



ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST

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

DECEMBER 31, 2006

DATED MARCH 7, 2007

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PART I

Forward-Looking Disclaimer

The terms “Allied Properties”, “the REIT”, “we”, “us” and “our” in the following Management’s Discussion and Analysis of Results of Operations and Financial Condition (“MD&A”) refer to Allied Properties Real Estate Investment Trust and its consolidated financial position and results of operations for the year ended December 31, 2006. This MD&A should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2006, and for the year ended December 31, 2005. Historical results and percentage relationships contained in our consolidated financial statements and MD&A, including trends which might appear, should not be taken as indicative of our future results, operations or performance. Unless otherwise indicated, dollar amounts in this MD&A are in thousands.

Certain information included in this MD&A contains forward-looking statements within the meaning of applicable securities laws, including, among other things, statements concerning our objectives and our strategies to achieve those objectives, statements with respect to Management’s beliefs, plans, estimates and intentions and statements concerning anticipated future events, circumstances, expectations, results, operations or performance that are not historical facts. Forward-looking statements can be identified generally by the use of forward-looking terminology, such as “indicators”, “outlook”, “objective”, “may”, “will”, “expect”, “intend”, “estimate”, “anticipate”, “believe”, “should”, “plans”, “continue” or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect Management’s current beliefs and are based on information currently available to Management.

The forward-looking statements in this MD&A are not guarantees of future results, operations or performance and are based on estimates and assumptions that are subject to risks and uncertainties, including those described below in this MD&A under “Risks and Uncertainties”, which could cause actual results, operations or performance to differ materially from the forward-looking statements in this MD&A. Those risks and uncertainties include risks associated with property ownership, property development, geographic focus, asset-class focus, competition for real property investments, financing and interest rates, government regulations, environmental matters, construction liability, unitholder liability and taxation. Material assumptions that were made in formulating the forward-looking statements in this MD&A include the following: that the general economy remains stable; that the REIT’s current target markets remain stable; that interest rates and capitalization rates are stable; and that the equity and debt markets continue to provide access to capital. Although the forward-looking statements contained in this MD&A are based on what Management believes are reasonable assumptions, there can be no assurance that actual results, operations or performance will be consistent with these statements.

All forward-looking statements in this MD&A are qualified by this forward-looking disclaimer. These statements are made as of March 7, 2007, and, except as required by applicable law, we undertake no obligation to update publicly or revise any such statements to reflect new information or the occurrence of future events or circumstances.

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 its portfolio.

Property Portfolio

The REIT completed its Initial Public Offering (“IPO”) on February 20, 2003. The REIT used the net proceeds of the IPO to acquire a portfolio of 14 predominantly Class I office properties in downtown Toronto with 820,000 square feet of gross leasable area (“GLA”). By the end of 2005, the REIT had acquired another 20 office properties in downtown Toronto, 19 of them Class I office properties, bringing its total GLA in that market to just under two million square feet. The REIT had also acquired two Class I office properties in downtown Montreal and one in downtown Winnipeg, bringing its total portfolio at the end of 2005 to 37 properties with 2.32 million square feet of GLA.

The REIT made the following acquisitions in 2006, bringing the portfolio to 56 properties with 3.4 million square feet of GLA:

Class I Office Property	Acquired	Office GLA	Retail GLA	Total GLA	Parking Spaces
4446 Saint Laurent Boulevard, Montreal	April 5, 2006	72,613	10,000	82,613	0
364 Richmond Street West, Toronto	May 2, 2006	21,300	17,300	38,600	0
257 Adelaide Street West, Toronto	June 28, 2006	40,050	5,843	45,893	0
400 Atlantic Avenue, Montreal	July 14, 2006	86,034	0	86,034	26
390 Charest Boulevard, Quebec City	September 8, 2006	66,771	6,348	73,119	56
410 Charest Boulevard, Quebec City	September 8, 2006	0	24,937	24,937	0
430 Charest Boulevard, Quebec City	September 8, 2006	44,051	13,285	57,336	0
622 Saint Joseph Street, Quebec City	September 8, 2006	3,620	3,300	6,920	0
633 Saint Joseph Street, Quebec City	September 8, 2006	15,558	6,000	21,558	0
6290-6306 Avenue du Parc, Montreal	December 1, 2006	217,022	950	217,972	90
King-Brant Parking, Toronto*	December 1, 2006	0	0	0	208
441-443 King Street West, Toronto*	December 1, 2006	6,820	3,065	9,885	0
Phase II, The Castle, Toronto*	December 1, 2006	71,035	17,761	88,796	9
54-70 Arthur Street, Winnipeg	December 1, 2006	110,918	10,500	121,418	98
250 McDermot Avenue, Winnipeg	December 1, 2006	41,446	10,200	51,646	40
138 Portage Avenue East, Winnipeg	December 1, 2006	43,960	0	43,960	22
309 Hargrave Street, Winnipeg	December 1, 2006	21,460	1,400	22,860	52
165 Garry Street, Winnipeg	December 1, 2006	4,400	10,362	14,762	0
1500 Notre Dame Avenue, Winnipeg	December 1, 2006	111,400	0	111,400	85
Total		978,458	141,251	1,119,709	686

*offered to, and accepted by, the REIT pursuant to the Option Agreement between the REIT and Allied Canadian Development Corporation

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’s portfolio accommodates a diverse base of tenants. At the end of 2006, business-service and professional tenants represented 35% of the REIT’s gross revenue, retail tenants 18%, telecommunications and IT tenants 16%, media and entertainment tenants 14%, financial-service tenants 11%, government tenants 3% and other tenants 3%.

The REIT is a leading provider of Class I office and ancillary retail space in Canada and intends to build on this advantage by continuing to make coherent office property acquisitions in its target markets. In

doing so, the REIT will strive to enhance on an ongoing basis the quantity and quality of its net rental revenue.

Four Toronto properties—QRC South (103 Richmond Street East), 257 Adelaide Street West, 47 Fraser Avenue and 47A Fraser Avenue—and one Montreal property—the land adjacent to 4446 Saint Laurent Boulevard—are properties under development (“Properties Under Development” or “PUD”). They are undergoing the development or redevelopment necessary to function as high quality, income-producing, Class I office properties.

The REIT has an option agreement (“Option Agreement”) with Allied Canadian Development 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. Six of the properties in the REIT’s portfolio were acquired pursuant to the Option Agreement. Three of the properties acquired by the REIT in 2006 were acquired pursuant to the Option Agreement. The Developer has two remaining properties subject to the provisions of the Option Agreement. Both properties are nearing substantial completion.

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

	IPO	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006
GLA (square feet)	820,120	984,856	1,636,343	2,321,507	3,415,279
% leased	96.9	97.5	99.2	97.0*	96.3*

*not including Properties Under Development

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 its unitholders. The chart below summarizes the annualized cash distribution level and the total annual return for each fiscal year since the REIT’s IPO:

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006
Distribution level per unit annualized	\$1.10	\$1.14	\$1.18	\$1.22
Total return with reinvestment through DRIP	40.7%	17.6%	32.3%	46.8%
Total return without reinvestment	38.0%	16.2%	31.3%	44.3%

Property Management

Effective July 1, 2005, the REIT’s wholly owned subsidiary, Allied Properties Management Limited Partnership (“Property Manager”), completed the acquisition of the property management business of the Developer. In addition to providing property management and related services in connection with the REIT’s portfolio, the Property Manager provides property management and related services to third-party property owners on a fee-for-service basis.

Performance Indicators

The REIT measures the 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. In March of 2006, the REIT increased its monthly distributions by 3.4% to \$1.22 per unit on an annualized basis.

2. Distributable Income

Increasing distributions can be achieved prudently by increasing Distributable Income (“DI”), as defined in the Declaration. See “Distributable Income” below. In 2005, DI per unit (diluted) was \$1.339. In 2006, DI per unit (diluted) was \$1.414, up 5.6% from 2005.

3. DI 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 DI pay-out ratio, the ratio of actual distributions to DI in a given period. In 2005, the REIT achieved a DI pay-out ratio of 87.9%. In 2006, the REIT achieved a DI pay-out ratio of 85.3%.

4. Adjusted Funds From Operations

Increasing distributions cannot be achieved prudently without reference to adjusted funds from operations (“AFFO”), as this financial indicator takes account of regular maintenance capital expenditures and regular leasing expenditures while ignoring the impact of non-cash revenue. See “Adjusted Funds from Operations” below. In 2005, AFFO per unit (diluted) was \$1.221. In 2006, AFFO per unit (diluted) was \$1.239, up 1.5% from 2005.

5. AFFO 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 AFFO pay-out ratio, the ratio of actual distributions to AFFO in a given period. In 2005, the REIT achieved an AFFO pay-out ratio of 96.3%. In 2006, the REIT achieved an AFFO pay-out ratio of 97.3%.

6. Debt Ratio

Gross Book Value (“GBV”) is defined as the book value of the assets of the REIT shown on the most recent balance sheet plus accumulated depreciation and amortization and an amount equal to the property management internalization expense recorded by the REIT. A conservative ratio of debt to GBV (“Debt Ratio”) mitigates unitholder risk. At the end of 2005, the Debt Ratio was 51.0%. As the end of 2006, the Debt Ratio was 48.2%.

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 274,437 square feet of GLA matured in 2006. By the end of 2006, the REIT had renewed leases representing 147,348 square feet of this GLA and re-leased another 92,126 square feet of this GLA, representing 87.3% of the GLA covered by the maturing leases.

2. Occupancy

The REIT strives to maintain consistently high levels of occupancy. At the end of 2005, the REIT’s leased area was 97.0% (not including Properties Under Development). At the end of 2006, the REIT’s leased area was 96.3% (not including Properties Under Development). The year-over-year decline in occupancy stems largely from the acquisitions made by the REIT on December 1, 2006, which included 47,809 square feet of vacant space. Management regards this vacant space as an opportunity to increase rental revenue over time.

3. Same-Asset Net Operating Income

The REIT strives to maintain or increase same-asset net operating income (“NOI”) over time. See “Net Operating Income” below. 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 mark-to-market rent adjustment), same-asset NOI was \$30,290 in 2006, up 4.4% from 2005.

4. Leasing Expenditures

The REIT monitors leasing expenditures carefully. 277,583 square feet of the GLA leased in 2006 involved new leases or lease-renewals that commenced in the year. \$2,982 in leasing expenditures relate to this space, representing \$10.74 per leased square foot.

5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2006, the REIT incurred \$1,147 in regular maintenance capital expenditures, representing \$0.46 per square foot of the average size of REIT's portfolio over the course of 2006.

Summary

The following table summarizes the key financial and operating performance indicators for 2006 and 2005, as well as the change between the two.

	2006	2005	Change
Year-end distribution level per unit annualized	\$1.22	\$1.18	\$0.04
DI per unit (diluted)	\$1.414	\$1.339	\$0.075
DI pay-out ratio	85.3%	87.9%	(2.6%)
AFFO per unit (diluted)	\$1.239	\$1.221	\$0.018
AFFO pay-out ratio	97.3%	96.3%	1.0%
Debt Ratio	48.2%	51.0%	(2.8)%
Renewal/replacement % of leases maturing in year	87.3%	77.0%	10.3%
Year-end leased area (not including PUD)	96.3%	97.0%	(0.7)%
Same-asset NOI	\$30,211	\$29,016	\$1,195
Leasing expenditures	\$2,982	\$1,620	\$1,362
Leasing expenditures per leased square foot	\$10.74	\$8.43	\$2.31
Maintenance capital expenditures	\$1,147	\$1,118	\$29
Maintenance capital expenditures per portfolio square foot	\$0.46	\$0.59	(\$0.13)

Business Environment and Outlook

The REIT operates in four target markets—downtown Toronto, downtown and midtown Montreal, downtown Winnipeg and downtown Quebec City. The following is a brief description of the REIT's target markets:

1. Downtown Toronto

This target market includes 13.2 million square feet of office inventory in three sub-markets, Downtown East (2.1 million square feet), Downtown West (9.2 million square feet) and King West (1.9 million square feet). Approximately half of the office inventory in this target market falls within the Class I category. The downtown Toronto office market strengthened in 2006, with the overall vacancy rate declining to 6.1% at the end of the year and the Downtown East, Downtown West and King West sub-markets finishing the year with vacancy rates of 5.1%, 5.6% and 12.0%, respectively.¹

¹ Cushman & Wakefield LePage, *Fourth Quarter 2006 Statistical Summary, Toronto Office Market*.

2. Downtown and Midtown Montreal

This target market includes 17.7 million square feet of office inventory in three sub-markets, Downtown East (7.5 million square feet), Old Montreal (7.7 million square feet) and Mile End (2.5 million square feet). Approximately half of the office inventory in this target market falls within the Class I category. The downtown Montreal office market was stable in 2006, with the overall vacancy rate declining to 9.7% at the end of the year and the Downtown East and Old Montreal sub-markets finishing the year with vacancy rates of 5.2% and 8.8%, respectively.²

3. Downtown Winnipeg

This target market includes 1.8 million square feet of office inventory, principally in the Exchange District. Most of the office inventory in the Winnipeg target market falls within the Class I category. The Winnipeg office market was stable in 2006, with the overall vacancy rate declining to 7.1% at the end of the year.³ While Class I office space is not tracked separately in Winnipeg, Colliers International observed that “certain users will continue to be attracted to [space in the Exchange District] by its ‘brick and beam ambience’ and lower occupancy costs”.⁴

4. Downtown Quebec City

This target market includes 1.5 million square feet of office inventory in the St. Roch office node. Most of the office inventory in this target market falls within the Class I category. The Quebec City office market strengthened in 2005, with the overall vacancy rate declining to 4.0%⁵. The strengthening continued in 2006, with the overall vacancy rate declining to 3.7% by mid-year.⁶

Demand for office space in the REIT’s target markets is stable or strengthening. The state of the REIT’s target markets, the quality of the REIT’s portfolio and the capabilities of the REIT’s personnel afford Management a reasonable basis for confidence in the REIT’s near-term performance. The REIT intends to continue the acquisition of Class I and other office properties in its target markets.

² Cushman & Wakefield LePage, *Fourth Quarter 2006 Statistical Summary, Montreal Office Market*.

³ Colliers International, *Winnipeg Year End Office Report, December 2006*.

⁴ Colliers International, *Winnipeg Year End Office Report, December 2006*.

⁵ Altus Helyar, *Greater Quebec City Office Market Study, May 2006*.

⁶ Altus Helyar, *Greater Quebec City Office Market Study, May 2006*.

PART II

Summary Information and Performance for the Year ended December 31, 2006

The following sets out summary information and financial results for the year ended December 31, 2006, and the comparable year and the change between the two.

(In thousands except for per unit and % amounts)	2006	2005	Change	%Change
Revenue from rental properties	64,229	51,170	13,059	25.5%
Rental property operating cost	23,181	18,264	4,917	26.9%
Net rental income	41,048	32,906	8,142	24.7%
Real estate service income	436	162	274	169.1%
Financing expense				
Interest	13,109	10,088	3,021	29.9%
Amortization - Mortgage premium	(283)	(530)	247	(46.6%)
Depreciation and amortization				
Rental properties	7,628	6,071	1,557	25.6%
Deferred leasing cost and tenant improvements	1,253	622	631	101.4%
Origination cost and acquired tenant relationships	8,413	5,267	3,146	59.7%
Acquired contracts and customer relationships	96	48	48	100.0%
Deferred financing cost	242	216	26	12.0%
Computer and office equipment	32	16	16	100.0%
Income from operations	10,994	11,270	(276)	(2.4%)
Trust expense	2,377	2,001	376	18.8%
Property management internalization expense	900	7,877	(6,977)	(88.6%)
Net income (loss)	7,717	1,392	6,325	454.4%
Amortization				
Rental properties	7,628	6,071	1,557	25.6%
Mortgage premium	(283)	(530)	247	(46.6%)
Acquired leases	2,719	2,082	637	30.6%
M-T-M acquired leases	162	229	(67)	(29.3%)
Acquired tenant relationships	5,694	3,185	2,509	78.8%
Acquired contracts and customer relationships	96	48	48	100.0%
Step-rent adjustments	(921)	(1,381)	460	(33.3%)
Property management internalization expense	900	7,877	(6,977)	(88.6%)
LTIP compensation expense	270	109	161	147.7%
DI	23,982	19,082	4,900	25.7%
Weighted average units outstanding (basic)	16,632	14,004	2,628	18.8%
Weighted average units outstanding (diluted)	16,964	14,249	2,715	19.1%
Distributions	20,457	16,761	3,696	22.1%
DI per unit (basic)	\$1.442	\$1.363	0.079	5.8%
DI per unit (diluted)	\$1.414	\$1.339	0.075	5.6%
DI pay-out ratio	85.3%	87.9%	(2.6%)	
FFO	25,911	21,229	4,682	22.1%
FFO per unit (basic)	\$1.558	\$1.516	\$0.042	2.8%
FFO per unit (diluted)	\$1.527	\$1.490	\$0.037	2.5%
FFO pay-out ratio	79.0%	79.0%	-	
AFFO	21,024	17,398	3,626	20.8%
AFFO per unit (basic)	\$1.264	\$1.242	\$0.022	1.8%
AFFO per unit (diluted)	\$1.239	\$1.221	\$0.018	1.5%
AFFO pay-out ratio	97.3%	96.3%	0.6%	
NOI	40,289	31,754	8,535	26.9%
Same-asset net operating income	30,290	29,016	1,274	4.4%
Total assets	\$502,906	\$384,538	\$118,368	30.8%
Total debt (excludes premium on assumed debt)	\$263,464	\$210,093	\$53,371	25.4%
Debt to GBV	48.20%	51.0%	(2.8%)	
Total GLA (s.f., excluding PUD)	3,321	2,266	1,055	46.6%
Leased GLA (s.f., excluding PUD)	3,197	2,197	1,000	45.5%
Leased GLA (% total GLA)	96.3%	97.0%	(0.7%)	

Net income for the year ended December 31, 2006, was \$7,717, as compared to \$1,392 in the year ended December 31, 2005. Net income per unit (diluted) for the year was \$0.455, as compared to net income per unit (diluted) of \$0.098 in the comparable year. The net income for the year ended December 31, 2005, was affected by the expense of \$7,877 recorded in connection with the internalization of property management on July 1, 2005. The net income for the year ended December 31, 2006, was affected by the expense of \$900 recorded in connection with the internalization of property management.

DI for the year ended December 31, 2006, increased by 25.7% to \$23,982 from \$19,082 for the year ended December 31, 2005. DI per unit (diluted) for the year was \$1.414, as compared to DI per unit (diluted) of \$1.339 in the comparable year.

Net Rental Income

Net rental income for the year ended December 31, 2006, increased by 24.7% to \$41,048 from \$32,906 in the year ended December 31, 2005, as follows:

- (i) \$7,475 due to net rental income from properties not owned for the entire period and the entire comparable period;
- (ii) \$831 due to the internalization of the property management function; and
- (iii) offset by \$165 due to the decrease in same-asset net rental income from properties owned for the entire period and the entire comparable period (which includes the period-over-period decrease in step-rent adjustments).

Of the \$41,048 of net rental income for the year, \$752 of operating cost recoveries is in dispute with a tenant. Based on the advice of legal counsel, Management is of the view that there is no merit to the tenant's position and is diligently pursuing the matter.

Net rental income per occupied square foot for the year ended December 31, 2006, was \$16.37, as compared to \$17.72 in the year ended December 31, 2005. The year-over-year decline is reflective of the fact that the REIT acquired more property in target markets with lower net rental rates than its Toronto target market.

Real Estate Service Income

The Property Manager provides real estate services to third-party property owners. Real estate service income for the year ended December 31, 2006, was \$436, as compared to \$162 in the year ended December 31, 2005. As the Property Manager commenced providing real estate services to third-party property owners on July 1, 2005, the real estate service income for the year ended December 31, 2005, covered a six-month period only.

Property Management Internalization

The economic benefit of the property management internalization for the year ended December 31, 2006, is summarized in the following table:

(In thousands)	2006
Increase in net rental income	\$1,538
Real estate service income	436
Net reduction in leasing expenditures payable as leasing fees	218
Net reduction in capital expenditures payable as project management fees	264
Total	\$2,456

This exceeded Management's expectations for the year and materially exceeded the threshold established for the final payment by the REIT of \$900 in connection with the internalization of property management.

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 \$283 in the year ended December 31, 2006.

Financing expense for the year ended December 31, 2006, increased by 34.2% to \$12,826 from \$9,558 in the year ended December 31, 2005, due to the increase in financing expense associated with additional properties acquired in 2005 and 2006.

Depreciation and Amortization

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the year ended December 31, 2006, increased by 25.6% to \$7,628 from \$6,071 in the year ended December 31, 2005.

The REIT records amortization of deferred leasing cost, tenant improvements and the assigned fair value of the origination cost 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 Expense

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 year ended December 31, 2006, increased by 18.8% to \$2,377 from \$2,001 in the year ended December 31, 2005, due to increased salary, bonus and occupancy costs and increased LTIP expense under the REIT's long-term incentive plan ("LTIP").

Leasing Activity

Leasing activity as at December 31, 2006, is summarized in the following table:

	Vacant or Maturing	Leased End of Year	% Leased End of Year	Vacant End of Year*
Vacant GLA on January 1, 2006*	68,666	47,303	68.9%	21,363
Vacant GLA on acquisition in 2006*	60,041	10,194	17.0%	49,847
GLA accessed through rationalization	37,969	19,706	51.9%	18,263
GLA that matured in 2006	274,437	239,474	87.3%	34,963
Total	441,113	316,677	71.8%	124,436

*not including Properties Under Development

68,666 square feet of GLA were vacant at the beginning of 2006. By year-end, the REIT had leased 47,303 square feet of this originally vacant GLA, leaving 21,363 square feet vacant.

In 2006, the REIT acquired properties with 60,041 square feet of vacant GLA, not including Properties Under Development, of which 10,194 square feet was leased by year-end.

In 2006, the REIT gained access to 19,706 square feet of GLA in the Balfour Building in Montreal, which it reconfigured and retrofitted to accommodate a high-value new tenancy for occupancy on September 1, 2006. The REIT also gained access late in the year to 18,263 square feet of GLA formerly used as a nightclub at 358-360 Adelaide Street West. The REIT is reconfiguring and retrofitting this space for office use, which Management expects to be more profitable going forward.

Leases for 274,437 square feet of GLA matured in 2006. By year-end, the REIT had renewed or replaced leases representing 239,474 square feet of the GLA that matured in the year, leaving 34,963 square feet vacant.

With respect to the maturing leases renewed or replaced in 2006 (239,474 square feet of GLA), the REIT achieved rental rates

- (i) above in-place rental rates with respect to 67% of this GLA and
- (ii) equal to in-place rental rates with respect to the balance of this GLA.

Capital Expenditures

The REIT's portfolio requires ongoing maintenance capital expenditures and leasing expenditures. Leasing expenditures include the cost of 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, as well as improvement allowances 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 year ended December 31, 2006, the REIT incurred or committed to (i) \$1,147 in regular maintenance capital expenditures (\$0.46 per portfolio square foot) and (ii) \$2,982 in leasing expenditures (\$10.47 per leased square foot) in connection with new leases or lease-renewals that commenced in the year. In addition, the REIT incurred (i) \$1,452 in capital expenditures in connection with a comprehensive cladding restoration program at 425 Viger Avenue West in Montreal, the need for which was recognized at the time of acquisition and the cost of which was partially reflected in a reduction to the purchase price, and (ii) \$2,602 in revenue-enhancing capital and leasing expenditures in connection space that was significantly reconfigured and retrofitted to accommodate high-value new tenancies.

\$365 of the salary expense incurred by the REIT in the year ended December 31, 2006, was capitalized in connection with capital improvements to the REIT's rental properties and Properties Under Development. This amount was equivalent to approximately 5% of the associated construction costs.

Properties Under Development

Management believes that the Properties Under Development represent risk-appropriate opportunities to enhance DI per unit and create value for unitholders. Management also believes that the Properties Under Development represent an opportunity to capitalize more fully on the experience and expertise of the REIT's personnel.

The REIT acquired 145 Berkeley Street, Toronto, in November of 2005 at a cost of approximately \$125 per square foot. At that time, 80% of the GLA in the property was vacant. The REIT has since leased all the vacant space in the property. From October 1, 2006, onward, the property ceased to be treated as a Property Under Development and was treated as a rental property for accounting purposes.

The REIT acquired QRC South in November of 2005 at a cost of approximately \$95 per square foot. The property is a brick-and-beam structure that extends south from Richmond Street East through to Lombard Street and has entrances from both streets connected along the north-south axis by an open corridor. The REIT has repositioned the property as an annex to The Queen Richmond Centre, a Class I office complex acquired by the REIT in 2004 and known as QRC. (QRC is a brick-and-beam complex that extends south from Queen Street East through to Richmond Street East and has entrances from both streets connected along the north-south axis by an open corridor.) The construction phase of the repositioning at QRC South is complete, and the re-leasing phase is well underway.

The REIT acquired 257 Adelaide Street West, Toronto, in June of 2006 at a cost of approximately \$127 per square foot. At that time, less than 60% of the GLA in the property was occupied. The construction phase of the upgrade of the property is largely complete, and the re-leasing phase has commenced.

The REIT acquired approximately 5,500 square feet of land adjacent to 4446 Saint Laurent Boulevard, Montreal, in April of 2006 at a cost of \$118 per square foot. The REIT has evaluated the potential development of a 22,000 square foot building on the land to accommodate office and ancillary retail users and concluded that it is feasible. The REIT is now working toward securing an anchor tenant for the development.

The REIT acquired 47 and 47A Fraser Avenue, Toronto (two satellite buildings at The Castle in Liberty Village) at a cost of approximately \$145 per square foot. The upgrade of the two properties will be performed in conjunction with, and customized to, the re-leasing effort, which is underway.

Properties Under Development are stated at the lower of cost and net recoverable value. Cost includes the cost of acquisition, other direct cost, realty tax, other operating expense and applicable financing expense during the development period, less the amount of operating revenue during the development period. The principal factors in determining when the redevelopment-period ends are (i) the achievement of positive cash flow after applicable interest expense and (ii) the passage of a predetermined period of time. Other criteria may be considered in determining when a redevelopment-period ends if warranted by circumstances relating to the relevant Property Under Development.

As at December 31, 2006, the cost of the REIT's Properties Under Development was \$17,074, which was equivalent to 3.1% of the REIT's GBV.

Distributable Income

The REIT defines 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) non-cash compensation expense with respect to the LTIP;
- (v) amortization of values ascribed in a building acquisition to in-place leases and tenant relationships;
- (vi) amortization of values ascribed in a building acquisition to above-market and below-market leases;
- (vii) amortization of values ascribed in the property management internalization to acquired contracts and customer relationships; and
- (viii) property management internalization expense.

DI is a non-GAAP financial measure used by some Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. DI does not have any standardized meaning prescribed by GAAP. As computed by the REIT, DI may differ from similar computations reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers DI to be a useful measure of cash available for distributions. The following reconciles cash flow from operations, as presented in the consolidated financial statements, to DI.

(In thousands)	2006	2005
Cash flow from operations	\$26,088	\$ 7,859
Amortization of deferred leasing cost, tenant improvements and financing cost	(1,495)	(838)
Amortization of computer and office equipment	(32)	(16)
Amortization, tenant inducements	(26)	-
Change in non-cash operating items	(1,453)	4,200
Property management internalization expense	900	7,877
DI	\$23,982	\$19,082

Distributions for the year ended December 31, 2006, were \$20,457, representing a DI pay-out ratio of 85.3%, as compared to distributions for the year ended December 31, 2005, of \$16,761, representing a DI pay-out ratio of 87.9%.

Funds From Operations

Funds From Operations (“FFO”) is a non-GAAP financial measure used by most Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. While FFO does not have any standardized meaning prescribed by GAAP, the Real Property Association of Canada (“REALpac”) established a standardized definition of FFO in its White Paper on Funds From Operations dated November 30, 2004. Essentially, the REALpac definition is net income with most non-cash expenses added back. Management believes that this definition is followed by most Canadian real estate investment trusts and that it is a useful measure of cash available for distributions. The following reconciles net income, as presented in the consolidated financial statements, with FFO, as calculated in accordance with recommendations of the REALpac definition.

(In thousands)	2006	2005
Net income	\$7,717	\$1,392
Amortization on rental properties	7,628	6,071
Amortization of deferred leasing cost and tenant improvements	1,253	622
Amortization of origination cost and acquired tenant relationships	8,413	5,267
Property management internalization expense	900	7,877
FFO	\$25,911	\$21,229

Distributions for the year ended December 31, 2006, represented an FFO pay-out ratio of 79.0%, as compared to distributions for the year ended December 31, 2005, which represented an FFO pay-out ratio of 79.0%.

Adjusted Funds From Operations

AFFO is a non-GAAP financial measure used by most Canadian real estate investment trusts as an indicator of financial performance and should not be considered as an alternative to net income, cash flow from operations or any other measure prescribed under GAAP. AFFO does not have any standardized meaning prescribed by GAAP. As computed by the REIT, AFFO may differ from similar computations reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers AFFO to be a useful measure of cash available for distributions. The principal advantage of AFFO is that it starts from the standardized definition of FFO and takes account of maintenance capital expenditures and regular leasing expenditures while ignoring the impact of non-cash revenue. Because maintenance capital expenditures and regular leasing expenditures are not incurred evenly throughout a fiscal year, there can be volatility in AFFO on a quarterly basis. The following reconciles net income, as presented in the consolidated financial statements, with AFFO, calculated in accordance with what Management believes to be industry practice.

(In thousands)	2006	2005
FFO	\$25,911	\$21,229
Step-rent adjustments	(920)	(1,381)
M-T-M acquired leases	162	288
Leasing expenditures	(2,982)	(1,620)
Maintenance capital expenditures	(1,147)	(1,118)
AFFO	21,024	17,398

Distributions for the year ended December 31, 2006, represented an AFFO pay-out ratio of 97.3%, as compared to distributions for the year ended December 31, 2005, which represented an AFFO pay-out ratio of 96.3%.

Net Operating Income

NOI 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. NOI does not have any standardized meaning prescribed by GAAP. As computed by the REIT, NOI may differ from similar computations

reported by other Canadian real estate investment trusts and, accordingly, may not be comparable to similar computations reported by such organizations. Management of the REIT considers NOI to be a useful measure of performance for rental properties. The following reconciles net rental income, as presented in the consolidated financial statements, to NOI.

(In thousands)	2006	2005
Revenue from rental properties	\$64,229	\$51,170
Rental property operating cost	23,181	18,264
Net rental income	41,048	32,906
M-T-M acquired leases	162	229
Step-rent adjustments	(920)	(1,381)
NOI	\$40,290	\$31,754

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 two Canadian chartered banks and (iii) equity. As at December 31, 2006, the REIT had mortgage debt of \$264,286 and unitholders' equity of \$215,704.

Unitholders' Equity

As at December 31, 2005, the REIT had a market capitalization of approximately \$271,521 based on a closing unit price of \$16.95 on the Toronto Stock Exchange. As at December 31, 2006, the REIT had a market capitalization of approximately \$468,029 based on a closing unit price of \$23.25 on the Toronto Stock Exchange.

In the year ended December 31, 2006, the REIT issued a total of 4,111,380 units for equity contributions of \$74,416. Costs incurred to issue the units were \$3,497. Units were issued as follows:

- (i) 26,000 units at \$10.00 per unit for \$260 to certain officers and trustees who exercised options under the REIT's Unit Option Plan;
- (ii) 137,069 units at \$17.21 for \$2,359 to certain officers and trustees under the LTIP;
- (iii) 1.9 million units at \$17.00 per unit for \$32,300 pursuant to a bought deal that closed on September 5, 2006;
- (iv) 2 million units at \$20.50 per unit for \$41,000 pursuant to a bought deal that closed on December 1, 2006; and
- (v) 48,311 units under its distribution re-investment plan at an average price of \$17.73 per unit for \$856.

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, 2005 and the year ended December 31, 2006, the trustees and officers of the REIT exercised 289,500 options in accordance with their terms. As at December 31, 2006, 55,500 options were outstanding, all of which had vested.

In May of 2004, the REIT adopted the LTIP whereby trustees and officers of the REIT ("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 ("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 Loan. The maximum number of units authorized for issuance under the LTIP is equal to 5% of the issued and outstanding units from time to time.

Mortgages Payable

Mortgages payable as at December 31, 2006, consisted of mortgage debt of \$263,461 and premium on mortgages assumed (net of accumulated amortization) of \$825

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	Balance Due at Maturity	Total Principal	% of Total Principal	Weighted Average Interest Rate of Maturing Mortgages
2007	\$ 6,979	\$19,433	\$ 26,412	10.0%	6.44%
2008	6,810	6,437	13,247	5.0%	6.50%
2009	6,698	14,022	20,720	7.9%	6.40%
2010	6,772	4,478	11,250	4.3%	5.35%
2011	6,938	8,496	15,434	5.8%	6.57%
Thereafter	26,476	149,922	176,398	67.0%	5.70%
Total	\$ 60,673	\$ 202,788	\$ 263,461		

Interest rates on the mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 5.9%. The weighted average term of the mortgage debt is 7.2 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 as needed. 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 a \$25,000 revolving credit facility with a Canadian chartered bank bearing interest at bank prime plus 1.0% and maturing on May 31, 2007, as well as a \$5,000 revolving credit facility with another Canadian chartered bank bearing interest at bank prime plus 1.0% and maturing on May 31, 2007. Each credit facility is secured by a combination of mortgage charges and security agreements on certain of the REIT's rental properties. In the year ended December 31, 2006, the average borrowings under the credit facilities were \$8,331. As at December 31, 2006, 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 expense and distributions to unitholders. The Declaration requires the REIT 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 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 expenditures using cash flow from operations retained by the REIT and through available borrowing capacity under the credit facilities.

The credit facilities, new mortgage financing and the access to the public equity markets will provide the necessary capital the REIT requires for acquisitions. The REIT's acquisition capacity, meaning its ability to use un-utilized borrowing capacity while not exceeding the 60% Debt Ratio, is \$160,000.

As at December 31, 2006, the REIT had future commitments as set out below.

(In thousands)	December 31, 2006
Leasing commissions	\$ 139
Tenant improvements	453
Building renovations and maintenance capital expenditures	356
Revenue-enhancing leasing expenditure	1,232
Properties Under Development	166
Expenses	199
Total	\$2,545

PART IV

Summary Information and Performance for the Quarter ended December 31, 2006

The following sets out summary information and financial results for the quarter ended December 31, 2006, and the comparable quarter in 2005 and the change between the two.

(In thousands except for per unit and % amounts)	Q4 2006	Q4 2005	Change	%Change
Revenue from rental properties	17,871	14,291	3,580	25.1%
Rental property operating cost	6,775	5,145	1,630	31.7%
Net rental income	11,096	9,146	1,950	21.3%
Real estate service income	113	78	35	44.9%
Financing expense				
Interest	3,493	2,893	600	20.7%
Amortization - Mortgage premium	(98)	(182)	84	(46.2%)
Depreciation and amortization				
Rental properties	2,107	1,692	415	24.5%
Deferred leasing cost and tenant improvements	390	184	206	112.0%
Origination cost and acquired tenant relationships	2,675	1,943	732	37.7%
Acquired contracts and customer relationships	24	24	-	0.0%
Deferred financing cost	60	66	(6)	(9.1%)
Computer and office equipment	8	10	(2)	(20.0%)
Income from operations	2,550	2,594	(44)	(1.7%)
Trust expense	597	631	(34)	(5.4%)
Property management internalization expense	900	-	900	
Net income (loss)	1,053	1,963	(910)	(46.4%)
Amortization				
Rental properties	2,107	1,692	415	24.5%
Mortgage premium	(98)	(182)	84	(46.2%)
Acquired leases	770	633	137	21.6%
M-T-M acquired leases	67	181	(114)	(63.0%)
Acquired tenant relationships	1,904	1,311	593	45.2%
Acquired contracts and customer relationships	24	24	-	0.0%
Step-rent adjustments	(165)	(339)	174	(51.3%)
Property management internalization expense	900	-	900	
LTIP compensation expense	-	-	-	-
DI	6,562	5,283	1,279	24.2%
Weighted average units outstanding (basic)	18,445	15,350	3,095	20.2%
Weighted average units outstanding (diluted)	18,824	15,606	3,218	20.6%
Distributions	5,696	4,578	1,118	24.4%
DI per unit (basic)	\$0.356	\$0.344	0.012	3.4%
DI per unit (diluted)	\$0.349	\$0.339	0.010	3.0%
DI pay-out ratio	86.8%	86.7%	0.1%	
FFO	7,125	5,782	1,343	23.2%
FFO per unit (basic)	\$0.386	\$0.377	\$0.009	2.6%
FFO per unit (diluted)	\$0.379	\$0.370	\$0.009	2.2%
FFO pay-out ratio	79.9%	79.2%	0.7%	
AFFO	5,928	5,124	804	15.7%
AFFO per unit (basic)	\$0.321	\$0.334	(\$0.013)	(3.9%)
AFFO per unit (diluted)	\$0.315	\$0.328	(\$0.013)	(4.0%)
AFFO pay-out ratio	96.1%	89.4%	6.7%	
NOI	10,998	8,988	2,010	22.4%
Same-asset net operating income	8,439	8,252	187	2.3%
Total assets	\$502,906	\$384,538	\$118,368	30.8%
Total debt (excludes premium on assumed debt)	\$263,464	\$210,093	\$53,371	25.4%
Debt Ratio	48.20%	51.0%	(2.8%)	
Total GLA (s.f., excluding PUD)	3,321	2,266	1,055	46.6%
Leased GLA (s.f., excluding PUD)	3,197	2,197	1,000	45.5%
Leased GLA (% total GLA)	96.3%	97.0%	(0.7%)	

Net income for the quarter ended December 31, 2006, was \$1,053, as compared to net income \$1,963 in the quarter ended December 31, 2005. The net income for the quarter ended December 31, 2006, was affected by the expense of \$900 recorded in connection with the internalization of property management. Net income per unit (diluted) for the quarter was \$0.056, as compared to net income per unit (diluted) of \$0.128 in the comparable quarter.

DI for the quarter ended December 31, 2006, increased by 24.2% to \$6,562 from \$5,283 for the quarter ended December 31, 2005. DI per unit (diluted) for the quarter was \$0.349, as compared to DI per unit (diluted) of \$0.339 in the comparable quarter.

Net Rental Income

Net rental income for the quarter ended December 31, 2006, increased by 21.3% to \$11,096 from \$9,146 in the quarter ended December 31, 2005, as follows:

- (i) \$1,981 due to net rental income from properties not owned for the entire quarter and the entire comparable quarter;
- (ii) \$85 due to the internalization of the property management function; and
- (iii) offset by \$116 due to the decrease in same-asset net rental income from properties owned for the entire quarter and the entire comparable quarter (which includes the quarter-over-quarter decrease in step-rent adjustments).

Net rental income per occupied square foot for the quarter ended December 31, 2006, was \$4.11 (\$16.44 annualized), as compared to \$4.50 (\$18.00 annualized) in the quarter ended December 31, 2005. The quarter-over-quarter decline is reflective of the fact that the REIT acquired more property in target markets with lower net rental rates than its Toronto target market.

Real Estate Service Income

The Property Manager provides real estate services to third-party property owners. Real estate service income for the quarter ended December 31, 2006, was \$113, as compared to \$78 in the quarter ended December 31, 2005.

Property Management Internalization

The economic benefit of the property management internalization for the quarter ended December 31, 2006, is summarized in the following table:

(In thousands)	Q4 2006
Increase in net rental income	\$272
Real estate service income	113
Reduction in leasing expenditures payable as leasing fees	10
Reduction in capital expenditures payable as project management fees	127
Total	\$522

This exceeded Management's expectations for the quarter.

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 \$98 in the quarter ended December 31, 2006.

Financing expense for the quarter ended December 31, 2006, increased by 25.2% to \$3,395 from \$2,711 in the quarter ended December 31, 2005, due to the increase in financing expense associated with additional properties acquired in 2005 and 2006.

Depreciation and Amortization

The REIT records depreciation on its buildings on a straight-line basis over their expected life. Depreciation recorded on buildings for the quarter ended December 31, 2006, increased by 24.5% to \$2,107 from \$1,692 in the quarter ended December 31, 2005.

The REIT records amortization of deferred leasing cost, tenant improvements and the assigned fair value of the origination cost 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 Expense

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 December 31, 2006, decreased by 5.4% to \$597 from \$631 in the quarter ended December 31, 2005.

PART V

Summary Quarterly Information and Performance

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

(In thousands except for per unit and % amounts)	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Revenue from rental properties	17,871	15,948	15,467	\$14,943	\$14,291	\$12,822	\$12,260	\$11,797
Rental property operating cost	6,775	5,478	5,385	5,543	5,145	4,442	4,480	4,197
Net rental income	11,096	10,470	10,082	9,400	9,146	8,380	7,780	7,600
Real estate service income	113	110	103	110	78	84	-	-
Financing expense	3,395	3,262	3,188	2,981	2,711	2,360	2,218	2,269
Depreciation and amortization	5,264	4,366	4,047	3,987	3,919	3,075	2,910	2,336
Income from operations	2,550	2,952	2,950	2,542	2,594	3,029	2,652	2,995
Trust expense	597	495	767	518	631	404	469	497
PM internalization expense	900	-	-	-	-	7,877	-	-
Net income (loss)	1,053	2,457	2,183	2,024	1,963	(5,252)	2,183	2,498
Amortization								
Rental properties	2,107	1,908	1,837	1,776	1,692	1,549	1,461	1,369
Mortgage premium	(98)	(89)	(54)	(42)	(182)	(145)	(99)	(104)
Acquired leases	770	678	635	636	633	535	501	413
M-T-M acquired leases	67	(61)	68	88	181	-	24	24
Acquired tenant relationships	1,904	1,355	1,191	1,244	1,311	720	761	393
Acquired contracts and customer relationships	24	24	24	24	24	24	-	-
Step-rent adjustments	(165)	(192)	(209)	(355)	(339)	(287)	(350)	(405)
Property management internalization expense	900	-	-	-	-	7,877	-	-
LTIP compensation expense	-	-	270	-	-	-	-	109
DI	6,562	6,080	5,945	5,395	\$5,283	\$5,021	\$4,481	\$4,297
Weighted average units (basic)	18,445	16,397	15,848	15,809	15,350	14,471	14,036	12,118
Weighted average units (diluted)	18,824	16,772	16,166	16,064	15,606	14,727	14,289	12,329
Distributions	5,696	5,102	4,891	4,768	4,578	4,317	4,295	3,557
DI per unit (basic)	\$0.356	\$0.371	\$0.375	\$0.341	\$0.344	\$0.347	\$0.319	\$0.355
DI per unit (diluted)	\$0.349	\$0.363	\$0.368	\$0.336	\$0.339	\$0.341	\$0.314	\$0.348
DI pay-out ratio	86.8%	83.9%	82.3%	88.4%	86.7%	86.0%	95.8%	82.8%
FFO	7,125	6,734	6,139	5,913	5,782	5,616	5,045	4,786
FFO per unit (basic)	\$0.386	\$0.411	\$0.387	\$0.374	\$0.377	\$0.388	\$0.359	\$0.395
FFO per unit (diluted)	\$0.379	\$0.402	\$0.380	\$0.368	\$0.370	\$0.381	\$0.353	\$0.388
NOI	10,998	10,217	9,941	9,133	8,988	8,093	7,454	7,219
Net income (loss) per unit (basic)	\$0.057	\$0.147	\$0.138	\$0.128	\$0.128	\$(0.363)	\$0.156	\$0.206
Net income (loss) per unit (diluted)	\$0.056	\$0.144	\$0.135	\$0.126	\$0.126	\$(0.363)	\$0.153	\$0.203
Total assets	\$502,906	\$443,945	\$405,827	\$384,963	\$384,538	\$321,659	\$309,822	\$284,741
Total debt	\$263,464	\$241,765	\$224,498	\$212,226	\$210,093	\$163,182	\$144,596	\$147,418
Debt Ratio	48.20%	50.2%	53.2%	51.2%	51.0%	47.7%	44.8%	50.0%
Total GLA (s.f., excluding PUD)	3,321	2,657	2,387	2,266	2,266	1,985	1,925	1,703
Leased GLA (s.f., excluding PUD)	3,197	2,599	2,346	2,202	2,197	1,933	1,885	1,687
Leased Area (%GLA)	96.3%	97.8%	98.3%	97.2%	97.0%	97.4%	97.3%	99.1%

PART VI

Critical Accounting Estimates

The significant accounting policies used in preparing the REIT's consolidated 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 VII

Related Party Transactions

At the time of its IPO, the REIT entered into an agreement (“Property Management Agreement”) with the Developer, a company owned in part and controlled by the President and CEO of the REIT and owned in part by the Executive Vice President of the REIT. Pursuant to the Property Management Agreement, the Developer provided property management and related services to the REIT. Effective July 1, 2005, the Property Manager, a wholly-owned subsidiary of the REIT, acquired the Developer’s property management business. Immediately prior to July 1, 2005, the Developer ceased to provide services to the REIT under the Property Management Agreement. Accordingly, the REIT made no payments to the Developer for property management and related services in the year ended December 31, 2006, as compared to payments of \$1,741 in the year ended December 31, 2005.

At the time of the REIT’s IPO, a subsidiary of the Developer leased 29,102 square feet of office space from the REIT pursuant to a lease expiring on September 30, 2010. Effective July 1, 2005, the REIT entered into a direct lease of this space with Loblaws Properties Limited for a term ending October 31, 2010, on the condition that the original indemnity of the Developer protecting the REIT from any revenue shortfall (on a cash basis) from the original lease remain in full force and effect.

PART VIII

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 four metropolitan real estate markets in Canada. This focus enables management to capitalize on certain economies of scale and competitive advantages that would not otherwise be available.

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 4.94% and 8.10% with a weighted average interest rate of 5.9%. The weighted average term of the REIT's mortgage debt is 7.2 years. As at December 31, 2006, 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.

The following sets out the REIT's tenant-mix on the basis of percentage of rental revenue for the year ended December 31, 2006, and the year ended December 31, 2005.

Category	% of Rental Revenue 2006	% of Rental Revenue 2005
Business service and professional	35	34
Retail (head office and storefront)	18	20
Telecommunications and information technology	16	15
Media and entertainment	14	13
Financial services	11	12
Government	3	2
Other	3	4

The following sets out the percentage of rental revenue from the REIT's top-10 tenants by rental revenue for the year ended December 31, 2006, as well as the percentage of rental revenue from those tenants for the year ended December 31, 2005.

Tenant	% of Rental Revenue 2006	% of Rental Revenue 2005
Desjardins	7.0	7.9
Cossette Communications	4.9	6.0
Publicis Toronto	3.0	3.2
MTS Allstream	2.9	4.3
St. Joseph Media	2.5	3.2
Algorithmics	2.2	2.7
Indigo Books & Music	1.9	2.4
Nelvana	1.9	2.3
Blast Radius	1.9	2.3
Bensimon Byrne	1.8	1.7

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.

96.3% of the GLA in the REIT's portfolio was leased as at December 31, 2006 (not including Properties Under Development). The following sets out the total GLA of the leases that mature during the period from January 1, 2007, to December 31, 2011, assuming tenants do not exercise renewal options, and the percentage of total GLA represented by the maturing leases.

Year Ended	Square Feet	% of Total GLA
December 31, 2007	504,240	14.1%
December 31, 2008	399,201	11.2%
December 31, 2009	543,686	15.3%
December 31, 2010	375,670	10.5%
December 31, 2011	381,277	10.7%

Leases representing 106,474 square feet of the GLA that matures in 2007 and 51,764 square feet of the GLA that matures in 2009 were renewed or replaced by December 31, 2006. The weighted average term to maturity of the REIT's leases is 4.3 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.

Development Risk

As an owner of Properties Under Development, the REIT is subject to development risks, such as construction delays, cost over-runs and the failure of tenants to take occupancy and pay rent in accordance with lease arrangements. In connection with all Properties Under Development, the REIT incurs development costs prior to (and in anticipation of) achieving a stabilized level of rental revenue. In the case of the development of ancillary land, these risks are managed by not commencing construction until a satisfactory level of pre-leasing is achieved. Overall, these risks are managed by ensuring that Properties Under Development do not represent a large component of the REIT's GBV. As at December 31, 2006, the cost of Properties Under Development was equivalent to 3.1% of the REIT's GBV.

Taxation Risk

On October 31, 2006, the Minister of Finance (Canada) announced proposed changes to the taxation of income trusts. On December 21, 2006, the Ministry introduced the related draft legislation, under which qualifying REITs are excluded from the proposed changes, provided they meet a series of conditions relating to the nature of their income and investments. Consistent with normal Canadian REIT practice, the REIT (i) uses wholly owned subsidiaries to hold title to its real properties and to provide management services and (ii) owns certain assets for which the capital cost allowance rate exceeds 5%, such as computers, office furniture, paving and signage. As a result, the REIT does not appear to be a qualifying REIT under the draft legislation. While the REIT may be able to restructure its operations and assets to become a qualifying REIT under the draft legislation, there can be no assurance in this regard. While Management does not believe this was the intended outcome of the draft legislation, there can be no assurance that the draft legislation will be amended to accommodate normal Canadian REIT practice.

PART IX

Subsequent Events

On January 12, 2007, the REIT completed the acquisition of 193 Yonge Street, a 49,284 square-foot Class I office property located in downtown Toronto, for a purchase price of \$10.25 million.

On February 8, 2007, the REIT completed the acquisition of 451-481 Saint Catherine Street West, a 30,439 square-foot restored office/retail property in downtown Montreal, for a purchase price of \$6 million.

On February 28, 2007, the REIT announced the acquisition of 106 Front Street East, a 34,497 square-foot Class I office property in downtown Toronto with 16 surface parking spaces, for a purchase price of \$8 million. The acquisition is scheduled to close on or about April 2, 2007.

PART X

Disclosure Controls and Procedures

As at December 31, 2006, the Chief Executive Officer, the Chief Financial Officer and other members of Management evaluated the effectiveness of the REIT's disclosure controls and procedures, as defined in Multilateral Instrument 52-109. They have concluded that these controls and procedures were adequate and effective to provide reasonable assurance that material information regarding the REIT was accumulated and communicated to them, as appropriate to allow timely decisions to be made by them regarding required disclosure.

As at December 31, 2006, the Chief Executive Officer, the Chief Financial Officer and other members of Management evaluated the design of the REIT's internal controls over financial reporting. These controls were designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. The Chief Executive Officer, the Chief Financial Officer and other members of Management have concluded that the design of these internal controls were adequate and effective to provide reasonable assurance that financial information is recorded, processed, summarized and reported in a timely manner. There were no significant changes made to internal controls in 2006.

PART XI

Property Table

The following lists and briefly describes the properties owned by the REIT as at December 31, 2006:

December 31, 2006 Properties	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Leased	Leased %
<i>The Castle</i>	100,300	34,323	134,623		4,087	-	130,536	97.0%
<i>905 King W</i>	103,054	9,832	112,886			600	112,286	99.5%
King West	203,354	44,155	247,509	7.19%	4,087	600	242,822	98.1%
<i>468 King W</i>	65,039	-	65,039		-	-	65,039	100.0%
<i>425-439 King W</i>	74,053	25,134	99,187		-	-	99,187	100.0%
<i>441-443 King West</i>	6,820	3,065	9,885		-	-	9,885	100.0%
<i>445-455 King W</i>	27,565	23,048	50,613		-	-	50,613	100.0%
<i>469 King W</i>	62,594	11,250	73,844		-	-	73,844	100.0%
<i>King-Brant Parking</i>	-	-	-		-	-	-	
<i>500-522 King W</i>	94,945	27,705	122,650		-	-	122,650	100.0%
<i>602-606 King W</i>	37,299	23,113	60,412		-	-	60,412	100.0%
<i>420 Wellington W</i>	33,813	3,137	36,950		-	-	36,950	100.0%
<i>425 Adelaide W</i>	74,008	4,104	78,112		11,918	-	66,194	84.7%
<i>579 Richmond W (+ Land)</i>	29,311	-	29,311		-	-	29,311	100.0%
<i>141 Bathurst (+ Land)</i>	10,521	-	10,521		-	-	10,521	100.0%
<i>662 King West</i>	29,691	2,126	31,817		2,840	-	28,977	91.1%
King West Central	545,659	122,682	668,341	19.42%	14,758	-	653,583	97.8%
<i>116 Simcoe</i>	13,819	-	13,819		-	-	13,819	100.0%
<i>200 Adelaide W</i>	28,024	-	28,024		-	-	28,024	100.0%
<i>208-210 Adelaide W</i>	12,330	-	12,330		-	-	12,330	100.0%
<i>312 Adelaide W</i>	63,904	7,891	71,795		-	-	71,795	100.0%
<i>331-333 Adelaide W</i>	20,951	3,209	24,160		-	-	24,160	100.0%
<i>358-360 Adelaide W</i>	35,986	18,263	54,249		8,983	18,263	27,003	49.8%
<i>134 Peter</i>	29,218	19,804	49,022		-	-	49,022	100.0%
<i>82 Peter</i>	38,623	8,287	46,910		-	-	46,910	100.0%
<i>364 Richmond W</i>	21,300	17,300	38,600		-	-	38,600	100.0%
<i>388 King W</i>	32,529	11,765	44,294		-	-	44,294	100.0%
<i>99 Spadina</i>	39,267	12,613	51,880		-	-	51,880	100.0%
<i>185 Spadina</i>	55,814	-	55,814		-	-	55,814	100.0%
<i>217-225 Richmond W</i>	34,877	21,684	56,561		-	-	56,561	100.0%
Entertainment District	426,642	120,816	547,458	15.91%	8,983	18,263	520,212	95.0%
<i>67 Richmond W</i>	44,870	5,794	50,664		2,339	-	48,325	95.4%
Downtown	44,870	5,794	50,664	1.47%	2,339	-	48,325	95.4%
<i>35-39 Front E</i>	30,811	16,606	47,417		-	-	47,417	100.0%
<i>41-45 Front E</i>	19,799	13,735	33,534		-	-	33,534	100.0%
<i>50 Wellington E</i>	21,144	11,049	32,193		3,283	-	28,910	89.8%
St. Lawrence Market	71,754	41,390	113,144	3.29%	3,283	-	109,861	97.1%
<i>Queen Richmond Centre</i>	175,081	48,818	223,899		-	-	223,899	100.0%
<i>230 Richmond E</i>	62,514	-	62,514		-	-	62,514	100.0%
<i>145 Berkeley</i>	10,625	-	10,625		2,050	-	8,575	80.7%
<i>489 Queen E</i>	32,592	-	32,592		-	-	32,592	100.0%
Queen Richmond	280,812	48,818	329,630	9.58%	2,050	-	327,580	99.4%
<i>QRC South</i>	44,600	-	44,600		20,747	-	23,853	53.5%
<i>257 Adelaide W</i>	40,050	5,843	45,893		12,890	5,843	27,160	59.2%
<i>47 Fraser</i>	11,626	-	11,626		11,626	-	-	0.0%
<i>47A Fraser</i>	18,111	-	18,111		18,111	-	-	0.0%
PUD	114,387	5,843	120,230	3.49%	63,374	5,843	51,013	42.4%
Toronto Including PUD	1,687,478	389,498	2,076,976	60.36%	98,874	24,706	1,953,396	94.1%
Toronto Excluding PUD	1,573,091	383,655	1,956,746	56.86%	35,500	18,863	1,902,383	97.2%

December 31, 2006 Properties	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Leased	Leased %
<i>425 Viger W</i>	205,314	820	206,134		-	-	206,134	100.0%
<i>3575 Saint-Laurent</i>	164,797	17,464	182,261		7,707	-	174,554	95.8%
<i>4446 Saint-Laurent</i>	72,613	10,000	82,613		1,354	-	81,259	98.4%
<i>Adjacent Land (PUD)</i>	-	-	-		-	-	-	
<i>6300 Avenue du Parc</i>	217,022	950	217,972		9,508	-	208,464	95.6%
<i>400 Atlantic</i>	86,034	-	86,034		9,975	-	76,059	88.4%
Montreal	745,780	29,234	775,014	22.52%	28,544	-	746,470	96.3%
<i>390 Charest</i>	66,771	6,348	73,119		700	-	72,419	99.0%
<i>410 Charest</i>	-	24,937	24,937		-	1,300	23,637	94.8%
<i>430 Charest</i>	44,051	13,285	57,336		500	-	56,836	99.1%
<i>622 Saint Joseph</i>	3,620	3,300	6,920		-	-	6,920	100.0%
<i>633 Saint Joseph</i>	15,558	6,000	21,558		-	-	21,558	100.0%
Quebec City	130,000	53,870	183,870	5.34%	1,200	1,300	181,370	98.6%
<i>115 Bannatyne</i>	34,495	4,815	39,310		-	4,815	34,495	87.8%
<i>50-70 Arthur</i>	110,918	10,500	121,418		11,295	-	110,123	90.7%
<i>250 McDermot</i>	41,446	10,200	51,646		6,000	-	45,646	88.4%
<i>138 Portage East</i>	43,960	-	43,960		6,600	-	37,360	85.0%
<i>309 Hargrave</i>	21,460	1,400	22,860		7,019	-	15,841	69.3%
<i>165 Garry</i>	4,400	10,362	14,762		-	-	14,762	100.0%
<i>1500 Notre Dame</i>	111,400	-	111,400		3,300	-	108,100	97.0%
Winnipeg	368,079	37,277	405,356	11.78%	34,214	4,815	366,327	90.4%
Total Including PUD	2,931,337	509,879	3,441,216	100.00%	162,832	30,821	3,247,563	94.4%
Total Excluding PUD	2,816,950	504,036	3,320,986	96.51%	99,458	24,978	3,196,550	96.3%