# ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST

## Interim Financial Statements
## Unaudited

### From the Commencement of Operations on February 19, 2003 to March 31, 2003

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**
**BALANCE SHEET**
**Unaudited**
**(in thousands)**
**At March 31, 2003**

| | | |
|---|---|---|
| **ASSETS** | | |
| Rental properties (Note 4) | **$** | **126,633** |
| Deferred expenses (Note 5) | | **107** |
| Other assets (Note 6) | | **1,262** |
| Cash and cash equivalents | | **565** |
| | **$** | **128,567** |
| **LIABILITIES** | | |
| Mortgages payable (Note 7) | **$** | **66,761** |
| Accounts payable and accrued liabilities (Note 8) | | **4,954** |
| Distributions payable | | **732** |
| | | **72,447** |
| **UNITHOLDERS' EQUITY** (Note 9) | | **56,120** |
| | **$** | **128,567** |

The accompanying notes are an integral part of these 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**
**STATEMENT OF UNITHOLDERS' EQUITY**
**Unaudited**
**(in thousands)**
**From the Commencement of Operations on February 19, 2003 to March 31, 2003**

| | | |
|---|---|---|
| Balance, beginning of period | **$** | **-** |
| Net earnings | | **820** |
| Distributions to unitholders | | **(732)** |
| Units issued | | **60,439** |
| Issue costs | | **(4,407)** |
| Balance, end of period | **$** | **56,120** |
| Units issued and outstanding (Note 9 ) | | **6,043,902** |

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**
**STATEMENT OF EARNINGS**
**Unaudited**
**(in thousands, except per unit amounts)**
**From the Commencement of Operations on February 19, 2003 to March 31, 2003**

| | | |
|---|---|---|
| Rental revenue | $ | **2,358** |
| Operating costs | | **838** |
| Amortization of buildings | | **99** |
| Amortization of deferred charges | | **3** |
| Operating income from rental properties | | **1,418** |
| Financing expense | | **465** |
| Trust expenses | | **133** |
| Net earnings | $ | **820** |
| Net earnings per unit | | |
| Basic and diluted | $ | **0.136** |
| Weighted average number of units | | |
| Basic and diluted | | **6,043,902** |

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**
**STATEMENT OF CASH FLOWS**
**Unaudited**
**(in thousands, except per unit amounts)**
**From the Commencement of Operations on February 19, 2003 to March 31, 2003**

| | | |
|---|---|---|
| **CASH PROVIDED BY (USED IN):** | | |
| **Operating activities** | | |
| Net earnings | $ | 820 |
| Items not affecting cash | | |
| Amortization, rental properties | | 99 |
| Amortization, deferred charges | | 3 |
| Amortization, premium on assumed mortgages payable | | (48) |
| **Funds from operations** | | 874 |
| Change in other non-cash operating items | | 912 |
| **Cash from operating activities** | | 1,786 |
| **Investing activities** | | |
| Net assets acquired (Note 2) | | (46,538) |
| Capital expenditures, rental properties | | (19) |
| **Cash used in investing activities** | | (46,557) |
| **Financing Activities** | | |
| Repayment of mortgages payable | | (147) |
| Deferred financing costs | | (110) |
| Proceeds of initial public offering of units (net of issue cost) | | 45,593 |
| **Cash flow provided by financing activities** | | 45,336 |
| **Increase in cash and cash equivalents and cash and cash equivalents, end of period** | $ | 565 |
| **Other cash flow information** | | |
| Interest paid | $ | 384 |

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

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**
**NOTES TO INTERIM FINANCIAL STATEMENTS**
**Unaudited**
**(In thousands of dollars except per unit amounts)**
**March 31, 2003**

## 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 *interim unaudited* financial statements present the financial position of the REIT as at March 31, 2003 and the results of operations and cash flow for the 41-day period from February 19, 2003 to March 31, 2003.

## 2. ACQUISITIONS

On February 19, 2003 the Trust acquired seven rental properties and acquired seven additional rental properties on February 20, 2003.

### (a) The Offering

On February 20, 2003, the REIT issued 5 million voting units at $10 per unit pursuant to an initial public offering (the "Offering"), resulting in gross proceeds of $50,000. Costs relating to the Offering, including underwriters' fees, were $4,407.

Net assets acquired were as follows (using the purchase method of accounting):

| | |
|---|---|
| Rental properties | $125,424 |
| Acquisition costs, including land transfer taxes | 1,289 |
| Amounts receivable | 1,034 |
| Secured debt | (66,956) |
| Accounts payable and accrued liabilities | (3,814) |
| | $56,977 |

Consideration paid for the net assets acquired consisted of the following:

| | |
|---|---|
| Cash | $46,538 |
| 1,043,902 units issued to vendors | 10,439 |
| | $56,977 |

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of presentation

The REIT's financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are also in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies, of which the REIT is a member.

### (b) Use of estimates

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

### (c) Cash and cash equivalents

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

### (d) Rental properties

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

Rental properties are stated at the lower of cost less accumulated amortization and net recoverable amounts. 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 5% sinking fund method to fully amortize the cost of the buildings over 40 years.

### (e) Distribution Reinvestment Plan (DRIP)

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

### (f) Revenue recognition

Rental revenue includes rents from tenants under leases, property tax and operating cost recoveries, parking income and incidental income. All rental revenue is recognized in accordance with each lease.

### (g) Unit-based compensation plan

The REIT has adopted section 3870 of the CICA Handbook with respect to the accounting and disclosure of unit-based compensation, which recommends that awards to employees and directors be valued using a fair-value method of accounting. Under section 3870, reporting entities that elect a method other than the fair-value method of accounting are required to disclose pro-forma net income and earnings per unit information, using a pricing model such as the Black-Scholes model as if the fair value method had been used.

The REIT has a unit based compensation plan, which is described in Note 9. No compensation expense is recognized for this plan when unit options are granted. Any consideration paid on exercise of unit options is credited to unitholders' equity.

### (h) Per unit calculations

Basic net income per unit are calculated by dividing net income by the weighted average number of units outstanding for the period. 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. For the period ended March 31, 2003, the exercise of options would be anti-dilutive.

## 4. Rental Properties

| | Cost | Accumulated Amortization | Net Carrying Amount March 31, 2003 |
|---|---|---|---|
| Land | $ 19,586 | $ - | $ 19,586 |
| Building, improvements and other costs | 107,146 | (99) | 107,047 |
| | $ 126,732 | $ (99) | $ 126,633 |

## 5. Deferred expenses

Deferred expenses consist of costs incurred by the REIT, net of amortization of $3, with respect to obtaining a $5,000 acquisition credit facility (the "Acquisition Credit Facility"). Amortization is recorded on a straight-line basis over the term of the Acquisition Credit Facility ending February 28, 2006.

## 6. Other Assets

Other assets of $1,262 consist of miscellaneous accounts receivable of $61 prepaid expenses of $208 and escrow accounts held by mortgagees of $993.

## 7. Mortgages Payable

Substantially all of the REIT's assets have been pledged as security under the mortgages and other security agreements. Interest rates on the mortgages payable are between 5.95% and 8.10% with a weighted average of 7.09%.

Mortgages payables at March 31, 2003 are due as follows:

| | Principal Repayments | Balance due at Maturity | Total |
|---|---|---|---|
| Nine month period ended December 31, 2003 | $1,204 | $5,239 | $6,443 |
| Year ended December 31, 2004 | 1,549 | 3,682 | 5,231 |
| Year ended December 31, 2005 | 1,564 | 1,850 | 3,414 |
| Year ended December 31, 2006 | 1,442 | 9,931 | 11,373 |
| Year ended December 31, 2007 | 1,305 | 4,975 | 6,280 |
| Thereafter | 4,180 | 28,926 | 33,106 |
| | $11,244 | $54,603 | $65,847 |
| Premium on assumed mortgages (net of amortization) | | | 914 |
| | | | $66,761 |

### *Bank Loan*

The REIT has a $5,000 revolving credit facility (the "Operating Credit Facility") with a Canadian chartered bank, which matures February 28, 2004. The Operating Credit Facility is secured by first mortgage charges on two rental properties and by second and third mortgage charges on three other rental properties. Interest is at bank prime rate plus 0.5%. The amount outstanding as at March 31, 2003 was $nil.

## 8. Accounts payable and accrued liabilities

Payables and tenant deposits of $4,954 consist of:

| | |
|---|---|
| General operating payables and tenant deposits | $2,094 |
| Accrued interest on mortgages payable | 386 |
| Due to vendors | 855 |
| Rental properties acquisition and offering costs | 1,137 |
| Deferred revenue with respect to Bridge Covenants (Note 16) | 482 |
| | $4,954 |

## 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 issued on February 19, 2003 pursuant to the acquisition of properties | 100 |
| Units issued on February 20, 2003 pursuant to the Offering | 5,000,000 |
| Units issued on February 20, 2003 to vendors of properties as partial satisfaction for the acquisition of properties | 1,043,902 |
| Redemption of units on February 20, 2003 | (100) |
| Units outstanding, March 31, 2003 | 6,043,902 |

## 10. 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 604,390 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, 2013. 115,000 options vested on February 20, 2003 and 115,000 options vests on each of February 20, 2004 and February 20, 2005.

A summary of the status of the Unit Option Plan as at March 31, 2003 and changes during the period ended March 31, 2003 are as follows:

| **Options** | **Units** | **Weighted Average Exercise Price** |
|---|---|---|
| Granted and outstanding as at March 31, 2003 | 345,000 | $10.00 |
| Options exercisable, March 31, 2003 | 115,000 | $10.00 |

The weighted average fair value of options granted during the period ended March 31, 2003 amounted to $0.088 per option. The fair value of each option granted was determined using the Black-Scholes option pricing model and the following average assumptions:

| | |
|---|---|
| Risk-free interest rate | 4.93% |
| Expected average life of option | 9 years |
| Expected volatility in the market price of units | 14% |
| Expected distribution yield | 11% |

If the Unit Option Plan had been accounted for based on fair value method, there would be no material affect on pro-forma net income for the quarter and pro-forma net income per unit would have remained as reported.

**11. Distributable Income**

The REIT is governed by a Declaration of Trust which defines distributable income as net income determined in accordance with Canadian generally accepted accounting principles, subject to certain adjustments, including adding back depreciation and amortization (excluding amortization of the net premium or discount arising on the assumption of long-term debt from vendors of properties at a rate of interest other than market rates, tenant inducements, leasing commission and other leasing costs) and any gains or losses on the disposition of any asset shall be excluded, and to reflect any other adjustments determined by the Trustees in their discretion**.**

Distributable income, a non-GAAP measure, has been calculated as follows:

| | **For the Period Ended March 31, 2003** |
|---|---|
| Net earnings | $ 820 |
| Amortization, building | 99 |
| Amortization, premium on assumed mortgages | (48) |
| Distributable income | 871 |
| Retention of distributable income | 139 |
| Distributions to unitholders | $ 732 |
| Distributable income per unit | $0.1441 |
| Retention of distributable income per unit | 0.0230 |
| Distributions to unitholders per unit | $0.1211 |

## 12. 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.

## 13. Financial instruments

The fair value of the REIT’s financial assets and liabilities, approximate their recorded values as at March 31, 2003.

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 outstanding debt at March 31, 2003 is at fixed interest rates and was not exposed to changes in interest rates during the period. However, as fixed rate debt matures and as the REIT utilizes floating rate debt under the revolving credit facilities, the REIT will be 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.

## 14. Segmented disclosure

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

## 15. Commitments and Contingencies

The REIT has entered into commitments for building renovations, leasing commissions and tenant inducements with respect to leasing activities. The commitments as at March 31, 2003 were $280.

## 16. Related Party Transactions

### (a) Property Management Agreement

Pursuant to the Property Management Agreement entered into by the REIT, Allied Canadian Corporation (“Allied Properties”) has been appointed as the property manager for the rental properties owned by the REIT. For its services as property manager, it is paid an annual fee equal to 4% of the gross revenues. Fees are paid monthly based on an annual budget and adjusted following the year end. During the period, fees of $94 were paid and included in operating costs. Substantially all of this fee is recoverable from tenants of the properties.

Pursuant to the Property Management Agreement, Allied Properties is entitled to recover the cost incurred by it in substituting on-site managers at the rental properties. The fee is charge on a monthly basis and is based upon a flat rate. Amounts paid and included in operating costs in the period were $15. Substantially all of this charge is recoverable from tenants of the properties.

Pursuant to the Property Management Agreement, Allied Properties is entitled to recover the costs incurred by its maintenance staff to perform regular maintenance at the rental properties. The recovery is charged on a monthly basis and is based upon a flat rate. Amounts paid and expensed in the period were $51. Substantially all of this charge is recoverable from tenants of the properties.

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

**(b) Rental revenues**

Rental revenues included amounts received from related parties for the period ended March 31, 2003:

| Related Party | Nature of Revenue | Amount |
|---|---|---|
| Vendors of properties | Bridge Covenants | $125 |
| TechSpace Canada Inc. | Lease | 93 |
| Vendors of properties | Head Lease | 37 |
| | | $255 |

TechSpace Canada Inc. is a subsidiary of Allied Properties.

Bridge Covenants:

Certain vendors of the rental properties provided bridge covenants (collectively the "Bridge Covenants") to the REIT in respect of certain office space leased to third party, non related tenants. These Bridge Covenants provide the REIT with an income stream to coincide with rent-free periods that the vendors provided to the tenants, prior to the REIT acquiring the rental properties. The Vendors have prepaid the obligations under the Bridge Covenants and the unamortized balance of the prepayment is recorded as deferred revenue. The vendors providing the bridge covenants are under common control of certain trustees of the REIT.

Head Lease:

Certain vendors entered in to a lease for 16,686 square feet of office space for a five year term, expiring on February 19, 2008, (the "Head Lease"). The obligations of the Vendors under the Head Lease are secured by cash of $1,613, which is held in an escrow account by Allied Properties. These vendors are under common control of certain trustees of the REIT.