 384,963	$ 384,538	$ 321,659	$ 309,822	$ 284,741
Total debt	$ 263,464	$ 241,765	$ 224,498	$ 212,226	$ 210,093	$ 163,182	$ 144,596	$ 147,418
Debt Ratio	48.20%	50.2%	53.2%	51.2%	51.0%	47.7%	44.8%	50.0%
Total GLA (s.f., excluding PUD)	3,321	2,657	2,387	2,266	2,266	1,985	1,925	1,703
Leased GLA (s.f., excluding PUD)	3,197	2,599	2,346	2,202	2,197	1,933	1,885	1,687
Leased Area (%GLA)	96.3%	97.8%	98.3%	97.2%	97.0%	97.4%	97.3%	99.1%

PART VI

Critical Accounting Estimates

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

Fair Value of Assumed Mortgages Payable and Fair Value of Mortgages Payable

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

Impairment of Assets

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

Depreciation

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

PART VII

Related Party Transactions

At the time of its IPO, the REIT entered into an agreement ("Property Management Agreement") with the Developer, a company owned in part and controlled by the President and CEO of the REIT and owned in part by the Executive Vice President of the REIT. Pursuant to the Property Management Agreement, the Developer provided property management and related services to the REIT. Effective July 1, 2005, the Property Manager, a wholly-owned subsidiary of the REIT, acquired the Developer's property management business. Immediately prior to July 1, 2005, the Developer ceased to provide services to the REIT under the Property Management Agreement. Accordingly, the REIT made no payments to the Developer for property management and related services in the year ended December 31, 2006, as compared to payments of $1,741 in the year ended December 31, 2005.

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

PART VIII

Risk and Uncertainties

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

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

Financing and Interest Rate Risk

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

Interest rates on the REIT's mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 5.9%. The weighted average term of the REIT's mortgage debt is 7.2 years. As at December 31, 2006, the borrowings under the REIT's credit facilities were nil.

Credit Risk

The REIT is subject to credit risk. Credit risk arises from the possibility that tenants may not be able to fulfill their lease obligations. The REIT will strive to mitigate this risk by maintaining a diversified tenant- mix and limiting exposure to any single tenant.

The following sets out the REIT's tenant-mix on the basis of percentage of rental revenue for the year ended December 31, 2006, and the year ended December 31, 2005.

Category	**% of Rental Revenue 2006**	% of Rental Revenue 2005
Business service and professional	35	34
Retail (head office and storefront)	18	20
Telecommunications and information technology	16	15
Media and entertainment	14	13
Financial services	11	12
Government	3	2
Other	3	4

The following sets out the percentage of rental revenue from the REIT's top-10 tenants by rental revenue for the year ended December 31, 2006, as well as the percentage of rental revenue from those tenants for the year ended December 31, 2005.

Tenant	**% of Rental Revenue 2006**	% of Rental Revenue 2005
Desjardins	7.0	7.9
Cossette Communications	4.9	6.0
Publicis Toronto	3.0	3.2
MTS Allstream	2.9	4.3
St. Joseph Media	2.5	3.2
Algorithmics	2.2	2.7
Indigo Books & Music	1.9	2.4
Nelvana	1.9	2.3
Blast Radius	1.9	2.3
Bensimon Byrne	1.8	1.7

Lease Roll-Over Risk

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

96.3% of the GLA in the REIT's portfolio was leased as at December 31, 2006 (not including Properties Under Development). The following sets out the total GLA of the leases that mature during the period from January 1, 2007, to December 31, 2011, assuming tenants do not exercise renewal options, and the percentage of total GLA represented by the maturing leases.

Year Ended	Square Feet	% of Total GLA
December 31, 2007	504,240	14.1%
December 31, 2008	399,201	11.2%
December 31, 2009	543,686	15.3%
December 31, 2010	375,670	10.5%
December 31, 2011	381,277	10.7%

Leases representing 106,474 square feet of the GLA that matures in 2007 and 51,764 square feet of the GLA that matures in 2009 were renewed or replaced by December 31, 2006. The weighted average term to maturity of the REIT's leases is 4.3 years.

Environmental Risk

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

Development Risk

As an owner of Properties Under Development, the REIT is subject to development risks, such as construction delays, cost over-runs and the failure of tenants to take occupancy and pay rent in accordance with lease arrangements. In connection with all Properties Under Development, the REIT incurs development costs prior to (and in anticipation of) achieving a stabilized level of rental revenue. In the case of the development of ancillary land, these risks are managed by not commencing construction until a satisfactory level of pre-leasing is achieved. Overall, these risks are managed by ensuring that Properties Under Development do not represent a large component of the REIT's GBV. As at December 31, 2006, the cost of Properties Under Development was equivalent to 3.1% of the REIT's GBV.

Taxation Risk

On October 31, 2006, the Minister of Finance (Canada) announced proposed changes to the taxation of income trusts. On December 21, 2006, the Ministry introduced the related draft legislation, under which qualifying REITs are excluded from the proposed changes, provided they meet a series of conditions relating to the nature of their income and investments. Consistent with normal Canadian REIT practice, the REIT (i) uses wholly owned subsidiaries to hold title to its real properties and to provide management services and (ii) owns certain assets for which the capital cost allowance rate exceeds 5%, such as computers, office furniture, paving and signage. As a result, the REIT does not appear to be a qualifying REIT under the draft legislation. While the REIT may be able to restructure its operations and assets to become a qualifying REIT under the draft legislation, there can be no assurance in this regard. While Management does not believe this was the intended outcome of the draft legislation, there can be no assurance that the draft legislation will be amended to accommodate normal Canadian REIT practice.

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PART IX

Subsequent Events

On January 12, 2007, the REIT completed the acquisition of 193 Yonge Street, a 49,284 square-foot Class I office property located in downtown Toronto, for a purchase price of $10.25 million.

On February 8, 2007, the REIT completed the acquisition of 451-481 Saint Catherine Street West, a 30,439 square-foot restored office/retail property in downtown Montreal, for a purchase price of $6 million.

On February 28, 2007, the REIT announced the acquisition of 106 Front Street East, a 34,497 square-foot Class I office property in downtown Toronto with 16 surface parking spaces, for a purchase price of $8 million. The acquisition is scheduled to close on or about April 2, 2007.

PART X

Disclosure Controls and Procedures

As at December 31, 2006, the Chief Executive Officer, the Chief Financial Officer and other members of Management evaluated the effectiveness of the REIT's disclosure controls and procedures, as defined in Multilateral Instrument 52-109. They have concluded that these controls and procedures were adequate and effective to provide reasonable assurance that material information regarding the REIT was accumulated and communicated to them, as appropriate to allow timely decisions to be made by them regarding required disclosure.

As at December 31, 2006, the Chief Executive Officer, the Chief Financial Officer and other members of Management evaluated the design of the REIT's internal controls over financial reporting. These controls were designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. The Chief Executive Officer, the Chief Financial Officer and other members of Management have concluded that the design of these internal controls were adequate and effective to provide reasonable assurance that financial information is recorded, processed, summarized and reported in a timely manner. There were no significant changes made to internal controls in 2006.

PART XI

Property Table

The following lists and briefly describes the properties owned by the REIT as at December 31, 2006:

December 31, 2006 Properties	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Leased	Leased %
The Castle	100,300	34,323	134,623		4,087	–	130,536	97.0%
905 King W	103,054	9,832	112,886			600	112,286	99.5%
King West	203,354	44,155	247,509	7.19%	4,087	600	242,822	98.1%
468 King W	65,039	–	65,039		–	–	65,039	100.0%
425-439 King W	74,053	25,134	99,187		–	–	99,187	100.0%
441-443 King W	6,820	3,065	9,885		–	–	9,885	100.0%
445-455 King W	27,565	23,048	50,613		–	–	50,613	100.0%
469 King W	62,594	11,250	73,844		–	–	73,844	100.0%
King-Brant Parking	–	–	–		–	–	–	–
500-522 King W	94,945	27,705	122,650		–	–	122,650	100.0%
602-606 King W	37,299	23,113	60,412		–	–	60,412	100.0%
420 Wellington W	33,813	3,137	36,950		–	–	36,950	100.0%
425 Adelaide W	74,008	4,104	78,112		11,918	–	66,194	84.7%
579 Richmond W (+ Land)	29,311	–	29,311		–	–	29,311	100.0%
141 Bathurst (+ Land)	10,521	–	10,521		–	–	10,521	100.0%
662 King West	29,691	2,126	31,817		2,840	–	28,977	91.1%
King West Central	545,659	122,682	668,341	19.42%	14,758	–	653,583	97.8%
116 Simcoe	13,819	–	13,819		–	–	13,819	100.0%
200 Adelaide W	28,024	–	28,024		–	–	28,024	100.0%
208-210 Adelaide W	12,330	–	12,330		–	–	12,330	100.0%
312 Adelaide W	63,904	7,891	71,795		–	–	71,795	100.0%

December 31, 2006 Properties	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Leased	Leased %
331-333 Adelaide W	20,951	3,209	24,160		–	–	24,160	100.0%
358-360 Adelaide W	35,986	18,263	54,249		8,983	18,263	27,003	49.8%
134 Peter	29,218	19,804	49,022		–	–	49,022	100.0%
82 Peter	38,623	8,287	46,910		–	–	46,910	100.0%
364 Richmond W	21,300	17,300	38,600		–	–	38,600	100.0%
388 King W	32,529	11,765	44,294		–	–	44,294	100.0%
99 Spadina	39,267	12,613	51,880		–	–	51,880	100.0%
185 Spadina	55,814	–	55,814		–	–	55,814	100.0%
217-225 Richmond W	34,877	21,684	56,561			–	56,561	100.0%
Entertainment District	426,642	120,816	547,458	15.91%	8,983	18,263	520,212	95.0%
67 Richmond W	44,870	5,794	50,664		2,339	–	48,325	95.4%
Downtown	44,870	5,794	50,664	1.47%	2,339	–	48,325	95.4%
35-39 Front E	30,811	16,606	47,417		–	–	47,417	100.0%
41-45 Front E	19,799	13,735	33,534		–	–	33,534	100.0%
50 Wellington E	21,144	11,049	32,193		3,283	–	28,910	89.8%
St. Lawrence Market	71,754	41,390	113,144	3.29%	3,283	–	109,861	97.1%
Queen Richmond Centre	175,081	48,818	223,899		–	–	223,899	100.0%
230 Richmond E	62,514	–	62,514		–	–	62,514	100.0%
145 Berkeley	10,625	–	10,625		2,050	–	8,575	80.7%
489 Queen E	32,592	–	32,592		–	–	32,592	100.0%
Queen Richmond	280,812	48,818	329,630	9.58%	2,050	–	327,580	99.4%
QRC South	44,600	–	44,600		20,747	–	23,853	53.5%
257 Adelaide W	40,050	5,843	45,893		12,890	5,843	27,160	59.2%
47 Fraser	11,626	–	11,626		11,626	–	–	0.0%
47A Fraser	18,111	–	18,111		18,111	–	–	0.0%
PUD	114,387	5,843	120,230	3.49%	63,374	5,843	51,013	42.4%
Toronto Including PUD	1,687,478	389,498	2,076,976	60.36%	98,874	24,706	1,953,396	94.1%
Toronto Excluding PUD	1,573,091	383,655	1,956,746	56.86%	35,500	18,863	1,902,383	97.2%
425 Viger W	205,314	820	206,134		–	–	206,134	100.0%
3575 Saint-Laurent	164,797	17,464	182,261		7,707	–	174,554	95.8%
4446 Saint-Laurent	72,613	10,000	82,613		1,354	–	81,259	98.4%
Adjacent Land (PUD)	–	–	–		–	–	–	–
6300 Avenue du Parc	217,022	950	217,972		9,508	–	208,464	95.6%
400 Atlantic	86,034	–	86,034		9,975	–	76,059	88.4%
Montreal	745,780	29,234	775,014	22.52%	28,544	–	746,470	96.3%
390 Charest E	66,771	6,348	73,119		700	–	72,419	99.0%
410 Charest E	–	24,937	24,937		–	1,300	23,637	94.8%
430 Charest E	44,051	13,285	57,336		500	–	56,836	99.1%
622 Saint Joseph E	3,620	3,300	6,920		–	–	6,920	100.0%
633 Saint Joseph E	15,558	6,000	21,558		–	–	21,558	100.0%
Quebec City	130,000	53,870	183,870	5.34%	1,200	1,300	181,370	98.6%
115 Bannatyne	34,495	4,815	39,310		–	4,815	34,495	87.8%
50-70 Arthur	110,918	10,500	121,418		11,295	–	110,123	90.7%
250 McDermot	41,446	10,200	51,646		6,000	–	45,646	88.4%
138 Portage E	43,960	–	43,960		6,600	–	37,360	85.0%
309 Hargrave	21,460	1,400	22,860		7,019	–	15,841	69.3%
165 Garry	4,400	10,362	14,762		–	–	14,762	100.0%
1500 Notre Dame	111,400	–	111,400		3,300	–	108,100	97.0%
Winnipeg	368,079	37,277	405,356	11.78%	34,214	4,815	366,327	90.4%
Total Including PUD	2,931,337	509,879	3,441,216	100.00%	162,832	30,821	3,247,563	94.4%
Total Excluding PUD	2,816,950	504,036	3,320,986	96.51%	99,458	24,978	3,196,550	96.3%

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 information presented. These financial statements were prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants and where necessary, include amounts, which are based on best estimates and judgment of management.

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

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

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

Michael R. Emory
President and Chief Executive Officer

Tom Wenner, CA
Chief Financial Officer

auditors' report

To the Unitholders of Allied Properties Real Estate Investment Trust

We have audited the consolidated balance sheets of Allied Properties Real Estate Investment Trust as at December 31, 2006 and 2005 and the consolidated statements of earnings, unitholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the REIT as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
February 22, 2007

consolidated balance sheet

(In thousands)	Note	Dec. 31, 2006	Dec. 31, 2005
ASSETS			
Rental properties	4	$ 426,442	$ 336,606
Properties under development		17,074	6,564
Deferred expenses	5	34,736	25,710
Other assets	6	20,852	15,658
Cash		3,405	–
		$ 502,509	$ 384,538
LIABILITIES			
Mortgages payable	7	$ 264,286	$ 198,876
Bank indebtedness	7	–	12,045
Accounts payable and other liabilities	8	20,473	15,258
Distributions payable		2,046	1,575
		286,805	227,754
UNITHOLDERS' EQUITY	9	215,704	156,784
		$ 502,509	$ 384,538

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

Approved by the Board of Trustees

Gordon Cunningham
Trustee

Michael R. Emory
Trustee

consolidated statement of unitholders' equity

(In thousands)	Notes	Cumulative Capital	Cumulative Issue Costs	Cumulative Net Income	Cumulative Distributions	Total
Unitholders' equity, December 31, 2004		$ 106,977	$ (6,728)	$ 14,301	$ (16,374)	$ 98,176
Year Ended December 31, 2005						
Net income		–	–	1,392	–	1,392
Distributions		–	–	–	(16,761)	(16,761)
Public offering		74,950	(3,754)	–	–	71,196
Distribution reinvestment plan		1,224	–	–	–	1,224
Unit option plan – options exercised	11	1,230	–	–	–	1,230
Long-term incentive plan	12	327	–	–	–	327
Unitholders' equity, December 31, 2005		$ 184,708	$ (10,482)	$ 15,693	$ (33,135)	$ 156,784
Year Ended December 31, 2006						
Net income		$ –	$ –	$ 7,717	$ –	$ 7,717
Distributions		–	–	–	(20,457)	(20,457)
Public offering		73,300	(3,481)	–	–	69,819
Distribution reinvestment plan		856	–	–	–	856
Unit option plan – options exercised	11	260	–	–	–	260
Long-term incentive plan	12	742	(17)	–	–	725
Unitholders' equity, December 31, 2006		$ 259,866	$ (13,980)	$ 23,410	$ (53,592)	$ 215,704

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

consolidated statement of earnings

(In thousands, except unit and per unit amounts)	Notes	Year Ended December 31, 2006	Year Ended December 31, 2005
Revenues			
Rental properties		$ 64,229	$ 51,170
Real estate services		1,010	422
		65,239	51,592
Expenses			
Rental property operating		23,181	18,264
Real estate services		574	260
Financing		12,826	9,558
Trust		2,377	2,001
Amortization of rental properties		7,628	6,071
Amortization of deferred expenses		9,272	6,153
Amortization of other assets		764	16
Internalization of property management		900	7,877
		57,522	50,200
Net income for the period		$ 7,717	$ 1,392
Net income per unit			
Basic		$ 0.464	$ 0.099
Fully diluted		$ 0.455	$ 0.098
Weighted average number of units	10		
Basic		16,631,597	14,004,054
Fully diluted		16,964,265	14,249,424

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

consolidated statement of cash flows

(In thousands)	Notes	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
CASH PROVIDED BY (USED IN):			
Operating activities			
Net income		$ 7,717	$ 1,392
Items not affecting cash			
Amortization of rental properties		7,628	6,071
Amortization of office equipment		32	16
Amortization of deferred expenses		9,272	6,153
Amortization of tenant improvements		732	–
Step rent adjustments		(920)	(1,381)
Amortization of tenant inducements		26	–
Mark to market rent adjustments		162	229
Amortization, premium on assumed mortgages		(284)	(530)
Interest benefit granted under long-term incentive plan		270	109
		24,635	12,059
Change in other non-cash operating items		1,453	(4,200)
Cash from operating activities		26,088	7,859
Investing activities			
Rental properties acquired, net of non-cash consideration	2 (a)	(87,296)	(92,756)
Properties under development acquired	2 (a)	(10,986)	(6,505)
Identifiable assets acquired, net of non-cash consideration	2 (b)	–	(967)
Capital expenditures, rental properties and other assets		(4,206)	(1,390)
Capital expenditures, properties under development		(1,045)	(59)
Deferred recoverable expenses		(79)	(16)
Tenant improvements and leasing cost		(4,271)	(1,970)
Tenant inducements		(208)	–
Cash used in investing activities		(108,091)	(103,663)
Financing Activities			
Repayment of mortgages payable		(21,032)	(22,432)
Proceeds from new mortgages payable		67,735	59,900
Deferred financing costs		(653)	(542)
Distributions		(19,130)	(14,949)
Proceeds of public offering (net of issue costs)		69,819	71,196
Proceeds from exercise of unit options		260	1,230
Proceeds from units issued under the LTIP (net of issue costs)	12	454	327
Net increase (decrease) in bank indebtedness		(13,853)	1,580
Cash provided by financing activities		83,600	96,310
Increase in cash and cash equivalents		1,597	506
Cash and cash equivalents, beginning of period		1,808	1,302
Cash and cash equivalents, end of period		$ 3,405	$ 1,808
Other cash flow information			
Interest paid		$ 13,419	$ 9,947
Supplemental disclosure of non-cash activities			
Units issued pursuant to the distribution reinvestment plan		$ 856	$ 1,224

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

consolidated notes to financial statements

(In thousands of dollars except per unit and unit amounts)
December 31, 2006 and December 31, 2005

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 REIT are traded on the Toronto Stock Exchange.

These consolidated financial statements present the financial position of the REIT as at December 31, 2006 and the results of operations and cash flows for the year ended December 31, 2006.

2. Acquisitions

(a) Rental Properties and Properties Under Development

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

	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Rental properties	$ 91,779	$ 101,566
Properties under development	10,986	–
Other assets	561	131
Fair value of in-place leases and tenant relationships	15,363	12,730
Fair value of above-market leases	1,708	2,764
Fair value of below-market leases	(1,360)	(1,795)
Mortgages payable	(18,991)	(17,591)
Accounts payable and accrued liabilities	(1,764)	(5,049)
Cash consideration paid for the net assets acquired	$ 98,282	$ 92,756

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

(b) Property Management Business

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

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

The following costs incurred are in connection with the internalization of the management function and were recorded as an expense in the consolidated statement of earnings for the years ended December 31, 2006 and 2005:

	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Property management contract termination fee	$ 900	$ 7,533
Legal, advisory and other costs	–	344
Internalization of property management	$ 900	$ 7,877

Identifiable assets acquired were recorded at the fair values as follows:

	Year Ended Dec. 31, 2005
Computer and office equipment	$ 77
Intangible assets – contracts and customer relationships	959
	1,036
Assumption of capital lease obligations	(69)
Total cash paid for identifiable assets	$ 967

3. Summary of Significant Accounting Policies

(a) Basis of Presentation

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

(b) Basis of Consolidation

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

Entity	**Interest Held on Dec. 31, 2006**	Interest Held on Dec. 31, 2005	Accounting Method
Allied Properties Management Limited Partnership	100%	100%	Consolidation
Allied Properties Management Trust	100%	100%	Consolidation
Allied Properties Management GP Limited	100%	100%	Consolidation

(c) Use of Estimates

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

(d) Cash and Cash Equivalents

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

(e) Rental Properties

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

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

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

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

(f) Properties Under Development

Properties under development are stated at the lower of cost and net recoverable value. Cost includes the cost of acquisition, other direct cost, realty tax, other operating expense and applicable financing expense during the development period, less the amount of operating revenue during the development period. The principal factors in determining when the redevelopment-period ends are (i) the achievement of positive cash flow after applicable interest expense and (ii) the passage of a predetermined period of time. Other criteria may be considered in determining when a redevelopment-period ends if warranted by circumstances relating to the relevant property under development.

(g) Computer and Office Equipment

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

(h) 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.

(i) Revenue Recognition

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

(j) Unit-based Compensation Plan

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

(k) Per Unit Calculations

Basic net income per unit is calculated by dividing net income by the weighted average number of units outstanding for the year, excluding those units issued under the Long Term Incentive Plan, which are not fully paid up. The calculations of net income 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 net income per unit on a diluted basis includes those units issued under the Long Term Incentive Plan, which are not fully paid up.

(l) Contracts and Customer Relationships

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

(m) Leasing Costs and Tenant Improvements

Leasing costs include costs associated with leasing activities such as commissions. These costs are amortized on a straight-line basis over the terms of the leases to which they relate.

The REIT may provide funding to tenants through allowances. In accounting for a tenant allowance, the REIT determines whether the allowance is for funding the construction of improvements and the ownership of such improvements. In those circumstances where the REIT is considered the owner of the improvements, the REIT capitalizes the amount of the allowance as a tenant improvement and amortizes it over the shorter of the useful life of the improvement and the lease term. If the REIT provides an allowance that does not represent a payment for funding improvements, or in the event the REIT is not considered the owner of the improvement, the allowance would be considered a lease incentive and would be deferred and amortized over the lease term as a reduction of revenue. Determination of the accounting treatment of a tenant allowance is made on a case-by-case basis.

(n) Comparative Amounts

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

4. Rental Properties

	Cost	Accumulated Amortization	Net Carrying Amount Dec. 31, 2006	Net Carrying Amount Dec. 31, 2005
Land	$ 85,754	$ –	$ 85,754	$ 64,375
Building, improvements and other costs	359,386	18,698	340,688	272,231
	$ 445,140	$ 18,698	$ 426,442	$ 336,606

5. Deferred Expenses

Deferred expenses consist of costs incurred by the REIT, net of accumulated amortization of $16,553 (December 31, 2005 – $8,103), with respect to obtaining debt financing, leasing costs incurred, the fair value attributed to in-place leases acquired, the fair value attributed to customer relationships with respect to rental property acquisitions and amounts recorded on the acquisition of the property manager – contracts and customer relationships. Amortization is recorded on a straight-line basis over the term of the respective credit facility and over the remaining term of the respective leases to which the costs or fair value relate.

	Cost	**Accumulated Amortization**	**Net Carrying Amount Dec. 31, 2006**	Net Carrying Amount Dec. 31, 2005
Leasing costs	$ 3,995	$ 758	$ 3,237	$ 1,782
Tenant inducements	208	26	182	–
Deferred financing costs	2,017	376	1,641	1,230
Amounts ascribed to leasing costs and tenant relationships on rental properties acquired	43,990	15,224	28,766	21,771
Amounts recorded on the acquisition of the property manager – contracts and customer relationships	959	144	815	911
Recoverable expenditures	100	5	95	16
	$ 51,269	$ 16,533	$ 34,736	$ 25,710

6. Other Assets

Other assets consist of:

	Dec. 31, 2006	Dec. 31, 2005
Above-market rents of leases acquired through rental property acquisitions net of amortization of $2,712 (December 31, 2005 – $1,404)	$ 6,281	$ 5,881
Accounts receivable	7,214	4,435
Tenant improvements, net of amortization of $1,158 (December 31, 2005 – $475)	3,880	2,317
Prepaid expenses	259	163
Escrow accounts held by mortgagees	3,101	2,746
Computer and office equipment, net of amortization of $43 (December 31, 2005 – $15)	84	79
Leasehold improvements, net of amortization of $4 (December 31, 2005 – $1)	33	37
	$ 20,852	$ 15,658

consolidated notes to financial statements

7. Mortgages Payable and Bank Indebtedness

Substantially all of the REIT's assets have been pledged as security under the related mortgages and other security agreements. Interest rates on the mortgages payable are between 4.94% and 8.10 % with a weighted average rate of 5.96% (December 31, 2005 – 6.03%).

Mortgages payable at December 31, 2006 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Year ended December 31, 2007	$ 6,979	$ 19,433	$ 26,412
Year ended December 31, 2008	6,810	6,437	13,247
Year ended December 31, 2009	6,698	14,022	20,720
Year ended December 31, 2010	6,772	4,478	11,250
Year ended December 31, 2011	6,938	8,496	15,434
Thereafter	26,476	149,922	176,398
	$ 60,673	$ 202,788	$ 263,461
Premium on assumed mortgages (net of amortization of $ 815)			825
			$ 264,286

The REIT has a $25,000 revolving credit facility with a Canadian chartered bank, which matures May 31, 2007 and bears interest at bank prime rate plus 1.0%. Security for the facility consists of first and second mortgage charges on seven rental properties and security agreements covering assignment of rents and personal property with respect to the seven properties.

The REIT has a $5,000 revolving credit facility with a Canadian chartered bank, which matures May 31, 2007 and bears interest at bank prime rate plus 1.0%. Security for the facility consists of first mortgage charges on one rental property and security agreements covering assignment of rents and personal property with respect to the property.

At December 31, 2006 the amount outstanding under the credit facilities was $ nil, (December 31, 2005 $12,045, net of cash of $1,808).

8. Accounts Payable and Other Liabilities

Accounts payables and other liabilities consist of:

	Dec. 31, 2006	Dec. 31, 2005
General operating payables and tenant deposits	$ 15,988	$ 11,233
Below market rents of leases acquired through rental property acquisition – net of amortization of $2,340 (December 31,2005 – $1,193)	3,274	3,057
Accrued interest	1,196	916
Capital lease obligations	15	52
	$ 20,473	$ 15,258

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.

The number of units issued and outstanding is as follows:

	Units
Units outstanding, December 31, 2005	16,018,933
Units issued pursuant to offering on September 1, 2006	1,900,000
Units issued pursuant to offering on December 1, 2006	2,000,000
Units issued pursuant to the Long Term Incentive Plan (Note 12)	137,069
Units issued pursuant to Unit Option Plan (Note 11)	26,000
Units issued under the Distribution Reinvestment Plan	48,311
Units outstanding, December 31, 2006	20,130,313

10. Weighted Average Units

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

	Year Ended Dec. 31, 2006	Year Ended Dec. 31, 2005
Basic	16,631,597	14,004,054
Unit option plan	27,935	38,144
Long-term incentive plan	304,733	207,226
Fully diluted	16,964,265	14,249,424

11. Unit Option Plan

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

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

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

Options	Units	Weighted Average Exercise Price
Options exercisable as at December 31, 2005	81,500	$ 10.00
Exercised between January 1 and December 31, 2006	26,000	$ 10.00
Options outstanding and exercisable as at December 31, 2006	55,500	$ 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 as to 5% upon issuance and as to the balance ("installment loan receivable") over a term not exceeding 10 years. The installment loan receivable bears 3% interest on any outstanding balance and is a direct, personal obligation of the participant. The units issued under the LTIP are held by a custodian for the benefit of the participants until the installment loan receivable has been paid in full. Cash distributions paid in respect of the units issued under the LTIP are applied first to the interest and then to reduce the balance of the installment loan receivable.

The fair value of the LTIP is the estimated present value of the imputed interest benefit over an estimated expected term of ten years. 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.

Units issued under the LTIP	Cumulative as at Dec. 31, 2006	Year Ended Dec. 31, 2006	Cumulative as at Dec. 31, 2005
Number of units issued	360,793	137,069	223,724
Units issued	$ 5,122	$ 2,359	$ 2,763
Compensation cost	468	270	198
	5,590	2,629	2,961
LTIP installment loans receivable	(4,750)	(2,126)	(2,624)
Interest on installment loan receivable	(212)	(121)	(91)
Distributions applied against installment loan receivable	662	360	303
	(4,300)	(1,887)	(2,413)
	$ 1,290	$ 742	$ 548

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 assests and liabilities with current maturities approximate their recorded values as at December 31, 2006. The fair value of the mortgages payable is $270,969 (2005 – $201,890).

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, 2006 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

The REIT's assets are in, and its revenue is derived from, the downtown office markets in four major Canadian cities.

16. Commitments and Contingencies

The REIT has entered into commitments for acquisitions, building renovations, leasing commissions and tenant inducements with respect to leasing activities and for repairs and operating costs. The commitments as at December 31, 2006 and December 31, 2005 were $2,545 and $1,161, respectively.

17. Related Party Transactions

(a) Property Management Agreement

Prior to July 1, 2005, the REIT was bound by the Property Management Agreement the REIT had entered into with Allied Canadian Development Corporation ("Developer"). The Developer was appointed as the property manager for the rental properties owned by the REIT. The Developer is a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Developer. For its services as property manager, the Developer was paid an annual fee equal to 4% of the gross revenues, was entitled to recover the cost incurred by it in substituting on-site managers at rental properties, the costs of its maintenance staff to perform regular maintenance at the rental properties and its out-of pocket expenses related to services provided. Amounts paid and included in rental operating cost during the years ended December 31, 2006 and December 31, 2005 were $nil and $1,571, respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a leasing fee. The fee was payable upon tenants having executed and delivered signed leases. Amounts paid and included in rental operating cost during the years ended December 31, 2006 and December 31, 2005 were $nil and $72, respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a project management fee based on customary market fees for project management services in connection with renovations, construction and reconstruction work on the rental properties. Amounts paid and included in rental operating cost during the years ended December 31, 2006 and December 31, 2005 were $nil and $10, respectively.

Pursuant to the Property Management Agreement, the Developer provided the REIT a fully equipped office and support staff and was entitled to recover its cost from the REIT. Amounts paid and included in rental operating cost during the years ended December 31, 2006 and December 31, 2005 were $nil and $38, respectively.

Included in accounts payable and other liabilities is an amount of $nil (December, 2005 – $31) related to the above noted services. Included in commitments and contingencies is an amount of $45 (December 31, 2005 – $45) related to the above noted services.

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

(b) Real Estate Services

As a result of the acquisition of the property management business on July 1, 2005 as disclosed in Note 2 (b), the REIT engages in third-party property management business, including the provision of services for properties in which certain trustees of the REIT have an ownership interest. For the year ended December 31, 2006 real estate service revenue earned from these properties was $383 (December 31, 2005 - $205), which was fully paid in the period. These transactions are in the normal course of operations and were measured at the exchange amount set out in agreement between the respective property owners and the Developer, prior to the REIT acquiring the business. The REIT assumed the terms of these agreements.

(c) Rental Revenues

Rental revenues included amounts received from related parties as follows:

Related Party	Nature of Revenue	**Year Ended Dec. 31, 2006**	Year Ended Dec. 31, 2005
Vendors of properties	Head Lease	$ 25	$ 165
Developer		–	151
TechSpace Canada Inc.	Guarantee	–	61
TechSpace Canada Inc.	Lease	33	178
Vendors of properties	Bridge Covenants	39	360
		$ 97	$ 915

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 vendors, which are under common control of certain trustees of the REIT, honoured all of their obligations under the Head Lease and were released from the balance of their obligations there under when the REIT entered into direct lease arrangements with acceptable replacement tenants on acceptable terms.

Guarantee and Lease:

TechSpace Canada Inc. ("TechSpace"), a subsidiary of the Developer, leased 29,102 square feet of office space from the REIT on commercial terms. The lease was to expire on September 30, 2010. The Developer indemnified the REIT in respect of all of TechSpace's obligations under the lease. Effective January 1, 2004, the REIT entered into a direct lease of this space with a new tenant for a term ending on September 30, 2010, on the condition that the original indemnity of the Developer remain in place to protect the REIT from any revenue shortfall (on a cash basis) from the original TechSpace lease. Effective July 1, 2005, the REIT entered into a direct lease of this space with Loblaws Properties Limited for a term ending October 31, 2010, on the condition that the original indemnity of the Developer remain 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 provided the REIT with an income stream to coincide with rent-free periods that these vendors provided to the tenants prior to the REIT acquiring the rental properties. The vendors, which are under common control of certain trustees of the REIT, honoured all of their obligations under the Bridge Covenants.

(d) Rental Property Acquisitions

Effective December 1, 2006 the REIT acquired from certain vendors that are under common control of certain Trustees of the REIT, 441 King Street West, King-Brant Parking Facilities and the Castle – Phase II for purchase prices of $3,000, $8,500 and $16,600, respectively. The purchase prices net of standard adjustments were paid in cash. The purchase prices were determined by an independent appraisal.

Effective January 1, 2005 and July 1, 2005 the REIT acquired from certain vendors that are under common control of certain Trustees of the REIT, 469 King Street West and 602 King Street West for purchase prices of $16,000 and $11,270, respectively. The purchase prices net of standard adjustments were paid in cash and the REIT assumed a first mortgage loan of $5,060 with respect to 469 King Street West. The purchase prices were determined by an independent appraisal.

18. Subsequent Events

On January 12, 2007, the REIT acquired 193 Yonge Street, a rental property in Toronto, Ontario for $10,250. The acquisition was financed with cash and utilization of the REIT's credit facilities.

On February 8, 2007, the REIT acquired St. James, a rental property in Montreal Quebec for $6,000. The acquisition was financed with cash and utilization of the REIT's credit facilities.

On February 28, 2007, the REIT announced the acquisition of 106 Front Street East, a 34,497 square-foot Class I office property in downtown Toronto with 16 surface parking spaces, for a purchase price of $8,000. The acquisition is scheduled to close on or about April 2, 2007.

Unitholder information

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Annual Meeting

Tuesday, May 8, 2007 at 4:30 p.m.
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