

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**

**Interim Financial Statements  
Unaudited**

**From the Commencement of Operations on February 19, 2003 to June 30, 2003**

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**  
**BALANCE SHEET**  
Unaudited  
(in thousands)  
At June 30, 2003

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**ASSETS**

Rental properties (Note 4)	\$ 126,531
Deferred expenses (Note 5)	203
Other assets (Note 6)	1,101
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	\$ 127,835

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**LIABILITIES**

Mortgages payable (Note 7)	\$ 66,249
Bank indebtedness (Note 7)	1,432
Accounts payable and accrued liabilities (Note 8)	3,046
Distributions payable	557
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	71,284

<b>UNITHOLDERS' EQUITY</b> (Note 9)	<b>56,551</b>
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	\$ 127,835

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

Approved by the Board of Trustees

"Gordon Cunningham"

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Gordon Cunningham  
Trustee

"Michael R. Emory"

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Michael R. Emory  
Trustee

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

**Unaudited**

**(in thousands)**

	Three Months Ended June 30, 2003	From February 19, 2003 to June 30, 2003
Balance, beginning of period	\$ 56,120	\$ -
Net earnings	1,777	2,597
Distributions to unitholders	(1,670)	(2,402)
Units issued	324	60,763
Issue costs	-	(4,407)
Balance, end of period	\$ 56,551	\$ 56,551
Units issued and outstanding (Note 9 )	6,080,303	6,080,303

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)**

	Three Months Ended June 30, 2003	From February 19, 2003 to June 30, 2003
Rental revenue	\$ 4,989	\$ 7,347
Operating costs	1,579	2,417
Amortization of buildings	224	323
Amortization of deferred charges	10	13
Operating income from rental properties	3,176	4,594
Financing expense	1,060	1,525
Trust expenses	339	472
Net earnings	\$ 1,777	\$ 2,597
Net earnings per unit Basic and diluted	\$ 0.293	\$ 0.429
Weighted average number of units Basic and diluted	6,066,839	6,059,835

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)

	Three Months Ended June 30, 2003	From February 19, 2003 to June 30, 2003
<b>CASH PROVIDED BY (USED IN):</b>		
<b>Operating activities</b>		
Net earnings	\$ 1,777	\$ 2,597
Items not affecting cash		
Amortization, rental properties	224	323
Amortization, deferred charges	10	13
Amortization, premium on assumed mortgages payable	(100)	(148)
<b>Funds from operations</b>	1,911	2,785
Change in other non-cash operating items	(1,747)	(835)
<b>Cash from operating activities</b>	164	1,950
<b>Investing activities</b>		
Net assets acquired (Note 2)	-	(46,538)
Capital expenditures, rental properties	(122)	(141)
Deferred leasing costs	(73)	(73)
<b>Cash used in investing activities</b>	(195)	(46,752)
<b>Financing Activities</b>		
Repayment of mortgages payable	(412)	(559)
Deferred financing costs	(33)	(143)
Distributions	(1,521)	(1,521)
Proceeds of initial public offering of units (net of issue cost)	-	45,593
<b>Cash flow provided by financing activities</b>	(1,966)	43,370
<b>Decrease in cash and cash equivalents</b>	(1,997)	-
<b>Cash and cash equivalents, beginning of period</b>	565	-
<b>Cash and cash equivalents, end of period</b>	\$(1,432)	\$ (1,432)
<b>Other cash flow information</b>		
Interest paid	\$ 1,192	\$ 1,576

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)**  
**June 30, 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 June 30, 2003 and the results of operations and cash flow for the 132-day period from February 19, 2003 to June 30, 2003 and for the quarter ended June 30, 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)
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	\$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
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	\$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 June 30, 2003 and for the quarter ended June 30, 2003, the exercise of options would be anti-dilutive.

**4. Rental Properties**

	Cost	Accumulated Amortization	Net Carrying Amount June 30, 2003
Land	\$ 19,586	\$ -	\$ 19,586
Building, improvements and other costs	107,266	(321)	106,945
	\$ 126,852	\$ (321)	\$ 126,531

**5. Deferred expenses**

Deferred expenses consist of costs incurred by the REIT, net of amortization of \$13, with respect to obtaining a \$5,000 acquisition credit facility (the "Acquisition Credit Facility") and leasing costs. Amortization is recorded on a straight-line basis over the term of the Acquisition Credit Facility ending February 28, 2006 and over the term of the respective leases to which the costs relate.

**6. Other Assets**

Other assets of \$1,101 consist of accounts receivable of \$167, prepaid expenses of \$187, and escrow accounts held by mortgagees of \$747.

**7. Mortgages Payable and Bank Indebtedness**

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

Mortgages payables at June 30, 2003 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Six month period ended December 31, 2003	\$ 817	\$ -	\$ 817
Year ended December 31, 2004	1,677	3,682	5,359
Year ended December 31, 2005	1,703	1,850	3,553
Year ended December 31, 2006	1,594	9,931	11,525
Year ended December 31, 2007	1,464	4,975	6,439
Thereafter	6,789	30,954	37,743
	\$14,044	\$51,392	\$65,436
Premium on assumed mortgages (net of amortization)			813
			\$66,249

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%. At June 30, 2003 the amount outstanding (net of cash and bank account deposits) was \$1,432.

#### 8. Accounts payable and accrued liabilities

Payables and tenant deposits of \$3,046 consist of:

General operating payables and tenant deposits	\$2,471
Accrued interest on mortgages payable	352
Deferred revenue with respect to Bridge Covenants (Note 16)	223
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	\$3,046

#### 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:

	<b>Units</b>
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 issued under the Dividend Reinvestment Plan	36,404
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Units outstanding, June 30, 2003	6,080,306

#### 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, 2008. 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 June 30, 2003 and changes during the period ended June 30, 2003 are as follows:

Options	Units	Weighted Average Exercise Price
Granted and outstanding as at June 30, 2003	345,000	\$10.00
Options exercisable, June 30, 2003	115,000	\$10.00

The weighted average fair value of options granted during the period ended June 30, 2003 amounted to \$0.155 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	4.18%
Expected average life of option	4 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 the period ended June 30, 2003 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 Three Months Ended June 30, 2003	For the 132-Day Period Ended June 30, 2003
Net earnings	\$ 1,777	\$ 2,597
Amortization, building	224	323
Amortization, premium on assumed mortgages	(100)	(148)
Distributable income	1,901	2,772
Retention of distributable income	231	371
Distributions to unitholders	\$ 1,670	\$ 2,401
Distributable income per unit	\$0.313	\$0.457
Retention of distributable income per unit	0.038	0.061
Distributions to unitholders per unit	\$0.275	\$0.396

## **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 June 30, 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**

97% of the REIT's outstanding debt at June 30, 2003 is at fixed interest rates and is not exposed to changes in interest rates. However, as fixed rate debt matures and as the REIT utilizes additional 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 June 30, 2003 were \$137.

## **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, is entitled to recover the cost incurred by it in substituting on-site managers at rental properties, the costs of its maintenance staff to perform regular maintenance at the rental properties and its out-of pocket expenses related to services provided. Amounts paid and included in operating cost for the 132-day period ended June 30, 2003 and the quarter ended June 30, 2003 were \$494 and \$334 respectively.

Pursuant to the Property Management Agreement, Allied Properties is entitled to a leasing fee. The fee is payable upon tenants having executed and delivered signed leases. Amounts paid and included in deferred expenses during the 132-day period ended June 30, 2003 and the quarter ended June 30, 2003 was \$11.

Pursuant to the Property Management Agreement, Allied Properties is entitled to a project management fee based on customary market fees for project management services in connection with renovations, construction and reconstruction work on the rental properties. Amounts paid and included in rental properties during the 132-day period ended June 30, 2003 and the quarter ended June 30, 2003 was \$5.

Pursuant to the Property Management Agreement, Allied Properties is to provide the REIT a fully equipped office and support staff and is entitled to recover its cost from the REIT. Amounts paid and included in trust expenses for the 132-day period ended June 30, 2003 and the quarter ended June 30, 2003 were \$23 and \$16 respectively.

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 June 30, 2003:

<b>Related Party</b>	<b>Nature of Revenue</b>	<b>Three Months Ended June 30, 2003</b>	<b>For the Period Ended June 30, 2003</b>
Vendors of properties	Bridge Covenants	\$246	\$372
TechSpace Canada Inc.	Lease	202	295
Vendors of properties	Head Lease	84	121
		<b>\$532</b>	<b>\$788</b>

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 \$1,545,516, which is held in an escrow account by Allied Properties. These vendors are under common control of certain trustees of the REIT.