

ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

JUNE 30, 2004

Dated August 11, 2004

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Forward-Looking Disclaimer

Management's discussion and analysis of results of operations and financial condition ("MD&A") should be read in conjunction with the un-audited financial statements of Allied Properties Real Estate Investment Trust (the "REIT") as at June 30, 2004, the audited financial statements and notes thereto for the year ended December 31, 2003, and Management's Discussion and Analysis for the year ended December 31, 2003. Unless otherwise indicated, dollar amounts in this MD&A are in thousands.

This MD&A contains forward-looking statements relating to the REIT's operations and the environment in which the REIT operates, which are based on expectations, estimates, forecasts and projections. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to control or predict. Therefore, actual outcomes and results may differ materially from those expressed in these forward-looking statements. Readers, therefore, should not place undue reliance on any such forward-looking statements. Further, a forward-looking statement speaks only as of the date on which such statement is made. Management believes that the expectations reflected in forward-looking statements are based on reasonable assumptions but can give no guarantees or assurances that actual results will be consistent with these forward-looking statements.

Many factors could cause actual results to differ from the forward-looking statements in this MD&A. Important factors that could cause actual results to differ include, but are not limited to, the following:

- the results of our efforts to implement our acquisition strategies;
- the effect of economic conditions, including rising interest rates;
- our ability to generate sufficient cash flow from rental properties;
- our ability to maintain occupancy and to lease or release space at favourable rents on a timely basis;
- tenants' financial difficulties;
- changes in operating costs;
- the cost of our capital and debt;
- changes in our capital requirements and availability of financing;
- the actions of our competitors and our ability to respond to those actions; and
- environmental uncertainties and disasters and the ability to obtain adequate insurance coverage at reasonable cost.

These forward-looking statements are made as of August 11, 2004, and the REIT undertakes no obligation to update publicly any such statements to reflect new information or the occurrence of future events or circumstances.

August 11, 2004

Business Overview and Strategy

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 ("Declaration"). The REIT is governed by the laws of Ontario. The units of the REIT are publicly traded on the Toronto Stock Exchange under the symbol AP.UN. Additional information relating to the REIT is available on SEDAR at www.sedar.com.

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

The REIT completed its Initial Public Offering ("IPO") on February 20, 2003. The net proceeds of the IPO were used to acquire a portfolio of 14 predominantly Class I office properties ("Initial Properties") in the downtown Toronto office market with approximately 820,000 square feet of space.

Effective October 1, 2003, the REIT acquired 99 Spadina Avenue, Toronto. On December 19, 2003, the REIT acquired 905 King Street West, Toronto. On February 28, 2004, the REIT acquired 217-225 Richmond Street West, Toronto. On April 1, 2004, the REIT acquired 185 Spadina Avenue, Toronto. On May 3, 2004, the REIT acquired 50 Wellington Street East, Toronto. Effective June 1, 2004, the REIT acquired The Queen Richmond Centre, 99-123 Queen Street East and 92-114 Richmond Street East, Toronto. Effective June 18, 2004, the REIT acquired Phase I of The Castle, 41 and 53 Fraser Avenue and 8 Pardee Avenue, Toronto. 99 Spadina Avenue, 905 King Street West, 217-225 Richmond Street West, 185 Spadina Avenue, 50 Wellington Street East, The Queen Richmond Centre and Phase I of The Castle are collectively referred to as the "Additional Properties".

The REIT financed the acquisition of the Additional Properties in part through a private placement of 900,000 units at \$11.15 per unit that closed on December 18, 2003, and a public offering of 2.9 million units at \$11.10 per unit that closed on May 27, 2004.

With over 1.4 million square feet of space as at June 30, 2004, the REIT's portfolio of 21 predominantly Class I office properties accommodates a diversified base of business tenants. Class I office properties are created through the adaptive re-use of light industrial structures in urban areas. They typically feature high ceilings, abundant natural light, post and beam structural frames, exposed interior brick and hardwood floors. When restored and retrofitted to the standards of the REIT's portfolio, Class I buildings can satisfy the needs of the most demanding office and retail tenants. When operated in the coordinated manner of REIT's portfolio, these buildings become a vital part of the urban fabric and contribute meaningfully to a sense of community.

The REIT enjoys a first-mover advantage in the large-scale provision of Class I space in Toronto and intends to build on this advantage through ongoing consolidation of a large, fragmented and growing target market. Through this consolidation, the REIT will strive to realize ever greater operating efficiencies, to diversify further its tenant mix and to reduce further its exposure to any particular tenant.

The REIT has the benefit of an option agreement ("Option Agreement") with Allied Canadian Corporation ("Developer"), a leading developer of Class I office properties in Toronto, pursuant to which the Developer must offer to sell to the REIT at fair market value all developed or redeveloped office properties upon substantial completion. The REIT believes that there are sufficient acquisition opportunities available to it in its target market through the Option Agreement and from third-party owners to achieve its operating and growth objectives.

The REIT measures the long-term success of its strategies through key financial and operating performance indicators.

Financial Indicators

1. Distributions

The REIT is focused on increasing distributions to its unitholders on a regular and prudent basis. During its first 12 months of operations, the REIT made regular monthly distributions of \$1.10 per unit on an

annualized basis. In March, 2004, the REIT increased its monthly distributions by 3.6% to \$1.14 per unit on an annualized basis.

2. Distributable Income

Increasing distributions can be achieved prudently by increasing Distributable Income. In 2003, the REIT forecast \$1.06 per unit in Distributable Income and achieved \$1.22 per unit in Distributable Income. Distributable Income was \$0.312 per unit in the second quarter, in line with the second quarter of 2003. Distributable Income was \$0.631 in the period ended June 30, 2004, up from \$0.457 in the abbreviated comparable period in 2003. Distributable Income per unit in the second quarter does not reflect either the level of Distributable Income per unit expected in the remaining two quarters of 2004 or the run-rate of Distributable Income per unit expected as a result of the REIT's recent growth. There are four reasons for this.

- First, the cash component of trust expenses in the second quarter increased by \$125 over the second quarter of 2003. The bulk of this increase relates to the accrual in the second quarter of 50% of the bonus payment that is expected to be made to management at the end of 2004. (Management was not eligible for, and did not receive, a bonus payment in 2003).
- Second, consistent with past experience, the REIT's expense recoveries are weighted toward the third and fourth quarter.
- Third, the REIT's two largest post-IPO acquisitions, 905 King Street West and The Queen Richmond Centre, have material increases in net rental income starting in July, 2004, and December, 2004, respectively. Both are a result of contractual rent escalation.
- Fourth, the funds raised from the recent offering of 2.9 million units, together with the proceeds resulting from the exercise in March and April by management and the trustees of options to acquire 140,500 units, were not substantially utilized until June 1 of this year and not fully utilized until June 18 of this year.

3. Pay-out Ratio

To ensure it retains sufficient cash to meet its capital improvement and leasing objectives, the REIT will strive to maintain an appropriate pay-out ratio, the ratio of actual distributions in a given period to Distributable Income in such period. In 2003, the REIT forecast a pay-out ratio of 90% and achieved a pay-out ratio of 85%. Although the REIT expects to maintain a pay-out ratio below 90%, the pay-out ratio in the second quarter was abnormally and temporarily high due to the fact that the public offering of 2.9 million units closed on May 27, 2004, just prior to the record date for the May distribution. The pay-out ratio in the period ended June 30, 2004, was 94.6%, again temporarily and abnormally high for the reason recited in connection with the second quarter.

4. Debt Ratio

A conservative ratio of debt to Gross Book Value mitigates unitholder risk. In 2003, the REIT forecast a 56% ratio of debt to Gross Book Value and finished the year with a 51% ratio of debt to Gross Book Value. As at June 30, 2004, the ratio of debt to Gross Book Value was 52.3%.

Operating Indicators

1. Tenant Retention and Replacement

The REIT places a high value on tenant retention, as the cost of retention is typically lower than the cost of securing new tenancies. If retention is neither possible nor desirable, the REIT will strive for high-calibre replacement tenants. In 2003, the REIT renewed leases representing 44% of the area covered by leases that matured that year and re-leased another 40% of that area. As at June 30, 2004, the REIT renewed leases representing 57% of the area covered by leases maturing in 2004 and re-leased another 38% of that area. Two of the areas re-leased represent significant increases in rental rate and another two represent significant long-term improvements to the stability of the REIT's rental income.

2. Occupancy

The REIT strives to maintain consistently high levels of occupancy. By the end of 2003, the REIT increased its leased area to 97.5%. As at June 30, 2004, the REIT's leased area was 98.5%.

3. Same Asset Net Operating Income

The REIT strives to maintain or increase same asset net operating income over time. Ignoring the step rent revenue, the NOI in the second quarter of 2004 is \$16 lower than the second quarter of 2003, due primarily to the temporary vacancy at 388 King St West while the prior retail tenant was replaced with Shoppers Drug Mart.

4. Leasing Costs

The REIT monitors leasing costs carefully. In the period ended June 30, 2004, the REIT incurred \$966 in leasing costs and has committed to another \$1,046 with respect to vacant spaces or areas covered by leases expiring in 2004. This corresponded to the high degree of leasing activity in that period and, in particular, to the cost of securing high-value new tenancies referred to above under the heading "Tenant Retention and Replacement".

5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In the period ended June 30, 2004, the REIT incurred \$1,296 in expenditures for capital improvements. The bulk of these expenditures, \$1,216, were incurred in connection with the high-value new tenancies referred to above under the heading "Tenant Retention and Replacement" as well as new tenancies in space that was vacant at the time of the REIT's IPO.

Business Environment and Outlook

The financial and operating implications of our growth to date are positive. The REIT's portfolio now represents 10.6% of the 13.5 million square feet of office inventory in the target market. The Class I value proposition remains compelling to existing and prospective tenants, giving us a distinct competitive advantage in the marketplace, and we expect the increase in our scale of operations will enable us to serve these tenants ever better and ever more efficiently.

The business climate remains positive for office properties in the REIT's target market, and the broader Downtown Toronto office market appears to be strengthening. Demand for the REIT's space continues to be solid, with very little new supply of competing space coming into the market. Management continues to see a steady flow of acquisition opportunities within the target market and will strive to maintain a brisk pace of appropriate acquisitions for the remainder of 2004 and beyond.

Summary Information and Performance for the Quarter ended June 30, 2004

Results for the quarter ended June 30, 2004 ("Q2 2004") are not directly comparable to the results for the quarter ended June 30, 2003 ("Q2 2003") for the following reasons:

- (i) the REIT's operations in Q2 2003 did not include the Additional Properties; and
- (ii) mandated changes in accounting policies apply for Q2 2004, as more fully describe in this MD&A.

Set out in Table 1 are the REIT's financial results for Q2 2004 and Q2 2003, the variance between the two and the variances attributable to the Initial Properties and to the Additional Properties.

Table 1

(In thousands except for per unit amounts)

	Q2 2004	Q2 2003	Variance	Variance Initial Properties	Variance Additional Properties
Revenue from rental properties	\$7,933	\$4,989	\$2,944	\$270	\$2,674
Rental property operating cost	2,656	1,579	(1,077)	(92)	(985)
Net rental income	5,277	3,410	1,867	178	1,689
Financing expense	1,618	1,060	(558)	40	(598)
Depreciation and amortization	1,354	234	(1,120)	(514)	(606)
Income from operations	2,305	2,116	189	(296)	485

(In thousands except for per unit amounts)	Q2 2004	Q2 2003	Variance	Variance Initial Properties	Variance Additional Properties
Trust expenses	527	339	(188)	(188)	-
Net income	1,778	1,777	1	(484)	485
Amortization on rental properties	1,001	224	777	471	306
Amortization on mortgage premium	(120)	(100)	(20)	25	(45)
Amortization of cost of acquired leases	172	-	172	-	172
Amortization of M-T-M acquired leases	(34)	-	(34)	-	(34)
Amortization of acquired tenant relationships	117	-	117	-	117
Step rent adjustments	(361)	-	(361)	(191)	(170)
Compensation expenses, long-term incentive plan	63	-	63	63	-
Distributable Income¹	\$2,616	\$1,901	\$715	\$(116)	\$831
Distributable Income per unit (basic)	\$0.312	\$0.313	(\$0.001)		

¹ Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

Net income in Q2 2004 was flat as compared to Q2 2003. The results of operations of the Additional Properties was primarily offset by the impact of the changes in accounting policies applied in Q2 2004, the increase in trust expenses and amortization of deferred expenses. Net income per unit in Q2 2004 was \$0.212 as compared to \$0.293 in Q2 2003.

Distributable Income in Q2 2004 increased by 37.6% to \$2,616 from \$1,901 in Q2 2003. Distributable Income per unit in Q2 2004 was \$0.312 as compared to \$0.313 in Q2 2003.

Net Rental Income

Net rental income in Q2 2004 increased by 54.8% to \$5,277 from to \$3,410 in Q2 2003 as follows:

- (i) \$191 due to new revenue recognition policies with respect to the REIT's Initial Properties; and,
- (ii) \$1,689 due to the acquisition of the Additional Properties.

Financing Expense

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on the assumed mortgages reduced financing expense by \$20, of which \$75 relates to mortgages assumed on the Initial Properties and \$45 relates to mortgages assumed on the Additional Properties.

Financing expense in Q2 2004 increased by 53% to \$1,618 from \$1,060 in Q2 2003 as follows:

- (i) A reduction of \$40 with respect to the Initial Properties due to a lower debt levels in Q2 2004; and
- (ii) \$598 with respect to the Additional Properties due to the mortgages assumed and debt utilized to finance the acquisitions.

Depreciation and Amortization

Effective January 1, 2004, the REIT records depreciation on its buildings on a straight-line basis over their expected life. In 2003, the REIT recorded depreciation on its buildings on a 5%, 40-year sinking fund basis.

Depreciation recorded on buildings for the Q2 2004 was \$1,001, \$777 higher than in Q2 2003. \$471 of the increase is directly attributable to the Initial Properties and \$306 of the increase is attributable to the Additional Properties in Q1 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in place leases acquired on acquisition of a rental property on a straight-line basis over the term of the corresponding lease. Deferred financing expense is amortized on a

straight-line basis over the term of the corresponding debt. For Q2 2004 and Q2 2003 amortization was as follows:

Table 2

(In thousand of dollars)

	Q2 2004	Q2 2003
Amortization of:		
Deferred leasing costs (tenant inducements and leasing commissions)	\$ 35	\$ -
Fair value origination cost and tenant relationships for in-place leases on acquisition	289	-
Deferred financing cost	29	10
	\$ 353	\$ 10

Trust Expenses

Trust expenses in Q2 2004 of \$527 were \$188 higher than Q2 2003, due to an increase in management salaries, the non cash expense associated with the long term incentive plan and the costs associated with statutory reporting requirements. In addition, management of the Trust is eligible for a bonus in 2004 in the event that targets established by the Governance and Compensation Committee are met. (Management was not eligible for a bonus in 2003 under any circumstances). An accrual has been made in the second quarter in respect of this bonus. Trust expenses includes those costs incurred by the REIT that are not directly attributable to a rental property and include such costs as officers' compensation, trustee fees, professional fees for legal and audit services, trustees and officers insurance premiums and general administrative expenses.

Summary Information and Performance for the Period ended June 30, 2004

Results for the period ended June 30, 2004 ("YTD Q2 2004") are not directly comparable to the results for the 132-day period ended June 30, 2003 ("YTD Q2 2003") for the following reasons:

- (i) YTD Q2 2004 is a 182-day period versus a 132-day period for YTD Q2 2003;
- (ii) the REIT's operations in YTD Q2 2003 did not include the Additional Properties; and
- (iii) mandated changes in accounting policies apply for YTD Q2 2004, as more fully describe in this MD&A.

Set out in Table 2 are the REIT's financial results for YTD Q2 2004 and YTD Q2 2003, the variance between the two and the variances attributable to the Initial Properties and to the Additional Properties.

Table 3

(In thousands except for per unit amounts)

	YTD Q2 2004	YTD Q2 2003	Variance	Variance due to Initial Properties	Variance due to Additional Properties
Revenue from rental properties	\$14,712	\$7,347	\$7,365	\$3,221	\$4,144
Rental property operating cost	4,995	2,417	(2,578)	(974)	(1,604)
Net rental income	9,717	4,930	4,787	2,247	2,540
Financing expense	2,923	1,525	(1,398)	(531)	(867)
Depreciation and amortization	2,295	336	(1,959)	(1,123)	(836)
Income from operations	4,499	3,069	1,430	593	837
Trust expenses	878	472	(406)	(406)	-
Net income	3,621	2,597	1,024	187	837
Amortization on rental properties	1,840	323	1,517	1,057	460
Amortization on mortgage premium	(228)	(148)	(80)	(3)	(77)
Amortization of cost of acquired leases	246	-	246	-	246
Amortization of M-T-M acquired leases	(87)	-	(87)	-	(87)
Amortization of acquired tenant relationships	117	-	117	-	117
Step rent adjustments	(674)	-	(674)	(428)	(246)
Compensation expenses, long-term incentive plan	63	-	63	63	-

(In thousands except for per unit amounts)	YTD Q2 2004	YTD Q2 2003	Variance	Variance due to Initial Properties	Variance due to Additional Properties
Distributable Income ¹	\$4,898	\$2,772	\$2,126	\$876	\$1,250
Distributable Income per unit (basic)	\$0.631	\$0.457	\$0.174		

¹ Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

Net income in YTD Q2 2004 increased by 39.4% to \$3,621 from \$2,597 in YTD Q2 2003, primarily to due to the longer operating period in YTD Q2 2004 and the results of operations of the Additional Properties, offset by the impact of the changes in accounting policies applied in YTD Q2 2004 and increases in trust expenses. Net income per unit in YTD Q2 2004 was \$0.466 as compared to \$0.429 in YTD Q2 2003.

Distributable Income in YTD Q2 2004 increased by 76.7% to \$4,898 from \$2,772 in YTD Q2 2003. Distributable Income per unit in YTD Q2 2004 was \$0.630 as compared to \$0.457 YTD Q2 2003.

Net Rental Income

Net rental income in YTD Q2 2004 increased by 97.1% to \$9,717 from \$4,930 in YTD Q2 2003 as follows:

- (iii) \$428 due to new revenue recognition policies with respect to the REIT's Initial Properties;
- (iv) \$1,834 due to the longer operating period in YTD Q2 2004; and
- (v) \$2,540 due to the acquisition of the Additional Properties.

Financing Expense

Financing expense includes interest cost on mortgage debt and other credit facilities and the amortization of the premiums and discounts on assumed mortgages. The amortization of the premiums and discounts on the assumed mortgages reduced financing expense by \$228, of which \$151 relates to mortgages assumed on the Initial Properties and \$77 relates to mortgages assumed on the Additional Properties.

Financing expense in YTD Q2 2004 increased by 92% to \$2,923 from \$1,525 in YTD Q2 2003 as follows:

- (iii) \$531 with respect to the Initial Properties due to a longer operating period in YTD Q2 2004, offset by slightly lower debt level; and
- (iv) \$867 with respect to the Additional Properties due to the mortgages assumed and debt utilized to finance the acquisitions.

Depreciation and Amortization

Effective January 1, 2004, the REIT records depreciation on its buildings on a straight-line basis over their expected life. In 2003, the REIT recorded depreciation on its buildings on a 5%, 40-year sinking fund basis.

Depreciation recorded on buildings for the YTD Q2 2004 was \$1,840, \$1,517 higher than in YTD Q2 2003. \$810 of the increase is directly attributable to the change in accounting policy as it relates to the Initial Properties. \$460 of the increase is attributable to the Additional Properties in YTD Q2 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in place leases acquired on acquisition of a rental property on a straight-line basis over the term of the corresponding lease. Deferred financing expense is amortized on a straight-line basis over the term of the corresponding debt. For Q1 2004 and Q1 2003 amortization was:

Table 4

(In thousand of dollars)

	YTD Q2 2004	YTD Q2 2003
Amortization of:		
Deferred leasing costs (tenant inducements and leasing commissions)	\$ 52	\$ -
Fair value origination cost and tenant relationships for in-place leases on acquisition	363	-
Deferred financing cost	40	13
	\$ 455	\$ 13

Trust Expenses

Trust expenses in YTD Q2 2004 of \$78 were \$406 higher than YTD Q2 2003, due to the longer operating period in YTD Q2 2004 and an increase in management salaries and the costs associated with statutory reporting requirements. In addition, management of the Trust is eligible for a bonus in 2004 in the event that targets established by the Governance and Compensation Committee are met. (Management was not eligible for a bonus in 2003 under any circumstances). An accrual has been made in the second quarter in respect of this bonus. Trust expenses includes those costs incurred by the REIT that are not directly attributable to a rental property and include such costs as officers' compensation, directors fees, professional fees for legal and audit services, trustees and officers insurance premiums and general administrative expenses.

Leasing Activity

As at December 31, 2003, 26,175 square feet of gross leaseable area ("GLA") was vacant and leases for 142,748 square feet of GLA were scheduled to expire in 2004. In YTD Q2 2004, the REIT leased or renewed leases on 135,974 square feet of that GLA..

The following sets out the GLA and leased area as at June 30, 2004.

Table 5

	Initial Properties	Additional Properties	Total
GLA (square feet)	821,361	606,818	1,428,179
Leased area (square feet)	808,107	598,926	1,407,033
Leased area as percentage of GLA	98.4%	98.7%	98.5%

Capital Expenditures

The REIT's portfolio requires ongoing investments for general capital improvements and tenant installation costs related to new and renewal leasing. These include providing tenant build-out allowances and tenant inducements and paying leasing commissions. In the period ended June 30, 2004, expenditures for capital improvements were \$1,296 and expenditures for leasing costs were \$966. These expenditures were incurred due to leasing activities at the Initial Properties. Of the total expenditures for capital improvements, \$956 were incurred in connection with four high-value new tenancies. Of the total expenditures for leasing costs, \$558 were incurred in connection with these tenancies.

Distributable Income

The REIT defines distributable income ("DI") as the net income of the REIT determined in accordance with Canadian generally accepted accounting principles ("GAAP") adjusted by adding back or deducting as required:

- (i) depreciation on rental properties;
- (ii) amortization of the premiums or discounts on assumed mortgages;
- (iii) non-cash rental revenue recorded to recognize rental income rateably over the life of each lease;
- (iv) amortization of values ascribed in a building acquisition to in-place leases and customer relationships; and
- (v) amortization of values ascribed in a building acquisition to above-market and below-market leases.

DI is a non-GAAP financial measure and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. The REIT considers DI to be a measure of its overall operating performance and is one of Management's key performance indicators. Set out in Table 1 are the calculations of DI, as defined above.

Pursuant to the Ontario Securities Commission Revised CSA Staff Notice 52-306, the Commission recommends that distributable cash (which is synonymous with DI) be reconciled to cash flows from operating activities as presented in the financial statements. Set out in Table 4 is this reconciliation.

Table 6

(In thousands except for unit and per unit amounts)	Q2 2004	Q2 2003	YTD Q2 2004	YTD Q2 2003
Cash from operating activities	\$2,894	\$164	\$5,283	\$1,950
Amortization, deferred leasing and financing cost	(64)	(10)	(92)	(13)
Change in non-cash operating items	(214)	1,747	(293)	835
Distributable Income¹	\$2,616	\$1,901	\$4,898	\$2,772
Distributions	\$2,638	\$1,670	\$4,634	\$2,402
Distributions as a percentage of Distributable Income	100.8%	84.5%	94.6%	86.7%
Weighted average number of units outstanding (basic)	8,395,633	6,066,839	7,766,899	6,059,835
Weighted average number of units outstanding (diluted)	8,427,322	6,066,839	7,818,355	6,059,835
Distributable Income per unit (basic)	\$0.312	\$0.313	\$0.631	\$0.457
Distributable Income per unit (diluted)	\$0.310	\$0.313	\$0.627	\$0.457

¹ 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.

Distributions for Q2 2004 were \$2,638, which corresponds to a pay-out ratio of 100.8%, as compared to distributions for Q2 2003 of \$1,670 and a corresponding pay-out ratio of 84.5%. Distributions for YTD Q2 2004 were \$4,634, which corresponds to a pay-out ratio of 94.6%, as compared to distributions for YTD Q2 2003 of \$2,402 and a corresponding pay-out ratio of 86.7%. These pay-out ratios are higher than normal as a result of the public offering of 2.9 million units, which closed on May 27, 2004, just prior to the record date for the May distribution. Without the extra distribution on the 2.9 million units, the pay-out ratio for YTD Q2 2004 would have been 89.0%.

Funds From Operations

In its December 31, 2003 MD&A, the REIT defined funds from operations ("FFO") as the net income of the REIT determined in accordance with GAAP adjusted by adding back depreciation on rental properties, deferred leasing costs and adding back or deducting the amortization of the premiums or discounts on assumed mortgages. The industry is planning to adopt a standard definition of FFO, which does not contemplate adjustments of the amortization of premiums or discounts on assumed mortgages. Accordingly, the REIT will adopt this standard definition of FFO as is currently proposed. FFO is a non-GAAP financial measure and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. The REIT considers FFO to be an indicative measure of operating performance. Set out in Table 5 is the calculation of FFO based on the industry's proposed standard definition.

Table 7

(In thousands)	Q2 2004	Q2 2003	YTD Q2 2004	YTD Q2 2003
Net income	\$1,778	\$1,777	\$3,621	\$2,597
Amortization on rental properties	1,001	224	1,840	323
Amortization of deferred leasing expenses	35	-	52	-
Amortization of values ascribed to the origination cost and tenant relationships for in-place leases acquired in a rental property acquisition	289	-	363	-
Funds from operations	\$3,103	\$2,001	\$5,876	\$2,920

Financial Condition

The REIT finances its operations through three sources of capital: (i) mortgage debt secured by the REIT's rental properties, (ii) secured short-term debt financing with Canadian chartered banks and (iii) equity. As at June 30, 2004, the REIT had mortgage debt of \$120,494, unitholders' equity of \$99,078 and bank debt of \$4, 753.

The REIT's Declaration provides for a maximum debt level of 60% of the REIT's gross book value ("GBV") excluding convertible debentures (or 65% of GBV, including the entire principal pursuant to any convertible debentures outstanding). GBV is defined in the Declaration to mean, at any time, the book value of the assets of the REIT shown on the then most recent balance sheet of the REIT plus accumulated depreciation and amortization included therein or in the notes thereto. As at June 30, 2004, the REIT's debt to GBV was 52.3%, compared to 51.2% as at December 31, 2003 and 52.2% as at June 30, 2003.

Unitholders' Equity

As at June 30, 2004, the REIT had a market capitalization of approximately \$119,471 based on a closing unit price of \$11.60 on the Toronto Stock Exchange.

YTD Q2 2004, 3,178,968 units were issued for equity contributions of \$33,961. Costs incurred to issue the units were \$1,886. Units were issued as follows:

- (i) in March, 2004, 130,000 units were issued at \$10.00 per unit for \$1,300 pursuant to certain officers and trustees exercising options under the unit option plan;
- (ii) in April, 2004 10,500 units were issued at \$10.00 per unit for \$105,000 pursuant to certain officers and trustees exercising options under the unit option plan;
- (iii) on May 27, 2004 2.9 million units were issued at \$11.10 per unit for \$32,190;
- (iv) on June 28, 2004, 110,000 units were issued pursuant to the LTIP at \$11.30 per unit for \$1,243; and
- (v) 28,468 units were issued at an average price of \$11.65 per unit through the REIT's distribution re-investment plan.

As a long-term incentive to its trustees and officers, the REIT adopted a unit option plan. As at December 31, 2003, 345,000 options were outstanding. As noted above, 130,000 options were exercised in Q1 2004 and 10,500 options were exercised in Q2 2004. Accordingly, as at June 30, 2004, 204,500 options remain outstanding, of which 89,500 options have vested and 115,000 will vest on February 20, 2005. The options granted permit the trustees and officers to acquire units at an exercise price of \$10.00 per unit and expire on February 19, 2008. In Q2 2004, the maximum number of units reserved for the unit option plan was reduced from 604,390 units to 345,000 units, of which 140,500 units have been issued.

In May 2004, the REIT adopted a long term incentive plan (the "LTIP") whereby certain trustees and officers of the REIT, as selected by the REIT (the "Participants") were offered the opportunity to participate in the LTIP. Under the LTIP, Participants subscribe for Units of the REIT at a market price payable as to 5% upon issuance of the units and the balance (the "LTIP Loan") over 10 years, bearing interest at 3%. The shares issued pursuant to the LTIP are registered in the name of a Custodian on behalf of the Participants who are the beneficial owners. The units are pledged to the REIT as security for payment of the LTIP Loan and all distributions paid on the LTIP Units are forwarded by the Custodian to the REIT and applied to reduce the LTIP loans. The maximum number of units reserved for the LTIP is 259,390 units, of which 110,000 units were issued in Q2 2004

Mortgages Payable

Mortgages payable as at June 30, 2004, consisted of mortgage debt of \$120,494 and premium on mortgages assumed (net of accumulated amortization) of \$1,265.

GAAP requires that the mortgages payable assumed on acquisition of 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.

The following sets out the maturity schedule of the REIT's mortgage debt, together with the weighted average interest on the mortgages that mature in the respective year.

Table 8

	Periodic Principal Payments (\$000)	Balance Due at Maturity (\$000)	Total Principal (\$000)	% of Total Principal	Weighted Average Interest Rate of Maturing Mortgages (%)
2004	\$1,453	\$3,682	\$5,135	4.3%	7.41
2005	3,002	1,850	4,852	4.0%	8.00
2006	2,710	9,931	12,641	10.5%	7.33
2007	3,078	19,403	22,481	18.7%	6.44
2008	1,968	14,404	16,372	13.6%	5.95
Thereafter	10,604	48,409	59,013	49.0%	6.78
	\$22,815	\$97,677	\$120,494		

Interest rates on mortgage indebtedness are between 5.2% and 8.1% with a weighted average interest rate of 6.72%. Each individual mortgage loan of the REIT is secured by a mortgage registered on title of a rental property and security agreements covering assignment of rents and personal property with respect to each property. The mortgage indebtedness has recourse to the assets of the REIT. The REIT attempts to stagger the maturity of the mortgages and to have mortgages maturing each year to be in a position to upward finance the principal amount of maturing mortgages. Additionally, the REIT attempts to maintain 15 to 20% of its rental properties free from traditional long-term mortgage financing and provides these assets as security to support bank credit facilities.

Bank Credit Facilities

During Q2 2004, the REIT had credit facilities, with two Canadian chartered banks as follows:

- (i) a \$5 million revolving credit facility bearing interest at bank prime plus 1.0%, which matures on February 28, 2006 ("Acquisition Credit Facility"); and
- (ii) a \$15 million revolving credit facility bearing interest at bank prime plus 1.0%, which matures on May 31, 2006 ("New Credit Facility").

Subordinated mortgage charges and security agreements on three rental properties secure the Acquisition Credit Facility. First mortgage charges against three rental properties, subordinate mortgages charges against two other rental properties and security agreements on each of the five properties secure the New Credit Facility.

For Q2 2004, the average borrowings under the credit facilities were \$1,062. As at June 30, 2004, the borrowings under the credit facilities were \$4,753.

Liquidity and Commitments

Net operating income generated from the rental properties is the primary source of liquidity to fund the REIT's financing expense, trust expenses and distributions to Unitholders. The REIT's Declaration requires it to declare distributions each year not less than the greater of (i) 75% of its DI or (ii) an amount to ensure that the REIT will not be subject to tax on its income and capital gains. The REIT intends to pay distributions of approximately 85% to 90% of DI.

The REIT expects that upward financing on maturing mortgages will provide sufficient cash flow to fund mortgage repayments. The REIT plans to fund anticipated ongoing commitments, obligations, capital expenditures and leasing costs using cash flow from operations retained by the REIT and through available borrowing capacity under the New Credit Facility.

The Acquisition Credit Facility, the New Credit Facility, new mortgage indebtedness and the access to the public equity markets will provide the necessary capital the REIT requires for acquisitions. The REIT's

acquisition capacity, meaning the ability of the REIT to acquire rental properties using un-utilized borrowing capacity while not exceeding the 60% debt-to-GBV ratio, is \$45 million.

As at June 30, 2004, the REIT had future commitments, and the estimated timing of these commitments is as follows:

Table 9

(In thousands)	2004	2005	Total
Leasing commissions	\$485	\$54	\$539
Tenant inducements	566	-	566
Building renovations	297	20	317
	\$1,348	\$74	\$1,422

Summary Quarterly Information and Performance

Set out in Table 8 is the summary of results for the most recently completed fiscal quarters and for the 41 day-period from the commencement of operations on February 19, 2003, to March 31, 2003.

Table 10

(In thousands except for per unit amounts)	April 1 to June 30, 2004	January 1, to March 31, 2004	October 1, to December 31, 2003	July 1 to September 30, 2003	April 1 to June 30, 2003	February 19 to March 31, 2003
Revenue from rental properties	\$7,933	\$6,779	\$5,541	\$5,057	\$4,989	\$2,358
Rental property operating cost	2,656	2,339	1,776	1,610	1,579	838
Net rental income	5,277	4,440	3,765	3,447	3,410	1,520
Financing expense	1,618	1,305	1,200	1,086	1,060	465
Depreciation and amortization	1,354	941	263	241	234	102
Income from operations	2,305	2,194	2,302	2,120	2,116	1,405
Trust expenses	527	351	303	282	339	133
Net income	1,778	1,843	1,999	1,838	1,777	820
Amortization on rental properties	1,001	839	246	220	224	99
Amortization on mortgage premium	(120)	(108)	(94)	(74)	(100)	(48)
Amortization of cost of acquired leases	172	73	-	-	-	-
Amortization of M-T-M acquired leases	(34)	(53)	-	-	-	-
Amortization of acquired tenant relationships	117	-	-	-	-	-
Step rent adjustments	(361)	(313)	-	-	-	-
Compensation expense, long-term incentive plan	63	-	-	-	-	-
Distributable Income ¹	\$2,616	\$2,281	\$2,151	\$1,984	\$1,901	\$871
Net income per unit (basic)	\$0.212	\$0.253	\$0.315	\$0.302	\$0.293	\$0.136
Distributable Income per unit (basic)	\$0.312	\$0.320	\$0.338	\$0.326	\$0.313	\$0.144

¹ Distributable Income, which is not defined within Canadian generally accepted accounting principles, has been calculated in accordance with the terms of the Declaration.

Critical Accounting Estimates

The significant accounting policies used in preparing the REIT's audited financial statements are described in Note 3 to those statements. The following is a discussion of Management's estimates that are most important to the presentation of the REIT's results of operations and financial condition and are most subjective as a result of matters that are inherently uncertain.

Fair Value of Assumed Mortgages Payable and Fair Value of Mortgages Payable

Most of the mortgage indebtedness of the REIT was assumed in conjunction with rental property acquisitions. GAAP requires that the mortgages payable assumed on acquisition of properties be

recorded at fair value. The REIT also disclosed the fair value of mortgages in the notes to its financial statements. 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. Market rates for debt are based on the yield of Canadian government bonds with similar maturity dates plus a credit spread based on Management's experience in obtaining financing and the current market conditions.

Impairment of Assets

The REIT is required to write down to fair value any long-life assets that are determined to have been permanently impaired. The REIT's long-life assets consist of rental properties. The REIT's policy is to assess any potential impairment by making a comparison of the current and projected operating cash flow of a rental property over its remaining useful life, on an un-discounted basis, to the carrying amount of the rental property. If such carrying amount was in excess of the projected operating cash flow of the rental property, impairment in value would be recognized to adjust the carrying amount to its estimated fair market value. Current operating cash flows are based on leases in place and projected operating cash flows are based on Management's estimates of future rental rates. There were no impairments recorded in the 316-day period. Prior to acquiring a rental property, the REIT commissions an appraisal and conducts due-diligence to satisfy itself that the acquisition price is representative of fair market value.

Depreciation

A significant portion of the purchase price of rental properties is allocated to buildings. The depreciation recorded on buildings is based on the straight-line basis over their expected useful life. The allocation of purchase price to buildings and the estimated useful life are based on Management's estimates and, if these estimates prove incorrect, the depreciation will not be appropriately recorded.

Changes to Accounting Policies

The impact of recent pronouncements of the Canadian Institute of Chartered Accountants (the "CICA") on the REIT's accounting policies are set out in the REIT Management's Discussion and Analysis for the year ended December 31, 2003, and summarized below.

Amortization of Rental Properties

Effective January 1, 2004, the sinking fund method of amortization will no longer be in compliance with GAAP, with the result that, from the effective date, the REIT will record depreciation on its buildings on a straight-line basis over their expected useful life.

Revenue Recognition

Effective January 1, 2004, the REIT will change its method of recognizing rental revenues from leases with "stepped rent increases", where such increases were designed to account for inflation. In accordance with GAAP, rental revenue will be recognized on a straight-line basis. The REIT will apply this new policy on a prospective basis effective January 1, 2004.

Accounting for Acquisitions of Rental Properties

Effective for transactions entered into after September 12, 2003, where operating leases are acquired in either an asset acquisition or a business combination, the purchase price is to be allocated to tangible assets (land, buildings and equipment) and identifiable intangibles.

The accounting treatment for intangibles is as follows:

- (i) the value of an above-market lease (lease that have a average rental rate in excess of the market rate at the time of acquisition) is recorded as an asset and amortized over the remaining term of the lease, which reduces rental revenue;
- (ii) the value of a below-market lease is recorded as a liability and amortized over the remaining term of the lease, which increases rental revenue; and
- (iii) the fair value of the origination cost associated with an in-place lease and the tenant relationship are recorded as assets and amortized over the remaining term of the lease, which increases amortization expense.

In the event an acquired lease is terminated prior to its contractual expiry date, the carrying amount of the intangibles with respect to that lease will be charged to rental revenue or amortization expense.

Related Party Transactions

The REIT has entered into an agreement (the "Property Management Agreement") with Allied Canadian Corporation ("Property Manager"), a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Property Manager.

Pursuant to the Property Management Agreement, the Property Manager is responsible for the overall management and operations of the REIT's rental properties, all aspects of the leasing of the rental properties owned by the REIT and to provide the REIT a fully equipped office and support staff. The initial term of the Property Management Agreement is five years to February 19, 2008 and renewable by the REIT for successive two year terms. Should the REIT decide not to renew the Property Management Agreement after the initial five term it is liable for the severance costs relating to the employees of the Property Manager dedicated to servicing any rental properties owned by the REIT.

Under the Property Management Agreement the REIT pays the following:

- (i) a management fee of 4% of rental revenue;
- (ii) a leasing fee of 15% of a third-party broker's fees if a broker originates a lease transaction;
- (iii) a leasing fee of 50% of the customary market brokerage fees if a third-party broker has not originated the lease transaction;
- (iv) a project management fee based on customary market fees for project management services for renovations, construction and reconstruction work on the rental properties;
- (v) the costs, plus applicable administrative charges, of staff supplied by the Property Manager to perform day-to-day maintenance and security functions for the rental properties;
- (vi) the costs, plus applicable administrative charges, of staff supplied by the Property Manager to perform duties that would typically be performed by on-site personnel;
- (vii) disbursements and out-of-pocket expenses related to services provided; and
- (viii) the costs incurred by the Property Manager to provide the REIT a fully equipped office and support staff.

Set out below are the fees paid or payable by the REIT to the Property Manager in connection with the provisions of its services for Q2 2004.

Table 11

(in thousands)

	Recoverable Operating Expenses	Trust Expenses	Deferred Expenses	Rental Properties	Commit- ments	Total
Management fee	\$284	\$ -	\$ -	\$ -	\$ -	\$ 284
Maintenance	139	-	-	-	-	139
On-site personnel	51	-	-	-	-	51
Disbursements	9	1	-	-	-	10
Leasing fees	-	-	66	-	27	93
Project management fees	-	-	-	43	-	43
Office and support staff	-	15	-	-	-	15
	\$483	\$ 16	\$ 66	\$ 43	\$ 27	635

TechSpace Canada Inc. ("TechSpace"), a subsidiary of the Property Manager, leased 29,102 square feet of office space from the REIT on commercial terms. The lease was to expire on September 30, 2010. The Property Manager indemnified the REIT in respect of all of TechSpace's obligations under the lease. The indemnity and the option expire six months after TechSpace's operations have stabilized. The REIT has

entered into a lease directly with a new tenant effective January 1, 2004 for the 29,102 square feet. The indemnity from the Property Manager remains in place to protect the REIT from any revenue shortfall (on a cash basis) from the original TechSpace lease.

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.

As at June 30, 2004, there were 120 tenants in the REIT's rental property portfolio and no single tenant accounted for more than 11% of the rental revenue for Q2 2004. Table 11 is the REIT's tenant mix on the basis of percentage of rental revenue for Q2 2004.

Table 12

Category	% of Rental Revenue
Service and professional	38.2
Retail (head office and storefront)	22.7
Telecommunications and information technology	17.2
Media and film	10.7
Financial services	4.0
Government	3.7
Other	3.5

98.5% of the space in the REIT's rental properties was leased as at June 30, 2004. Table 12 sets out the total leased square footage of the rental properties subject to lease expiry during the period ended December 31, 2008, assuming tenants do not exercise renewal options, and the percentage of leased leaseable area.

Table 13

Year Ended	Square Feet	% of Leased Area
December 31, 2004	20,327	1.4
December 31, 2005	159,715	11.2
December 31, 2006	137,619	9.6
December 31, 2007	193,997	13.6
December 31, 2008	80,958	5.6