



**ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST**

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

**MARCH 31, 2005**

**DATED MAY 9, 2005**

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## PART I

### Forward-Looking Disclaimer

Management's discussion and analysis of results of operations and financial condition ("MD&A") should be read in conjunction with the financial statements and notes thereto of Allied Properties Real Estate Investment Trust ("REIT") as at March 31, 2005, and December 31, 2004. 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 the REIT's efforts to implement its acquisition strategies;
- the effect of economic conditions, including rising interest rates;
- the REIT's ability to generate sufficient cash flow from rental properties;
- the REIT's 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 the REIT's equity and debt capital;
- changes in the REIT's capital requirements and availability of financing;
- the actions of the REIT's competitors and its 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 May 9, 2005, and the REIT undertakes no obligation to update publicly any such statements to reflect new information or the occurrence of future events or circumstances.

**May 9, 2005**

## 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](http://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 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 in downtown Toronto with approximately 820,000 square feet of gross leasable area (“GLA”). The REIT acquired eight additional properties in 2003 and 2004, seven in downtown Toronto and one in downtown Montreal, bringing the 2004 year-end total to 22 properties with 1.64 million square feet of GLA.

The REIT has made the following acquisitions in 2005, bringing the current portfolio to 24 properties with nearly 1.9 million square feet of GLA:

Class I Office Property	Acquired	Office GLA	Retail GLA	Total GLA	Occupancy
469 King Street West, Toronto	Jan 1, 2005	62,639	11,250	73,889	100.0%
3575 Saint-Laurent Boulevard, Montreal	April 18, 2005	164,344	17,464	181,808	94.8%

The REIT’s portfolio of 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 is a leading provider of Class I office and ancillary retail space and intends to build on this advantage through ongoing consolidation of large, fragmented and growing target markets. 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, 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. Two of the properties in the REIT’s current portfolio were acquired pursuant to the Option Agreement.

The REIT’s portfolio has operated stably. The chart below summarizes the levels of leased area in the portfolio since the REIT’s IPO:

	IPO	Dec 31, 2003	Dec 31, 2004	March 31, 2005
GLA (square feet)	820,120	984,856	1,636,343	1,703,426
% leased	96.9	97.5	99.2	99.1

Stable portfolio operations and manageable growth in assets have enabled the REIT to achieve its overriding objective of providing regular and growing cash distributions to unitholders. The chart below summarizes the annualized cash distribution level and the total annual return since the REIT’s IPO and the total quarterly return on March 31, 2005:

	IPO Feb 20, 2003	Dec 31, 2003	Dec 31, 2004	March 31, 2005
Distribution level per unit annualized	\$1.10	\$1.10	\$1.14	\$1.18
Total annual return with reinvestment	NA	40.7%	17.6%	5.0%
Total annual return without reinvestment	NA	38.0%	15.2%	4.5%

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 of 2004, the REIT increased its monthly distributions by 3.6% to \$1.14 per unit on an annualized basis. In March of 2005, the REIT increased its monthly distributions by 3.5% to \$1.18 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 \$1.122 per unit. In 2004, Distributable Income was \$1.325 per unit, up 18% from the abbreviated comparable period in 2003. In the first quarter of 2005, Distributable Income was \$0.355 per unit, up 10.8% for the same quarter in 2004.

#### **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%. In 2004, the REIT achieved a pay-out ratio of 88.1%. In the first quarter of 2005, the REIT achieved a pay-out ratio of 82.7%.

#### **4. Debt Ratio**

Gross Book Value ("GBV") is defined in the Declaration as the book value of the assets of the REIT shown on the most recent balance sheet plus accumulated depreciation and amortization. A conservative ratio of debt to GBV ("Debt Ratio") mitigates unitholder risk. In 2003, the REIT forecast a 56% Debt Ratio and finished the year with a 51% Debt Ratio. As at December 31, 2004, the Debt Ratio was 56.3%. As at March 31, 2005, the Debt Ratio was 50.0%.

### ***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-quality replacement tenants. Leases representing 163,580 square feet of GLA in the REIT's portfolio mature in 2005. As at March 31, 2005, the REIT had renewed leases representing 69,530 square feet of this area and re-leased another 10,971 square feet of this area, representing 49% of space covered by the maturing leases. It had also renewed a lease representing 33,244 square feet of space maturing in 2006.

#### **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%. By the end of 2004, the REIT's leased area was 99.2%. As at March 31, 2005, the REIT's leased area was 99.1%.

#### **3. Same-Asset Net Operating Income**

The REIT strives to maintain or increase same-asset net operating income over time. Same-asset refers to those properties that were owned and operated by the REIT for the entire period in question and for the same period in the prior year. Ignoring the step-rent revenue and the amortization of the fair value assigned to above-market and below-market rents with respect to acquired properties (the marked-to-market rent adjustment), the same-asset net operating income was \$4,386 in the first quarter of 2005, \$379 higher than the comparable period in 2004.

#### 4. Leasing Expenditures

The REIT monitors leasing expenditures carefully. In 2004, the REIT incurred substantial leasing expenditures in connection with the leasing of space that was vacant or substantially un-renovated at the time of the IPO or significantly reconfigured to accommodate high-value new tenancies. The REIT does not anticipate similar or comparable leasing expenditures in 2005. During the first quarter of 2005, the REIT leased 21,950 square feet of GLA and renewed leases on 102,774 square feet of GLA. As at March 31, 2005, the REIT incurred or committed to \$1,056 in leasing expenditures in connection with this leasing activity. This represents \$8.47 per square foot of space leased in the first quarter of 2005.

#### 5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2004, the REIT incurred substantial capital expenditures in connection with base-building improvements made to space that was vacant or substantially un-renovated at the time of the IPO or significantly reconfigured to accommodate high-value new tenancies. The REIT does not anticipate similar or comparable expenditures in 2005. As at March 31, 2005, the REIT incurred \$23 in expenditures for capital improvements. This represents \$0.02 per square foot of the REIT's portfolio at the outset of 2005.

### Summary

The following table summarizes the key financial and operating performance indicators for the quarters ended March 31, 2005, and March 31, 2004, as well as the change between the two quarters.

	Q1 2005	Q1 2004	Change
Distribution level per unit annualized	\$1.18	\$1.14	\$0.04
Distributable Income per unit	\$0.355	\$0.320	\$0.035
Pay-out ratio	82.7%	87.5%	(4.8%)
Debt Ratio	50.0%	52.7%	(2.7%)
Renewal/replacement % of leases maturing in 2005/2004	49.3%	86.3%	(37.0%)
Occupancy	99.1%	97.6%	1.7%
Same-asset net operating income	\$4,386	\$4,007	\$379
Leasing costs per leased square foot	\$8.47	\$11.77	(\$3.30)
Capital expenditures per portfolio square foot	\$0.02	\$0.54	(\$0.52)

### Business Environment and Outlook

The downtown Toronto office market strengthened modestly in 2004, though it remained more a tenants' than a landlords' market with little if any upward pressure on net rental rates. There was positive absorption over the course of the year, with Class A office space recording the most absorption in absolute terms (471,127 square feet, representing 1.3% of the Class A inventory) followed by Class I office space (285,684 square feet, representing 4% of the Class I inventory).<sup>1</sup> The modest strengthening continued into the first quarter of 2005 with the overall vacancy rate in the downtown Toronto office market declining to 10.4% and the Class I category recording positive absorption of 70,018 square feet.<sup>2</sup>

The downtown Montreal office market was essentially flat in 2004, and it remained more a tenants' than a landlords' market with little if any upward pressure on net rental rates. While Class I office space is not tracked separately in the downtown Montreal market, there is data available on the Old Montreal submarket. There was positive absorption over the course of the year in Old Montreal (109,616 square

<sup>1</sup> Colliers International, *Office Quarterly Update for Greater Toronto, Fourth Quarter 2004*.

<sup>2</sup> Colliers International, *Office Quarterly Update for Greater Toronto, First Quarter 2005*.

feet, representing 1.5% of the total submarket inventory)<sup>3</sup>. This continued into the first quarter of 2005 with positive absorption of 99,373 square feet in Old Montreal.<sup>4</sup>

In summary, the REIT's target markets are stable, with little new supply of office space generally and Class I office space in particular. Combined with the operating advantages stemming from the size and quality of the REIT's portfolio, the stable markets afford Management a reasonable basis for confidence in the REIT's near-term performance and in the REIT's ability to sustain a manageable rate of growth.

The REIT intends to continue the consolidation process in its Toronto target market and to expand the strategic foothold it has established in its Montreal target market. In doing so, it will continue to focus on its competitive strengths -- convenient locations, distinctive internal and external environments and significantly lower overall occupancy costs. It will also continue to work with existing and prospective tenants to remain a preferred provider of office space in its target markets.

The REIT has not established a rigid target in terms of the allocation of its portfolio between the Toronto and Montreal target markets. With the closing of the acquisition of 3575 Saint-Laurent Boulevard, Montreal, on April 18, 2005, the properties in the Toronto target market represent 80% of the total GLA in the portfolio while the properties in the Montreal target market represent 20% of the total GLA in the portfolio.

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<sup>3</sup> Colliers International, *Market at a Glance, Old Montreal Office Market, Fourth Quarter 2004*.

<sup>4</sup> Colliers International, *Market at a Glance, Old Montreal Office Market, First Quarter, 2005*.

## PART II

### Summary Information and Performance for the Quarter ended March 31, 2005

The following sets out summary information and financial results for the quarter ended March 31, 2005, and the comparable quarter in 2004 and the change between the two.

(In thousands except for per unit and percentage amounts)	Q1 2005	Q1 2004	Change	% Change
Revenue from rental properties	\$11,797	\$6,779	\$5,018	74.0%
Rental property operating cost	4,197	2,339	1,858	79.4%
Net rental income	7,600	4,440	3,160	71.2%
Financing expense				
Interest	2,373	1,413	960	67.9%
Amortization - Mortgage premium	(104)	(108)	4	(3.7%)
Depreciation and amortization				
Rental properties	1,369	839	530	63.2%
Deferred leasing costs (tenant inducements and leasing commissions)	113	17	96	564.7%
Fair value origination cost and tenant relationship for in place leases on acquisition	806	73	733	1,004.1%
Deferred financing cost	48	12	36	300.0%
Income from operations	2,995	2,194	801	35.5%
Trust expense	497	351	146	41.6%
Net income	2,498	1,843	655	35.5%
Amortization on rental properties	1,369	839	530	63.2%
Amortization on mortgage premium	(104)	(108)	4	(3.7%)
Amortization of cost of acquired leases	413	73	340	465.8%
Amortization of M-T-M acquired leases	24	(53)	77	(145.3%)
Amortization of acquired tenant relationships	393	-	393	-
Step-rent adjustments	(405)	(313)	(92)	29.4%
Compensation expenses, LTIP	109	-	109	-
Distributable Income <sup>1</sup>	\$4,297	\$2,281	\$2,016	88.4%
Weighted average units outstanding (basic)	12,118	7,138	4,980	69.8%
Weighted average units outstanding (diluted)	12,329	7,174	5,155	71.9%
Distributable Income per unit (basic)	\$0.355	\$0.320	\$0.035	10.8%
Distributable Income per unit (diluted)	\$0.348	\$0.318	\$0.030	9.6%
Distributions	3,557	1,996	1,561	78.2%
Pay-out ratio	82.7%	87.5%	(4.8%)	
Funds from operations	4,786	2,772	2,014	72.7%
Funds from operations per unit (basic)	\$0.395	\$0.388	\$0.007	1.7%
Funds from operations per unit (diluted)	\$0.388	\$0.386	\$0.002	0.4%
Net operating income	7,219	4,074	3,145	77.2%
Net income per unit (basic)	\$0.206	\$0.258	(\$0.052)	(20.2%)
Net income per unit (diluted)	\$0.203	\$0.257	(\$0.054)	(21.2%)
Total assets	284,741	165,809	118,932	71.7%
Total debt (excludes premium on assumed debt)	147,418	87,207	59,929	67.8%
Debt to GBV	50.0%	52.7%	(2.7%)	
Total GLA (square feet)	1,703	1,042	661	63.4%
Leased GLA (square feet)	1,687	1,017	670	65.9%
Leased GLA (% total GLA)	99.1%	97.6%	1.5%	

<sup>1</sup> 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 for the quarter ended March 31, 2005, increased by 35.5% to \$2,498 from \$1,843 in the quarter ended March 31, 2004. Net income per unit (basic) for the quarter was \$0.206, as compared to \$0.258 in the comparable quarter.

Distributable Income for the quarter ended March 31, 2005, increased by 88.4% to \$4,297 from \$2,281 for the quarter ended March 31, 2004. Distributable Income per unit (basic) for the quarter was \$0.355, as compared to \$0.320 in the comparable quarter.

### ***Net Rental Income***

Net rental income for the quarter ended March 31, 2005, increased by 71.2% to \$7,600 from \$4,440 in the quarter ended March 31, 2004, as follows:

- (i) \$245 due to the increase in same-asset net rental income from properties owned for the entire quarter and the entire comparable quarter; and
- (ii) \$2,915 due to net rental income from properties acquired in 2004 and the quarter.

Net rental income per occupied square foot for the quarter ended March 31, 2005, was \$4.51, as compared to \$4.37 in the quarter ended March 31, 2004.

### ***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 assumed mortgages reduced financing expense by \$104 in the quarter ended March 31, 2005.

Financing expense for the quarter ended March 31, 2005, increased by 73.9% to \$2,269 from \$1,305 in the quarter ended March 31, 2004, due to the \$1,054 increase in financing expense associated with properties acquired in 2004 and in the quarter, offset in part by the \$90 decrease in same-asset financing expense associated with properties owned for the entire quarter and the comparable quarter.

### ***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 quarter ended March 31, 2005, increased by 63.2% to \$1,369 from \$839 in the quarter ended March 31, 2004, due to the \$520 increase in depreciation associated with properties acquired in 2004 and in the quarter and the \$10 increase in same-asset depreciation associated with properties owned for the entire quarter and the comparable quarter.

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 cost is amortized on a straight-line basis over the term of the corresponding debt.

### ***Trust Expenses***

Trust expense includes cost incurred by the REIT that is not directly attributable to rental property, such as officers' compensation, trustees' fees, professional fees for legal and audit services, trustees' and officers' insurance premiums and general administrative expenses.

Trust expense for the quarter ended March 31, 2005, increased by 41.6% to \$497 from \$351 in the quarter ended March 31, 2004, due to an increase in management staff, an increase in salaries and the non-cash expense associated with the REIT's Long-Term Incentive Plan ("LTIP").

### ***Leasing Activity***

As at December 31, 2004, 15,555 square feet of GLA were vacant. Leases for 163,580 square feet of GLA are scheduled to expire in 2005. During the quarter ended March 31, 2005, the REIT leased 21,950

square feet of GLA and renewed leases on 69,530 square feet of GLA. It also renewed a lease representing 33,244 square feet of space maturing in 2006.

### **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 the following: maintenance capital expenditures; in-suite or base-building improvements made in connection with the leasing of vacant space or the renewal or replacement of tenants occupying space covered by maturing leases; and improvement allowances, inducements and commissions paid in connection with the leasing of vacant space and the renewal or replacement of tenants occupying space covered by maturing leases. In the quarter ended March 31, 2005, expenditures for capital improvements were \$23 and expenditures for leasing were \$485. The leasing expenditures were incurred in connection with the leasing of space that was vacant as at December 31, 2004, or the renewal or replacement of tenants occupying space covered by maturing leases in 2005 and 2006.

### **Distributable Income**

The REIT defines Distributable Income 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) non-cash compensation expenses with respect to the long term incentive plan;
- (v) amortization of values ascribed in a building acquisition to in-place leases and customer relationships; and
- (vi) amortization of values ascribed in a building acquisition to above-market and below-market leases.

Distributable Income 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 Distributable Income to be a measure of its overall operating performance and is one of Management's key performance indicators.

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

(In thousands except for unit and per unit amounts)	Q1 2005	Q1 2004
Cash from operating activities	\$3,249	\$2,389
Amortization, deferred leasing and financing cost	(161)	(29)
Change in non-cash operating items	1,209	(79)
<b>Distributable Income<sup>1</sup></b>	<b>\$4,297</b>	<b>\$2,281</b>

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

Distributions for the period ended March 31, 2005, were \$3,557, representing a pay-out ratio of 82.7%, as compared to distributions for the period ended March 31, 2004, of \$1,996, representing a pay-out ratio of 87.5%.

## Funds From Operations

Funds From Operations (“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, which is widely used by the real estate industry. The following sets out FFO, calculated in accordance with recommendations of Real Property Association of Canada (formerly Canadian Institute of Public and Private Real Estate Companies) in its White Paper on Funds From Operations dated November 30, 2004.

(In thousands)	Q1 2005	Q1 2004
Net income	\$2,498	\$1,843
Amortization on rental properties	1,369	839
Amortization of deferred leasing expenses	113	17
Amortization of fair value of origination cost and tenant relationships for in-place leases on acquisition	806	73
FFO	\$4,786	\$2,772

## PART III

### 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 March 31, 2005, the REIT had mortgage debt of \$147,418, no outstanding bank indebtedness and unitholders' equity of \$122,152.

The Declaration provides for a maximum Debt Ratio of 60% excluding convertible debentures (or 65%, including the entire principal pursuant to any convertible debentures outstanding). GBV is defined in the Declaration to mean the book value of the assets of the REIT shown on the most recent balance sheet of the REIT plus accumulated depreciation and amortization. As at March 31, 2005, the Debt Ratio was 50.0%, compared to 56.3% as at December 31, 2004.

### Unitholders' Equity

As at December 31, 2004, the REIT had a market capitalization of approximately \$143,323 based on a closing unit price of \$13.80 on the Toronto Stock Exchange. As at March 31, 2005, the REIT had a market capitalization of approximately \$177,540 based on a closing unit price of \$14.21.

In the quarter ended March 31, 2005, the REIT issued a total of 2,031,768 units for equity contributions of \$26,109. Costs incurred to issue the units were \$1,260. Units were issued as follows:

- (i) on January 4, 2005, the REIT issued 1.9 million units at \$13.00 per unit for gross proceeds of \$24,700;
- (ii) 108,000 units were issued at \$10.00 per unit for \$1,080,000 pursuant to certain officers and trustees exercising options under the REIT's Unit Option Plan;
- (iii) 23,768 units were issued pursuant to the distribution re-investment plan at an average price of \$13.85 per unit for \$329; and
- (iv) 76,224 units were issued pursuant to the long-term incentive plan at \$13.46 per unit for \$1,026, plus compensation costs of \$109.

The REIT adopted a Unit Option Plan at the time of its IPO and granted at that time options to the trustees and officers of the REIT to acquire 345,000 units at an exercise price of \$10.00 per unit prior to February 19, 2008. In 2004, the maximum number of units reserved for the Unit Option Plan was reduced from 604,390 units to 345,000 units. In 2004 and the quarter ended March 31, 2005, the trustees and officers of the REIT exercised 248,500 options in accordance with their terms. As at March 31, 2005, 96,500 options were outstanding, all of which had vested.

In May 2004, the REIT adopted the LTIP whereby trustees and officers of the REIT (the "Participants") may from time to time, at the discretion of the Trustees and subject to regulatory approval, subscribe for units at a market price established in accordance with the provisions of the LTIP. The price for the units is payable as to 5% upon issuance and as to the balance (the "LTIP Loan") over 10 years with interest on the LTIP Loan at an annual rate established in accordance with the provisions of the LTIP. The units 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 units are forwarded by the Custodian to the REIT and applied first on account of interest on the LTIP Loan and then to reduce the outstanding balance of the LTIP loans. The maximum number of units reserved for the LTIP is 259,390 units, of which 147,500 units were issued in 2004 and 76,224 in the quarter ended March 31, 2005.

### Mortgages Payable

Mortgages payable as at March 31, 2005, consisted of mortgage debt of \$147,418 and premium on mortgages assumed (net of accumulated amortization) of \$945.

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.

	Periodic Principal Payments (\$000)	Balance Due at Maturity (\$000)	Total Principal (\$000)	% of Total Principal	Weighted Average Interest Rate of Maturing Mortgages (%)
2005	\$ 2,971	\$ 1,850	\$ 4,821	3.3%	8.00%
2006	3,977	9,931	13,908	9.4%	7.33%
2007	3,876	19,408	23,284	15.8%	6.44%
2008	3,091	14,404	17,495	11.9%	5.95%
2009	3,040	8,735	11,775	8.0%	6.84%
Thereafter	16,068	60,067	76,135	51.6%	
	\$33,023	\$ 114,395	\$147,418		

Interest rates on the mortgage debt are between 5.20% and 8.10% with a weighted average interest rate of 6.51%. The weighted average term of the mortgage debt is 6.38 years.

Each individual mortgage loan of the REIT is secured by a mortgage registered on title of a rental property and by security agreements covering assignment of rents and personal property with respect to such property. The mortgage debt provides the holder with recourse to the assets of the REIT.

The REIT attempts to stagger the maturity of its 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 with a view to providing these assets as security for bank credit facilities.

#### **Bank Credit Facilities**

The REIT has 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 mortgage charges against two other rental properties and security agreements on each of the five properties secure the New Credit Facility.

In the quarter ended March 31, 2005, the average borrowings under the credit facilities were \$490. As at March 31, 2005, the borrowings under the credit facilities were \$nil.

#### **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 Declaration requires it to declare distributions each year not less than the greater of (i) 75% of its Distributable Income 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 Distributable Income.

The REIT expects that increased 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 Ratio, is \$73 million.

As at March 31, 2005, the REIT had future commitments as set below.

(In thousands)	<b>March 31, 2005</b>
Leasing commissions	\$394
Tenant inducements	254
Building renovations	183
Operating costs	81
	<b>\$912</b>

## PART IV

### Summary Quarterly Information and Performance

The following sets out summary information and financial results for the most recently completed fiscal quarters.

(In thousands except for per unit and percentage amounts)	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003	Q3 2003	Q2 2003
Revenue from rental properties	\$11,797	\$10,119	\$9,734	\$7,933	\$6,779	\$5,541	\$5,057	\$4,989
Rental property operating cost	4,197	3,664	3,369	2,656	2,339	1,776	1,610	1,579
Net rental income	7,600	6,455	6,365	5,277	4,440	3,765	3,447	3,410
Financing expense	2,269	2,117	1,957	1,618	1,305	1,200	1,086	1,060
Depreciation and amortization	2,336	1,958	1,855	1,354	941	263	241	234
Income from operations	2,995	2,380	2,553	2,305	2,194	2,302	2,120	2,116
Trust expense	497	382	305	527	351	303	282	339
Net income	2,498	1,998	2,248	1,778	1,843	1,999	1,838	1,777
Amortization on rental properties	1,369	1,194	1,175	1,001	839	246	220	224
Amortization on mortgage premium	(104)	(103)	(113)	(120)	(108)	(94)	(74)	(100)
Amortization of cost of acquired leases	413	308	267	172	73	-	-	-
Amortization of M-T-M acquired leases	24	31	38	(34)	(53)	-	-	-
Amortization of acquired tenant relationships	393	317	291	117	-	-	-	-
Step-rent adjustments	(405)	(276)	(375)	(361)	(313)	-	-	-
Compensation expense, LTIP	109	26	-	63	-	-	-	-
Distributable Income <sup>1</sup>	\$4,297	\$3,495	3,531	\$2,616	\$2,281	\$2,151	\$1,984	\$1,901
Weighted average units outstanding (basic)	12,118	10,226	10,200	8,396	7,138	6,352	6,087	6,066
Weighted average units outstanding (diluted)	12,329	10,389	10,348	8,427	7,174	6,365	6,087	6,067
Distributable Income per unit (basic)	\$0.355	\$0.342	\$0.346	\$0.312	\$0.320	\$0.338	\$0.326	\$0.313
Distributable Income per unit (diluted)	\$0.348	\$0.336	\$0.341	\$0.310	\$0.318	\$0.338	\$0.326	\$0.313
Distributions	3,557	2,939	2,933	2,638	1,996	1,791	1,675	1,670
Pay-out ratio	82.7%	84.1%	83.1%	100.8%	87.5%	83.3%	84.4%	87.9%
Funds from operations	4,786	3,912	4,062	3,103	2,772	2,225	2,068	2,001
Funds from operations per unit (basic)	\$0.395	\$0.383	\$0.398	\$0.370	\$0.388	\$0.247	\$0.341	\$0.330
Funds from operations per unit (diluted)	\$0.388	\$0.377	\$0.393	\$0.368	\$0.386	\$0.244	\$0.341	\$0.330
Net operating income	7,219	6,210	6,028	4,882	4,074	3,765	3,447	3,410
Net income per unit (basic)	\$0.206	\$0.195	\$0.220	\$0.212	\$0.258	\$0.222	\$0.303	\$0.293
Net income per unit (diluted)	\$0.203	\$0.192	\$0.217	\$0.211	\$0.257	\$0.220	\$0.303	\$0.293
Total assets	284,741	266,835	237,786	236,330	165,809	157,069	128,402	127,835
Total debt	147,418	154,273	125,514	125,247	87,207	80,891	66,827	66,868
Total debt to GBV	50.0%	56.3%	52.1%	52.3%	52.7%	51.2%	51.8%	52.2%
Total GLA (sq. ft.)	1,703	1,641	1,430	1,428	1,042	984	820	820
Leased GLA (sq. ft.)	1,687	1,627	1,410	1,407	1,017	960	804	802
Leased Area (%GLA)	99.1%	99.2%	98.6%	98.5%	97.6%	97.5%	98.0%	97.8%

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

## PART V

### Critical Accounting Estimates

The significant accounting policies used in preparing the REIT's 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 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. 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.

## PART VI

### Related Party Transactions

The REIT has entered into an agreement (“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 the provision of 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 the quarter ended March 31, 2005.

(in thousands)	Recoverable Operating Expenses	Trust Expenses	Deferred Expenses	Rental Properties	Commit- ments	Total
Management fee	\$ 436	\$ -	\$ -	\$ -	\$ -	\$ 436
Maintenance	226	-	-	-	-	226
On-site personnel	63	-	-	-	-	63
Disbursements	5	2	-	-	-	7
Leasing fees	-	-	19	-	59	78
Project management fees	-	-	-	3	-	3
Office and support staff	-	15	-	-	-	15
	\$ 730	\$ 17	\$ 19	\$ 3	\$ 59	\$ 828

TechSpace Canada Inc., a subsidiary of the Property Manager, leased 29,102 square feet of office space from the REIT pursuant to a lease expiring on September 30, 2010. Effective January 1, 2004, the REIT entered into a direct lease of this space with a new tenant on the condition that the original indemnity of the Property Manager protecting the REIT from any revenue shortfall (on a cash basis) from the original lease to TechSpace would remain in full force and effect.

## PART VII

### Risk and Uncertainties

There are certain risk factors inherent in the investment and ownership of real estate. Real estate investments are capital intensive, and success from real estate investments depends upon 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 two largest metropolitan real estate markets 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 real estate ownership.

### Financing and Interest Rate Risk

The REIT is 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.

Interest rates on the REIT's mortgage debt are between 5.20% and 8.10% with a weighted average interest rate of 6.51%. The weighted average term of the REIT's mortgage debt is 6.38 years. As at March 31, 2005, the borrowings under the REIT's credit facilities were \$nil.

### Credit Risk

The REIT is subject to credit risk. Credit risk arises from the possibility that tenants may not be able to fulfill their lease obligations. The REIT will strive to mitigate this risk by maintaining a diversified tenant-mix and limiting exposure to any single tenant. As at March 31, 2005, there were 135 tenants in the REIT's portfolio.

The following sets out the REIT's tenant-mix on the basis of percentage of rental revenue for the quarter ended March 31, 2005, and the year ended December 31, 2004.

Category	% of Rental Revenue Q1 2005	% of Rental Revenue 2004
Service and professional	40	39
Retail (head office and storefront)	20	21
Telecommunications and information technology	11	16
Media and film	10	14
Financial services	10	4
Government	3	3
Other	6	3

The following sets out the percentage of rental revenue from the REIT's top-10 tenants by rental revenue for the quarter ended March 31, 2005, and the year ended December 31, 2004.

Tenant	% of Rental Revenue Q1 2005	% of Rental Revenue 2004
Desjardins	8.2	0.9
Cossette Communications	6.8	9.1
MTS Allstream	4.1	5.3
Publicis Toronto	4.0	3.1
St. Joseph Media	3.4	2.6
Algorithmics	3.3	3.2
Nelvana	2.8	1.9
Indigo Books & Music	2.6	4.3
Blast Radius	2.6	3.4
Redwood Communications	2.5	2.4

### ***Lease Roll-Over Risk***

The REIT is subject to lease roll-over risk. Lease roll-over risk arises from the possibility that the REIT may experience difficulty renewing or replacing tenants occupying space covered by leases that mature. The REIT strives to stagger its lease maturity schedule so that it is not faced with a disproportionately large level of lease maturity in a given year.

99.1% of the space in the REIT's rental properties was leased as at March 31, 2005. The following sets out the total GLA of the leases expiring during the period ended December 31, 2009, assuming tenants do not exercise renewal options, and the percentage of total GLA represented by the expiring leases.

<b>Year Ended</b>	<b>Square Feet</b>	<b>% of Total GLA</b>
December 31, 2005	83,079	5
December 31, 2006	129,971	8
December 31, 2007	198,729	12
December 31, 2008	74,710	4
December 31, 2009	220,462	13

The weighted average term to maturity of the REIT's leases is 5.75 years.

### ***Environmental Risk***

As an owner of real property, the REIT is subject to various federal, provincial and municipal laws relating to environmental matters. Such laws provide that the REIT could be liable for the costs of removal of certain hazardous substances and remediation of certain hazardous locations. The failure to remove or remediate such substances or locations, if any, could adversely affect the REIT's ability to sell such real estate or to borrow using such real estate as collateral and could potentially also result in claims against the REIT. The REIT is not aware of any material non-compliance with environmental laws at any of the properties in its portfolio. The REIT is also not aware of any pending or threatened investigations or actions by environmental regulatory authorities in connection with any of the properties in its portfolio or any pending or threatened claims relating to environmental conditions at the properties in its portfolio.

## **PART VIII**

### **Subsequent Events**

On April 18, 2005, the REIT issued 2.15 million voting units at \$14 per unit pursuant to a public offering (the "Offering"), resulting in gross proceeds of \$30.1 million. Costs relating to the Offering, including underwriters' fees, are estimated to be \$1.5 million.

On April 18, 2005, the REIT acquired 3575 Saint-Laurent Boulevard, a Class I office property in Montreal, Quebec, for \$23.35 million. The acquisition was financed initially from the proceeds of the Offering.