

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**

**Consolidated Financial Statements**

**For the Period Ended June 30, 2006**

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**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST  
CONSOLIDATED BALANCE SHEET**

(in thousands)	Note	June 30, 2006 (Unaudited)	December 31, 2005 (Audited)
<b>ASSETS</b>			
Rental properties	4	\$ 347,527	\$ 336,606
Properties under development		13,607	6,564
Deferred expenses	5	25,701	25,710
Other assets	6	18,992	15,658
		<b>\$ 405,827</b>	<b>\$ 384,538</b>
<b>LIABILITIES</b>			
Mortgages payable	7	\$ 225,281	\$ 198,876
Bank indebtedness	7	9,398	12,045
Accounts payable and other liabilities	8	16,929	15,258
Distributions payable		1,647	1,575
		<b>253,255</b>	<b>227,754</b>
<b>UNITHOLDERS' EQUITY</b>	<b>9</b>	<b>152,572</b>	<b>156,784</b>
		<b>\$ 405,827</b>	<b>\$ 384,538</b>

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

Approved by the Board of Trustees

"Gordon Cunningham"  
 Gordon Cunningham  
 Trustee

"Michael R. Emory"  
 Michael R. Emory  
 Trustee

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST  
CONSOLIDATED STATEMENT OF UNITHOLDERS' EQUITY**

(in thousands)

	Notes	Cumulative Capital	Cumulative Issue Costs	Cumulative Net Income	Cumulative Distributions	Total (Audited)
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
<b>Unitholders' equity, December 31, 2005</b>		<b>\$ 184,708</b>	<b>\$ (10,482)</b>	<b>\$ 15,693</b>	<b>\$ (33,135)</b>	<b>\$ 156,784</b>
Six Months Ended June 30, 2006 (Unaudited)						
Net income		\$ -	\$ -	\$ 4,207	\$ -	\$ 4,207
Distributions		-	-	-	(9,659)	(9,659)
Distribution reinvestment plan		406	-	-	-	406
Unit option plan - options exercised	11	260	-	-	-	260
Long-Term incentive plan	12	584	(10)	-	-	574
<b>Unitholders' equity, June 30, 2006</b>		<b>\$ 185,958</b>	<b>\$ (10,492)</b>	<b>\$ 19,900</b>	<b>\$ (42,794)</b>	<b>\$ 152,572</b>

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST  
CONSOLIDATED STATEMENT OF EARNINGS**

(in thousands, except unit and per unit amounts)

	Notes	Three Months Ended June 30, 2006 (Unaudited)	Three Months Ended June 30, 2005 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2005 (Unaudited)
<b>Revenues</b>					
Rental properties		\$ 15,467	\$ 12,260	\$ 30,410	\$ 24,057
Real estate services		245	-	469	-
		<b>15,712</b>	<b>12,260</b>	<b>30,879</b>	<b>24,057</b>
<b>Expenses</b>					
Rental property operating		5,385	4,480	10,928	8,677
Real estate services		142	-	256	-
Financing		3,188	2,218	6,169	4,487
Trust		767	469	1,285	966
Amortization of rental properties		1,837	1,461	3,613	2,830
Amortization of deferred expenses		2,036	1,363	4,111	2,263
Amortization of other assets		174	86	310	153
		<b>13,529</b>	<b>10,077</b>	<b>26,672</b>	<b>19,376</b>
<b>Net income for the period</b>		<b>\$ 2,183</b>	<b>\$ 2,183</b>	<b>\$ 4,207</b>	<b>\$ 4,681</b>
<b>Net income per unit</b>					
Basic		\$ 0.138	\$ 0.156	\$ 0.266	\$ 0.358
Fully diluted		\$ 0.135	\$ 0.153	\$ 0.261	\$ 0.352
<b>Weighted average number of units</b>	<b>10</b>				
Basic		15,848,429	14,036,486	15,828,813	13,082,356
Fully diluted		16,166,214	14,288,758	16,115,520	13,314,016

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST  
CONSOLIDATED STATEMENT OF CASH FLOWS**

(in thousands)

Notes	Three Months Ended June 30, 2006 (Unaudited)	Three Months Ended June 30, 2005 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2005 (Unaudited)
<b>CASH PROVIDED BY (USED IN):</b>				
<b>Operating activities</b>				
Net income	\$ 2,183	\$ 2,183	\$ 4,207	\$ 4,681
Items not affecting cash				
Amortization of rental properties	1,837	1,461	3,613	2,830
Amortization of office equipment	8	-	16	-
Amortization of deferred expenses	2,036	1,516	4,111	2,416
Amortization of tenant improvements	166	(67)	294	-
Amortization, other	11	-	11	-
Step rent adjustments	(209)	(350)	(564)	(755)
Mark to market rent adjustments	68	24	156	48
Amortization, premium on assumed mortgages	(54)	(99)	(96)	(203)
Interest benefit granted under long-term incentive plan	270	-	270	109
	<b>6,316</b>	<b>4,668</b>	<b>12,018</b>	<b>9,126</b>
Change in other non-cash operating items	<b>280</b>	<b>(995)</b>	<b>(336)</b>	<b>(2,204)</b>
<b>Cash from operating activities</b>	<b>6,596</b>	<b>3,673</b>	<b>11,682</b>	<b>6,922</b>
<b>Investing activities</b>				
Rental properties acquired, net of non-cash consideration	2 (a) (10,752)	(26,041)	(10,752)	(36,407)
Properties under development acquired	2 (a) (6,640)	-	(6,640)	-
Capital expenditures, rental properties and other assets	(495)	(150)	(891)	(173)
Capital expenditures, properties under development	(315)	-	(403)	-
Tenant improvements	(786)	(252)	(1,029)	(560)
Tenant inducements	(189)	-	(189)	-
Deferred leasing costs	(692)	(267)	(961)	(444)
<b>Cash used in investing activities</b>	<b>(19,869)</b>	<b>(26,710)</b>	<b>(20,865)</b>	<b>(37,584)</b>
<b>Financing Activities</b>				
Repayment of mortgages payable	(16,719)	(2,822)	(18,041)	(3,765)
Proceeds from new mortgages payable	23,300	-	38,800	-
Deferred financing costs	(192)	(26)	(312)	(44)
Distributions	(4,674)	(3,762)	(9,181)	(6,748)
Proceeds of public offering (net of issue costs)	-	28,644	-	52,084
Proceeds from exercise of unit options	20	150	260	1,230
Proceeds from units issued under the LTIP (net of issue costs)	12 141	52	304	238
Net increase (decrease) in bank indebtedness	10,254	-	(3,599)	(12,273)
<b>Cash provided by financing activities</b>	<b>12,130</b>	<b>22,236</b>	<b>8,231</b>	<b>30,722</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1,143)</b>	<b>(801)</b>	<b>(952)</b>	<b>60</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>1,999</b>	<b>2,163</b>	<b>1,808</b>	<b>1,302</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 856</b>	<b>\$ 1,362</b>	<b>\$ 856</b>	<b>\$ 1,362</b>
<b>Other cash flow information</b>				
Interest paid	\$ 3,289	\$ 2,294	\$ 6,198	\$ 4,676
<b>Supplemental disclosure of non-cash activities</b>				
Units issued pursuant to the distribution reinvestment plan	\$ 202	\$ 332	\$ 406	\$ 661

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**  
**CONSOLIDATED NOTES TO FINANCIAL STATEMENTS**  
(In thousands of dollars except per unit and unit amounts)  
(Unaudited)  
**June 30, 2006 and June 30, 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 Trust are traded on the Toronto Stock Exchange.

These consolidated financial statements present the financial position of the REIT as at June 30, 2006 and the results of operations and cash flows for the three month period ended June 30, 2006 and the six month period ended June 30, 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):

	Six Month Period Ended June 30, 2006 (Unaudited)	Three Month Period Ended June 30, 2006 (Unaudited)	Year Ended December 31, 2005 (Audited)
Rental properties	\$ 13,642	\$ 13,642	\$101,566
Properties under development	6,640	6,640	
Other assets	176	176	131
Fair value of in-place leases and tenant relationships	2,649	2,649	12,730
Fair value of above-market leases	610	610	2,764
Fair value of below-market leases	(427)	(427)	(1,795)
Mortgages payable	(5,742)	(5,742)	(17,591)
Accounts payable and accrued liabilities	(156)	(156)	(5,049)
Cash consideration paid for the net assets acquired	\$ 17,392	\$ 17,392	\$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 year ended December 31, 2005:

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

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

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

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

### 3. Summary of Significant Accounting Policies

#### (a) Basis of Presentation

The REIT's 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 June 30, 2006	Interest Held on December 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**

	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount June 30, 2006 (Unaudited)</b>	<b>Net Carrying Amount December 31, 2005 (Audited)</b>
Land	\$ 68,685	\$ -	\$ 68,685	\$ 64,375
Building, improvements and other costs	293,524	14,682	278,842	272,231
	<b>\$ 362,209</b>	<b>\$ 14,682</b>	<b>\$ 347,527</b>	<b>\$ 336,606</b>

**5. Deferred Expenses**

Deferred expenses consist of costs incurred by the REIT, net of accumulated amortization of \$11,750 (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 June 30, 2006 (Unaudited)	Net Carrying Amount December 31, 2005 (Audited)
Leasing costs	\$ 3,139	\$ 628	\$ 2,511	\$ 1,782
Tenant inducements	189	6	183	-
Deferred financing costs	1,916	498	1,418	1,230
Amounts ascribed to leasing costs and tenant relationships on rental properties acquired	31,231	10,518	20,713	21,771
Amounts recorded on the acquisition of the property manager – contracts and customer relationships	959	96	863	911
Recoverable expenditures	16	3	13	16
	<b>\$ 37,450</b>	<b>\$ 11,749</b>	<b>\$ 25,701</b>	<b>\$ 25,710</b>

## 6. Other Assets

Other assets consist of:

	June 30, 2006 (Unaudited)	December 31, 2005 (Audited)
Above-market rents of leases acquired through rental property acquisitions net of amortization of \$2,046 (December 31, 2005 - \$1,404)	\$5,850	\$5,881
Accounts receivable	6,494	4,435
Tenant improvements, net of amortization of \$769 (December 31, 2005 - \$475)	3,052	2,317
Prepaid expenses	1,202	163
Escrow accounts held by mortgagees	2,296	2,746
Computer and office equipment, net of amortization of \$27 (December 31, 2005 - \$15)	67	79
Leasehold improvements, net of amortization of \$7 (December 31, 2005 - \$1)	31	37
	<b>\$ 18,992</b>	<b>\$ 15,658</b>

## 7. Mortgages Payable and Bank Indebtedness

Substantially all of the REIT's assets have been pledged as security under the related mortgages and other security agreements. Interest rates on the mortgages payable are between 4.94% and 8.10 % with a weighted average rate of 5.95% (December 31, 2005 – 6.03%).

Mortgages payable at June 30, 2006 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Year ended December 31, 2006	\$2,853	\$ -	\$ 2,853
Year ended December 31, 2007	5,761	19,408	25,169
Year ended December 31, 2008	5,641	-	5,641
Year ended December 31, 2009	5,695	14,022	19,717
Year ended December 31, 2010	5,897	1,926	7,823
Thereafter	28,290	135,004	163,294
	<b>\$ 54,137</b>	<b>\$ 170,360</b>	<b>\$ 224,497</b>
Premium on assumed mortgages (net of amortization of \$728)			784
			<b>\$ 225,281</b>

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 June 30, 2006 the amount outstanding under the credit facilities was \$9,398, net of cash of \$856, (December 31, 2005 \$12,045, net of cash of \$1,808).

## 8. Accounts Payable and Other Liabilities

Accounts payables and other liabilities consist of:

	June 30, 2006 (Unaudited)	December 31, 2005 (Audited)
General operating payables and tenant deposits	\$ 12,928	\$ 11,233
Below market rents of leases acquired through rental property acquisition – net of amortization of \$1,678 (December 31, 2005 - \$1,193)	3,000	3,057
Accrued interest	967	916
Capital lease obligations	34	52
	<b>\$ 16,929</b>	<b>\$ 15,258</b>

## 9. Unitholders' Equity

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

The number of units issued and outstanding is as follows:

	Units
Units outstanding, December 31, 2005	16,018,933
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	23,681
	<b>16,205,683</b>
Units outstanding, June 30, 2006	<b>16,205,683</b>

## 10. Weighted Average Units

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

	Three Months Ended June 30, 2006 (Unaudited)	Three Months Ended June 30, 2005 (Unaudited)	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2005 (Unaudited)
<b>Basic</b>	<b>15,848,429</b>	14,036,486	<b>15,828,813</b>	13,082,356
<b>Unit option plan</b>	<b>25,736</b>	28,548	<b>28,797</b>	41,626
<b>Long-term incentive plan</b>	<b>292,049</b>	223,724	<b>257,910</b>	190,034
<b>Fully diluted</b>	<b>16,166,214</b>	14,288,758	<b>16,115,520</b>	13,314,016

## 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 June 30, 2006	26,000	\$10.00
Options outstanding and exercisable as at June 30, 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.

An aggregate of 441,965 units are reserved for issuance, pursuant to the LTIP.

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 June 30, 2006 (Unaudited)	Six Month Period Ended June 30, 2006 (unaudited)	Cumulative as at December 31, 2005 (Audited)
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	(155)	(64)	(91)
Distributions applied against installment loan receivable	447	145	302
	\$ 1,132	\$ 584	\$ 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

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 June 30, 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

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

## **16. Commitments and Contingencies**

The REIT has entered into commitments for acquisitions, building renovations, leasing commissions and tenant inducements with respect to leasing activities and for repairs and operating costs. The commitments as at June 30, 2006 and December 31, 2005 were \$3,793 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 three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$840 respectively. Amounts paid and included in rental operating cost during the six month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$1,605, respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a leasing fee. The fee was payable upon tenants having executed and delivered signed leases. Amounts paid and included in deferred expenses during the three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$27, respectively. Amounts paid and included in rental operating cost during the three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$47, respectively.

Pursuant to the Property Management Agreement, the Developer was entitled to a project management fee based on customary market fees for project management services in connection with renovations, construction and reconstruction work on the rental properties. Amounts paid and included in rental properties during the three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$8, respectively. Amounts paid and included in rental operating cost during the three month periods ended June 30, 2006 and June 30, 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 trust expenses during the three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$16, respectively. Amounts paid and included in rental operating cost during the three month periods ended June 30, 2006 and June 30, 2005 were \$ nil and \$33, 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 three month and the six month periods ended June 30, 2006 real estate service revenue earned from these properties was \$121 and \$208 respectively, 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	Three month period ended June 30, 2006 (Unaudited)	Three month period ended June 30, 2005 (Unaudited)	Six month period ended June 30, 2006 (Unaudited)	Six month period ended June 30, 2005 (Unaudited)
Vendors of properties	Head Lease	\$ 6	\$43	\$ 12	\$85
TechSpace Canada Inc.	Guarantee	11	-	23	61
TechSpace Canada Inc.	Lease	-	141	-	156
Vendors of properties	Bridge Covenants	-	297	39	484
		<b>\$ 17</b>	<b>\$ 481</b>	<b>\$ 74</b>	<b>\$ 786</b>

#### Head Lease:

Certain vendors entered into a lease dated February 20, 2003 for 16,686 square feet of office space for a five year term, expiring on February 19, 2008 (the "Head Lease"). The 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 thereunder 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 January 1, 2005 and July 1, 2005 the REIT acquired from certain vendors that are under common control of certain Trustees of the REIT, 469 King Street West and 602 King Street West for purchase prices of \$16.0 million and \$11.27 million respectively. The purchase prices net of standard adjustments were paid in cash and the REIT assumed a first mortgage loan of \$5.06 million with respect to 469 King Street West. The purchase price was determined by an independent appraisal.

## **18. Subsequent Events**

On July 14, 2006, the REIT completed the acquisition of 400 Atlantic Avenue, a Class I office property located in downtown Montreal for an aggregate purchase price of \$5,000.

On July 26, 2006 the REIT entered into an unconditional agreement to acquire a 183,780 square-foot portfolio of predominately Class I office properties located in downtown Quebec City, for an aggregate purchase price of \$32.5 million.

On July 26, 2006 the REIT entered into an agreement to issue on a bought deal basis, 1.9 million units from treasury at a price of \$17.00 for gross proceeds of \$32,300. Costs relating to the offering, including underwriters' fees, are estimated at \$1,592.