

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**

**Financial Statements**

**From the Commencement of Operations on February 19, 2003 to December 31, 2003**

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

**At December 31, 2003**

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## Auditors' Report

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**To the Unitholders of  
Allied Properties Real Estate Investment Trust**

We have audited the balance sheet of Allied Properties Real Estate Investment Trust as at December 31, 2003 and the statements of earnings, unitholders' equity and cash flows for the period then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2003 and the results of its operations and its cash flows for the period then ended in accordance with Canadian generally accepted accounting principles.

(signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario

February 3, 2004 (except Note 16, as of February 27, 2004)

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

(in thousands)  
At December 31, 2003

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**ASSETS**

Rental properties (Note 4)	\$ 153,744
Deferred expenses (Note 5)	1,749
Other assets (Note 6)	1,271
Cash	305
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	<b>\$ 157,069</b>

**LIABILITIES**

Mortgages payable (Note 7)	\$ 82,096
Accounts payable and other liabilities (Note 8)	6,387
Distributions payable	653
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	89,136

<b>UNITHOLDERS' EQUITY</b> (Note 9)	<b>67,933</b>
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	<b>\$ 157,069</b>

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**

(in thousands, except unit amounts)

From February 19, 2003 to  
December 31, 2003

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Balance, beginning of period	\$	-
Net earnings		6,434
Distributions to unitholders		(5,868)
Units issued		72,229
Issue costs		(4,862)
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Balance, end of period	\$	67,933
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Units issued and outstanding (Note 9 )		7,120,279
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The accompanying notes are an integral part of these financial statements.

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

(in thousands, except per unit and unit amounts)

From February 19, 2003 to  
December 31, 2003

Rental revenue	<b>\$ 17,945</b>
Operating costs	<b>5,803</b>
Amortization of rental properties	<b>789</b>
Amortization of deferred expenses	<b>51</b>
	<b>6,643</b>
Operating income from rental properties	<b>11,302</b>
Financing expense	<b>3,811</b>
Trust expenses	<b>1,057</b>
Net earnings	<b>\$ 6,434</b>
Net earnings per unit	
Basic	<b>\$ 1.046</b>
Fully diluted	<b>\$ 1.045</b>
Weighted average number of units	
Basic	<b>6,153,384</b>
Fully diluted	<b>6,155,538</b>

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

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

(in thousands)

From February 19, 2003 to  
December 31, 2003

**CASH PROVIDED BY (USED IN):**

**Operating activities**

Net earnings	\$ 6,434
Items not affecting cash	
Amortization, rental properties	789
Amortization, deferred expenses	51
Amortization, premium on assumed mortgages payable	(316)
	6,958
Change in other non-cash operating items	43

**Cash from operating activities** 7,001

**Investing activities**

Net assets acquired (Note 2)	(54,974)
Capital expenditures, rental properties	(270)
Deferred leasing costs	(481)

**Cash used in investing activities** (55,725)

**Financing Activities**

Repayment of mortgages payable	(1,383)
Deferred financing costs	(173)
Distributions	(4,588)
Proceeds of initial public offering of units (net of issue cost)	45,593
Proceeds of private placements (net of issue costs)	9,580

**Cash provided by financing activities** 49,029

**Increase in cash and cash equivalents** 305

**Cash and cash equivalents, beginning of period** -

**Cash and cash equivalents, end of period** \$ 305

**Other cash flow information**

Interest paid	\$ 3,702
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**Supplemental disclosure of non-cash activities**

Units issued pursuant to the distribution reinvestment plan	\$ 628
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The accompanying notes are an integral part of these financial statements.

**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**  
**NOTES TO FINANCIAL STATEMENTS**  
(In thousands of dollars except per unit and unit amounts)  
December 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 financial statements present the financial position of the REIT as at December 31, 2003 and the results of operations and cash flow for the 316-day period from February 19, 2003 to December 31, 2003.

**2. ACQUISITIONS**

On February 19, 2003 the Trust acquired seven rental properties and acquired seven additional rental properties on February 20, 2003. On each of October 1, 2003 and December 19, 2003 the REIT acquired an additional rental property.

**(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)
	<hr/>
	\$56,977

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

Cash	\$46,538
1,043,902 units issued to vendor	10,439
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	\$56,977

**(b) Other Acquisitions**

On each of October 1, 2003 and December 19, 2003 the REIT acquired an additional rental property. Net assets acquired were as follows (using the purchase method of accounting):

Rental properties	\$27,056
Acquisition costs, including land transfer taxes	494
Amounts receivable	11
Fair value of in-place leases	1,146
Fair value of above and below-market leases	(883)
Secured debt	(16,839)
Accounts payable and accrued liabilities	(1,421)
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	\$9,564
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Consideration paid for the net assets acquired consisted of the following:

Cash	\$8,436
110,000 units issued to vendors	1,128
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	\$9,564
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**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 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.

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. The REIT adopted prospective application of this policy with respect to acquisitions of rental properties that were initiated after September 12, 2003.

**(e) 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.

**(f) Revenue recognition**

Rental revenue includes rents from tenants under leases, property tax and operating cost recoveries, parking income and incidental income.

**(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 December 31, 2003, the exercise of options would have been dilutive by a minimal amount.

#### 4. Rental Properties

	Cost	Accumulated Amortization	Net Carrying Amount September 30, 2003
Land	\$ 24,187	\$ -	\$ 24,187
Building, improvements and other costs	130,346	(789)	129,557
	\$ 154,533	\$ (788)	\$ 153,744

#### 5. Deferred expenses

Deferred expenses consist of costs incurred by the REIT, net of amortization of \$51, with respect to obtaining debt financing, leasing costs incurred and the fair value attributed to in-place leases acquired in a rental property acquisition. Amortization is recorded on a straight-line basis over the term respective credit facility and over the remaining term of the respective leases to which the costs or fair value relate.

#### 6. Other Assets

Other assets of \$1,271 consist of accounts receivable of \$190, cash deposits of \$70 on account for a pending property acquisition, prepaid expenses of \$38 and escrow accounts held by mortgagees of \$973.

#### 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%. The fair value of the mortgages payable is \$83,735.

Mortgages payable at December 31, 2003 are due as follows:

	Principal Repayments	Balance due at Maturity	Total
Year ended December 31, 2004	\$1,936	\$3,682	\$5,618
Year ended December 31, 2005	1,993	1,850	3,843
Year ended December 31, 2006	1,904	9,931	11,835
Year ended December 31, 2007	1,758	11,146	12,904
Year ended December 31, 2008	1,101	14,404	15,505
Thereafter	5,901	25,285	31,186
	\$14,593	\$66,298	\$80,891
Premium on assumed mortgages (net of amortization)			1,205
			\$82,096

The REIT has a \$5,000 revolving credit facility (the "Operating Credit Facility") with a Canadian chartered bank, which matures February 28, 2004, (see Note 16) and bears interest at bank prime rate plus 0.5%. The REIT also has a \$5,000 revolving credit facility (the Acquisition Credit Facility") with a Canadian chartered bank, which matures February 28, 2006 and bears interest at bank prime rate plus 1.0%. Both credit facilities are secured by first mortgage charges on two rental properties and by second and third mortgage charges on three other rental properties. At December 31, 2003 the amount outstanding under both credit facilities was \$ nil.

## 8. Accounts payable and other liabilities

Accounts payables and other liabilities consist of:

General operating payables and tenant deposits	\$5,025
Below market rents of leases acquired through rental property acquisition (net of above market rents)	883
Accrued interest on mortgages payable	425
Deferred revenue with respect to Bridge Covenants (Note 16)	54
	<hr/>
	\$6,387

## 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 on October 3, 2003 pursuant to a private placement	110,000
Units issued on December 18, 2003 pursuant to a private placement	900,000
Units issued under the Dividend Reinvestment Plan	66,377
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Units outstanding, December 31, 2003	7,120,279

## 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 is as follows:

Options	Units	Weighted Average Exercise Price
Granted and outstanding as at December 31, 2003	345,000	\$10.00
Options exercisable, December 31, 2003	115,000	\$10.00

The weighted average fair value of options granted during the period ended December 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	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 period ended December 31, 2003 and pro-forma net income per unit would have remained as reported.

## 11. 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.

## 12. Financial instruments

The fair value of the REIT's financial assets and liabilities with current maturities approximate their recorded values as at December 31, 2003. The fair value of the mortgages payable is \$83,735.

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 December 31, 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.

### **13. Segmented disclosure**

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

### **14. 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 December 31, 2003 were \$1,281.

### **15. 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 rental operating cost for the period ended December 31, 2003 was \$1,165.

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 period ended December 31, 2003 was \$34.

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 period ended December 31, 2003 was \$11.

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 period ended December 31, 2003 was \$52.

Included in accounts payable and other liabilities is an amount of \$6 related to the above noted services. Included in commitments and contingencies is an amount of \$80 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) Rental revenues

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

<b>Related Party</b>	<b>Nature of Revenue</b>	<b>For the Period Ended December 31, 2003</b>
Vendors of properties	Bridge Covenants	\$602
TechSpace Canada Inc.	Lease	643
Vendors of properties	Head Lease	284
		<b>\$1,529</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 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 Head Lease has been amended such that the term with respect to 2,747 square feet and 5,596 square feet will expire on May 31, 2004 and July 31, 2004, respectively. The REIT has entered into lease agreements with new tenants for the 2,747 square feet and the 5,596 square feet for terms, which expire subsequent to February 20, 2008. The obligations of the vendors under the Head Lease are secured by cash of \$920, which is held in an escrow account by Allied Properties. These vendors are under common control of certain trustees of the REIT.

## 16. Subsequent Event

On February 27, 2004 the REIT acquired 217-225 Richmond Street West, a rental property in Toronto, Ontario for \$7,500. The acquisition was financed with an assumed mortgage of \$2,730, due November 1, 2007, bearing interest at 6.53% with a 20-year amortization, and the balance with cash.

On February 27, 2004 the REIT accepted a commitment with a Canadian chartered bank to provide the REIT with a \$15,000 revolving credit facility with a two-year term. Interest is payable monthly at bank prime rate plus 1.0%. Security for the facility consists of first and second mortgage charges on six rental properties and security agreements covering assignment of rents and personal property with respect to the six properties.