

## MANAGEMENT'S DISCUSSION AND ANALYSIS

(All dollar references other than per unit amounts are in thousands).

Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the unaudited interim financial statements of Allied Properties Real Estate Investment Trust (the "REIT") prepared as at March 31, 2003 and for the period from the commencement of operations of the REIT on February 19, 2003 to March 31, 2003.

### Initial Public Offering

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. The REIT is governed by the laws of Ontario. The units of the REIT are traded on the Toronto Stock Exchange.

The REIT completed its Initial Public Offering ("IPO") of 5,000,000 units on February 20, 2003 for gross proceeds of \$50,000 and net proceeds of \$45,593 pursuant to a prospectus dated February 6, 2003 (the "Prospectus"). A portion of the net proceeds of the IPO was used to acquire a portfolio of 14 Class I office properties in downtown Toronto with an aggregate square footage of approximately 820,000 (the "Portfolio Properties").

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

### Distribution Reinvestment Plan

The REIT implemented a Distribution Reinvestment Plan (the "DRIP") in March, 2003. The DRIP provides unitholders with the option of reinvesting their total monthly cash distributions in additional units of the REIT without incurring brokerage commissions or other transaction cost. As an incentive to participate, the DRIP entitles unitholders to receive additional units equal in value to 5% of the monthly cash distribution otherwise payable to them. The DRIP is administered by the REIT's transfer agent, CIBC Mellon Trust Company.

### Financial Results

	February 19 to March 31, 2003	Prospectus Forecast <sup>1</sup>	Variance to Prospectus Forecast	Pro-rated Forecast <sup>2</sup>	Variance to Pro-rated Forecast
Revenue from rental properties	\$2,358	\$5,256	\$(2,898)	\$2,340	\$18
Expenses					
Rental property operating cost	838	1,968	1,130	857	19
Financing expense	465	1,211	746	541	76
Depreciation and amortization	102	220	118	98	(4)
	1,405	3,399	1,994	1,496	91
Income from operations	953	1,857	(904)	844	109
Trust expenses	133	285	152	129	(4)
Net income	820	1,572	(752)	715	105
Amortization on rental properties	99	219	(120)	98	1
Amortization on mortgage premium	(48)	-	(48)	-	(48)
Distributable Income <sup>3</sup>	\$871	\$1,791	\$(920)	\$813	\$58
Net income per unit	\$0.136	\$0.260	(\$0.124)	\$0.118	\$0.018
Distributable Income per unit	\$0.144	\$0.296	(\$0.152)	\$0.135	\$0.009

<sup>1</sup> The forecast in the Prospectus assumed the completion of the IPO and the acquisition of the Portfolio Properties by the REIT on January 1, 2003.

<sup>2</sup> The forecast included in the Prospectus pro-rated for the period of operations of the REIT from February 19, 2003 to March 31, 2003. These figures have been prepared by management and are unaudited.

<sup>3</sup> Distributable income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration of Trust.

Results for the period do not compare to the three month forecast included in the Prospectus, as the REIT commenced operations on February 19, 2003. On a pro-rated basis, actual results compared favourably to the forecast.

Revenue of \$2,358 for the period of February 19, 2003 to March 31, 2003 was \$18 higher than the pro-rated forecast of \$2,340 due to a better than expected lease renewal and better than expected incidental revenue, particularly parking revenue.

Net income for the period exceeded the pro-rated forecast by \$105. The difference in net income resulted from better than expected revenue (\$18 over pro-rated forecast), lower property operating costs (\$19 less than pro-rated forecast) and lower financing costs (\$76 less than pro-rated forecast). The favourable variances were partially offset by higher amortization (\$4 higher than pro-rated forecast) and slightly higher trust expenses (\$4 higher than pro-rated forecast).

During the period ended March 31, 2003, the REIT concluded leasing arrangements with three new tenants for premises aggregating 9,241 square feet. One of the leases (3,078 square feet) is for a ten-year term commencing May 1, 2003, one (4,222 square feet) for a five-year term commencing August 1, 2003, and one (1,941 square feet) is for a nine-month term commencing April 1, 2003. During the same period, three tenants occupying 19,310 square feet renewed their leases beyond the scheduled expiry dates. Two tenants occupying 6,605 square feet advised the REIT that they do not intend to renew their leases beyond the scheduled expiry dates. Management is actively engaged in re-leasing the 6,605 square feet.

### **Distributable Income**

Distributions for the period ended March 31, 2003 were \$732, which corresponds to a pay-out ratio of 84%, compared to the expected pay-out ratio of 90%. Distributable income for the period ended March 31, 2003 was \$0.144 per unit, compared to the pro-rated forecast of \$0.135 per unit.

The REIT distributed \$0.1211 per unit to unitholders of record as of March 31, 2003 and declared a distribution of \$0.09166 per unit to unitholders of record as of April 30, 2003, payable on May 15, 2003.

### **Financing and Trust Expenses**

Financing expense consists of interest on mortgages payable, less the amortization of the premium on the mortgages payable that were assumed on acquisition of the Portfolio Properties.

Financing expense of \$465 for the period ended March 31, 2003 was \$76 lower than the pro-rated forecast of \$541. The lower financing costs resulted from lower debt utilization (\$28 less than pro-rated forecast) and the amortization of the premium on the mortgages payable (\$48 less than pro-rated forecast).

Subject to any significant negative change to variable interest rates and interest rates assumed on refinancing any loans maturing during the year and before taking into account increased financing costs due to acquisitions in the year, Management expects financing expense will be lower than that reflected in the prospectus forecast for the balance of 2003.

Trust expenses for the period ended March 31, 2003 of \$133 were consistent with the pro-rated forecast.

## **Liquidity and Capital Resources**

The REIT finances its operations through three sources of capital: (i) mortgage debt secured by the Portfolio Properties, (ii) secured short-term financing through its \$5,000 revolving credit facility (the "Operating Credit Facility") with a Canadian chartered bank and (iii) equity. As at March 31, 2003 the REIT had mortgage debt of \$66,761, unitholders' equity of \$56,120 and no amounts outstanding under the Operating Credit Facility.

Since March 31, 2003 the REIT has drawn down \$1,500 on its Operating Credit Facility.

The debt to gross book value was 51.8%, comparing favourably to the expected leverage ratio of 53.8% and substantially below the 60% threshold as mandated by REIT's Declaration of Trust.

Two of the mortgage loans assumed by the REIT on the acquisition of the Portfolio Properties mature in 2003. The lender has issued a commitment to renew one of the mortgage loans and to increase its principal in an amount sufficient to enable the REIT to repay the other mortgage loan as it falls due. This will enable the REIT to discharge the other mortgage loan, thus affording additional flexibility for future financing, if required. The renewed mortgage loan will have a term of 15 years, bear interest at 6.88% and have an amortization period of 20 years.

The REIT plans to fund anticipated capital expenditures and leasing costs using cash flow from operations retained by the REIT, cash on hand and available borrowing capacity under the Operating Credit Facility. As at March 31, 2003, the REIT had cash and cash equivalents of \$565.

The REIT is also finalizing a \$5,000 acquisition credit facility with a Canadian chartered bank, which it expects to have in place by mid to late May, 2003 (the "Acquisition Credit Facility").

## **Capital Expenditures**

The REIT's portfolio requires ongoing investments for general capital improvements, tenant installation costs related to new and renewal leasing. These include providing tenants build-out allowances and paying leasing commissions. For the period ended March 31, 2003, expenditures for capital improvements were \$19, all of which related to space leased to new tenants.

## **Mortgages Payable**

Generally accepted accounting principals require that the mortgages payable assumed on acquisition of the Portfolio 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. Based on these assumptions, the fair value of mortgages payable at the time of acquisition, and therefore the amount at which they were recorded at that time, was \$66,956. (The face value (legal liability) of the mortgages payable at the time of acquisition was \$65,994).

## **Accounts Payable**

Payables and accrued liabilities of \$4,954 included general operating payables and tenant deposits of \$2,094 and accrued interest on mortgages payable of \$386. Also included is \$855 received from vendors as deposits for their performance of certain obligations with respect to the Portfolio Properties and accounts payable of \$1,137 for costs incurred with respect to the IPO and the acquisitions of the Portfolio Properties. In addition, the REIT recorded deferred revenue of \$482 with respect to the bridge covenants provided by certain vendors of the Portfolio Properties in connection with the acquisition of the Portfolio Properties by the REIT.

## **Risk and Uncertainties**

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

The REIT's portfolio is focused on a particular asset class in the largest metropolitan real estate market in Canada. This concentration enables Management to capitalize on certain economies of scale and competitive advantages that would not otherwise be available, and contributes to mitigating the risk associated with the real estate ownership.

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