



ALLIED PROPERTIES REAL ESTATE INVESTMENT TRUST

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

DECEMBER 31, 2005

DATED MARCH 15, 2006

TABLE OF CONTENTS

PART I	
Forward-Looking Disclaimer	3
Business Overview and Strategy	4
Performance Indicators	6
Business Environment and Outlook	8
PART II	
Summary Information and Performance for the Year ended December 31, 2005	9
Distributable Income	12
Funds From Operations	13
Adjusted Funds From Operations	13
PART III	
Financial Condition	14
Liquidity and Commitments	15
PART IV	
Summary Information and Performance for the Quarter ended December 31, 2005	17
Part V	
Summary Quarterly Information and Performance	20
Part VI	
Critical Accounting Estimates	21
PART VII	
Related Party Transactions	22
PART VIII	
Risk and Uncertainties	23
PART IX	
Subsequent Events	25
PART X	
Property Table	26

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, 2005. This MD&A should be read in conjunction with our consolidated financial statements and notes thereto for the year ended December 31, 2005. Historical results and percentage relationships contained in our annual 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, geographic concentration, asset-class concentration, competition for real property investments, financing and interest rates, government regulations, environmental matters, construction liability and unitholder liability. 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 15, 2006, 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.

March 15, 2006

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 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 made the following acquisitions in 2005, bringing the portfolio to 37 properties with just over 2.3 million square feet of GLA:

Class I Office Property	Acquired	Office GLA	Retail GLA	Total GLA
469 King Street West, Toronto	Jan 1, 2005	62,594	11,250	73,844
3575 Saint-Laurent Boulevard, Montreal	April 18, 2005	164,797	17,464	182,261
115 Bannatyne Avenue, Winnipeg	June 1, 2005	34,495	4,815	39,310
602-606 King Street West, Toronto	July 8, 2005	37,299	23,113	60,412
67 Richmond Street West, Toronto	Oct. 11, 2005	44,870	5,794	50,664
579 Richmond Street West, Toronto	Nov. 1, 2005	29,311	-	29,311
141 Bathurst Street, Toronto	Nov. 1, 2005	10,521	-	10,521
662 King Street West, Toronto	Nov. 1, 2005	29,691	2,126	31,817
312 Adelaide Street West, Toronto	Nov. 1, 2005	63,904	7,891	71,795
208-210 Adelaide Street West, Toronto	Nov. 1, 2005	12,330	-	12,330
200 Adelaide Street West, Toronto	Nov. 1, 2005	28,024	-	28,024
116 Simcoe Street, Toronto	Nov. 1, 2005	13,819	-	13,819
489 Queen Street East, Toronto	Nov. 1, 2005	32,592	-	32,592
100 Lombard Street, Toronto	Nov. 1, 2005	44,600	-	44,600
145 Berkeley Street, Toronto	Nov. 1, 2005	10,625	-	10,625
Total		619,472	72,453	691,925

Two of the properties acquired in 2005, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, are properties under development, in that they are undergoing the repositioning and redevelopment necessary for them to function as high quality, income-producing, Class I office properties. The costs related to these redevelopments are comprised of acquisition costs and external and internal costs directly related to the repositioning and redevelopment, including administrative costs and carrying costs.

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 by consolidating ownership in 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 reliance upon any particular tenant.

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. Three of the properties in the REIT's portfolio were acquired pursuant to the Option Agreement.

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
GLA (square feet)	820,120	984,856	1,636,343	2,321,507
% leased	96.9	97.5	99.2	97.0*

*not including property under development, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto

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 for each fiscal year since the REIT's IPO:

	IPO Feb 20, 2003	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
Distribution level per unit annualized	\$1.10	\$1.10	\$1.14	\$1.18
Total return with reinvestment through DRIP	NA	40.7%	17.6%	32.3%
Total return without reinvestment	NA	38.0%	16.2%	31.3%

Property Management

On July 4, 2005, with an effective date of 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, which involved the provision of property management and related services to the REIT and to third-party owners of commercial real estate in Toronto.

The Developer was appointed by the REIT as its property manager at the time of the REIT's IPO. The principal reason for the external arrangement was the fact that the REIT's initial portfolio was not large enough on its own for the property management function to be undertaken profitably.

Recognizing the substantial growth of the REIT's portfolio by early 2005, the Trustees of the REIT established an Independent Committee to consider the possibility of internalizing the property management function. The Independent Committee retained Desjardins Securities Inc. to act as its financial advisor.

On completion of the evaluation process by the Independent Committee and Desjardins Securities Inc., the independent Trustees of the REIT approved the acquisition ("Property Management Acquisition") by the REIT of the property management business of the Developer for a base price of \$8.5 million and an additional payment on March 31, 2007, equal to the lesser of \$0.9 million and the amount, if any, by which a five-times multiple of actual EBITDA from the business in 2006 exceeds the base price. Desjardins Securities Inc. delivered its opinion that the acquisition was fair, from a financial point of view, to unitholders.

The Developer employed 44 employees in its property management business, all of whom became employees of the Property Manager on closing of the Property Management Acquisition. The Developer and its operating principals have agreed not engage in the third-party property management business. The Developer is no longer entitled to use the name "Allied Properties" or the logo associated with the name "Allied Properties", which name and logo became the sole and exclusive property of the REIT on closing of the Property Management Acquisition. The Developer will continue to engage in the business of real estate development, subject to the provisions of the Option Agreement.

Performance Indicators

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, as defined in the Declaration ("DI"). In 2003, the REIT forecast \$1.06 per unit in DI and achieved \$1.122 per unit. In 2004, DI was \$1.325 per unit, up 18% from the abbreviated comparable period in 2003. In 2005, DI was \$1.363 per unit, up 2.8% from 2004. See "Distributable Income" below.

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 2003, the REIT forecast a DI pay-out ratio of 90% and achieved a DI pay-out ratio of 85%. In 2004, the REIT achieved a DI pay-out ratio of 88.1%. In 2005, the REIT achieved a DI pay-out ratio of 87.9%.

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 capital expenditures and leasing expenditures while ignoring the impact of step-rent revenue. In 2004, AFFO per unit was \$1.132 per unit. In 2005, AFFO per unit was \$1.238 per unit, up 9.4% from 2004. See "Adjusted Funds from Operations" below.

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 2004, the REIT achieved an AFFO pay-out ratio of 103.2%. In 2005, the REIT achieved an AFFO pay-out ratio of 96.7%.

6. Debt Ratio

Gross Book Value ("GBV") is defined pursuant to the Declaration 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 in the year ended December 31, 2005. A conservative ratio of debt to GBV ("Debt Ratio") mitigates unitholder risk. In 2003, the REIT forecast a 56.0% Debt Ratio and finished the year with a 51.2% Debt Ratio. At the end of 2004, the Debt Ratio was 56.3%. At the end of 2005, the Debt Ratio was 51.0%.

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 207,584 square feet of GLA matured in 2005. At the end of 2005, the REIT had renewed leases representing 97,752 square feet of this GLA and re-leased another 60,793 square feet of this GLA, representing 77% of the GLA covered by the maturing leases. It had also renewed leases representing 126,590 square feet of GLA maturing in 2006, 5,900 square feet of GLA maturing in 2007 and 32,719 square feet of GLA maturing in 2009.

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%. By the end of 2005, the REIT's leased area was 97.0% (not including 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, properties under development).

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), same-asset net operating income was \$17,356 in 2005, up 4.8% from 2004.

4. Leasing Expenditures

The REIT monitors leasing expenditures carefully. 192,164 square feet of the GLA leased in 2005 involved the lease of originally vacant space in 2005 or the renewal or replacement of leases that matured in 2005. \$1,620 of the leasing expenditures incurred or committed to in 2005 relate to this space. This represents \$8.43 per leased square foot.

5. Capital Expenditures

The REIT strives to maintain the properties in its portfolio in top physical condition. In 2005, the REIT incurred \$1,118 in expenditures for capital improvements. This represents \$0.59 per square foot of the average size of the REIT's portfolio over the course of 2005.

Summary

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

	2005	2004	Change
Year-end distribution level per unit annualized	\$1.18	\$1.14	\$0.04
DI per unit	\$1.363	\$1.325	\$0.038
DI pay-out ratio	87.9%	88.1%	(0.2%)
AFFO per unit	\$1.238	\$1.132	0.107
AFFO pay-out ratio	96.7%	103.2%	(6.8%)
Debt Ratio	51.0%	56.3%	(5.3%)
Renewal/replacement % of leases maturing	77%	94%	(17%)
End of period occupancy	97.0%	99.2%	(2.2%)
Same-asset net operating income	\$17,356	\$16,565	\$791
Leasing expenditures	\$1,620	\$1,768	(\$148)
Leasing expenditures per leased square foot	\$8.43	\$9.55	(\$1.08)
Capital expenditures	\$1,118	\$559*	\$559
Capital expenditures per portfolio square foot	\$0.59	\$0.43*	\$0.16

* not including leasing expenditures in connection with the leasing of space that was vacant or substantially un-renovated at the time of the REIT's IPO or significantly reconfigured to accommodate high-value new tenancies

Business Environment and Outlook

The downtown Toronto office market strengthened in 2005, with the overall vacancy rate declining to 9.2% and the Class I category recording positive absorption of 257,946 square feet.¹

The downtown Montreal office market was stable in 2005, with the overall vacancy rate declining to 12.7%.² While Class I office space is not tracked separately in Montreal, there is data available on the Old Montreal sub-market. In 2005, there was positive absorption of 15,215 square feet in Old Montreal.³

The Winnipeg office market was also stable in 2005, with a year-end vacancy rate of 7.8%.⁴ While Class I office space is not tracked separately in Winnipeg, Colliers International observed that “businesses continue to be lured to renovated historic buildings in the Exchange area in downtown Winnipeg.”⁵

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.

The REIT intends to continue the consolidation process in its Toronto target market and to expand the foothold it has established in its Montreal and Winnipeg target markets.

The REIT has not established a rigid target in terms of the allocation of its portfolio between the Toronto, Montreal and Winnipeg target markets. At the end of 2005, the properties in the Toronto, Montreal and Winnipeg target markets (including properties under development) represented 81.6%, 16.7% and 1.7%, respectively, of the total GLA in the portfolio.

¹ Colliers International, *Greater Toronto Office Quarterly Update, Fourth Quarter 2005*.

² Colliers International, *Greater Montreal Office Quarterly Update, Fourth Quarter 2005*.

³ Colliers International, *Greater Montreal Office Quarterly Update, Fourth Quarter 2005*.

⁴ Colliers International, *Winnipeg Year-End Office Report, December 2005*.

⁵ Colliers International, *Winnipeg Year-End Office Report, December 2005*.

PART II

Summary Information and Performance for the Year ended December 31, 2005

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

(In thousands except for per unit and % amounts)	2005	2004	Change	%Change
Revenue from rental properties	\$51,170	\$34,565	\$16,605	48.0%
Rental property operating cost	18,264	12,028	6,236	51.8%
Net rental income	33,906	22,537	10,369	46.0%
Real estate service income	162	-	162	
Financing expense				
Interest	10,088	7,441	2,647	35.6%
Amortization - Mortgage premium	(530)	(444)	(86)	19.4%
Depreciation and amortization				
Rental properties	6,071	4,209	1,862	44.2%
Deferred leasing cost	622	228	394	172.8%
Origination cost and acquired tenant relationships	5,267	1,545	3,722	240.9%
Acquired contracts and customer relationships	48	-	48	
Deferred financing cost	216	126	90	71.4%
Computer and office equipment	16	-	16	
Income from operations	11,270	9,432	1,838	19.5%
Trust expense	2,001	1,565	436	27.9%
Property management internalization expense	7,877	-	7,877	
Net income	1,392	7,867	(6,475)	(82.3%)
Amortization				
Rental properties	6,071	4,209	1,862	44.2%
Mortgage premium	(530)	(444)	(86)	19.4%
Acquired leases	2,082	820	1,262	153.9%
M-T-M acquired leases	229	(18)	247	(1,372.2%)
Acquired tenant relationships	3,185	725	2,460	339.3%
Acquired contracts and customer relationships	48	-	48	
Step-rent adjustments	(1,381)	(1,325)	(56)	4.2%
Property management internalization expense	7,877	-	7,877	
LTIP compensation expense	109	89	20	22.5%
DI	\$19,082	\$11,923	\$7,159	60.0%
Weighted average units outstanding (basic)	14,004	8,996	5,008	55.7%
Weighted average units outstanding (diluted)	14,249	9,101	5,148	56.6%
Distributions	16,761	10,506	6,255	59.5%
DI per unit (basic)	\$1.363	\$1.325	0.037	2.8%
DI per unit (diluted)	\$1.339	\$1.310	0.029	2.2%
DI pay-out ratio	87.9%	88.1%	(0.2%)	
FFO	21,229	13,849	7,380	53.3%
FFO per unit (basic)	\$1.516	\$1.539	(\$0.024)	(1.5%)
FFO per unit (diluted)	\$1.490	\$1.522	(\$0.032)	(2.1%)
FFO pay-out ratio	79.0%	75.9%	3.1%	
AFFO	17,338	10,179	7,159	70.3%
AFFO per unit (basic)	\$1.238	\$1.132	\$0.107	9.4%
AFFO per unit (diluted)	\$1.217	\$1.118	\$0.098	8.8%
AFFO pay-out ratio	96.7%	103.2%	(6.8%)	
Net operating income	31,754	21,194	10,560	49.8%
Same-asset net operating income	17,356	16,565	791	4.8%
Total assets	\$384,538	\$266,835	\$117,703	44.1%
Total debt (excludes premium on assumed debt)	\$210,093	\$154,273	\$55,820	36.2%
Debt to GBV	51.04%	56.30%	(5.26%)	
Total GLA (s.f., not including properties under dev.)	2,266	1,640	626	38.2%
Leased GLA (s.f., not including properties under dev.)	2,197	1,627	570	35.0%
Leased GLA (% total GLA)	97.0%	99.2%	(2.2%)	

Net income for the year ended December 31, 2005, was \$1,392, as compared to net income of \$7,867 in the year ended December 31, 2004. Net income per unit (basic) for the year was \$0.099, as compared to net income per unit (basic) of \$0.874 in the comparable year. The year-over-year decline in net income was due entirely to expense of \$7,877 associated with the internalization of property management (see “*Property Management Internalization Expense*” below).

DI for the year ended December 31, 2005, increased by 60.0% to \$19,082 from \$11,923 for the year ended December 31, 2004. DI per unit (basic) for the year was \$1.363, as compared to \$1.325 in the comparable year.

Net Rental Income

Net rental income for the year ended December 31, 2005, increased by 46.0% to \$32,906 from \$22,537 in the same year ended December 31, 2004, as follows:

- (i) \$188 due to the increase in same-asset net rental income from properties owned for the entire year and the entire comparable year;
- (ii) \$9,640 due to net rental income from properties acquired in 2004 and the year; and
- (iii) \$541 due to the internalization of the property management function effective July 1, 2005.

Net rental income per occupied square foot for the year ended December 31, 2005, was \$17.72, as compared to \$17.55 in the year ended December 31, 2004.

Real Estate Service Income

The Property Manager provided real estate services to third-party owners of commercial real estate from the effective date of July 1, 2005. For the year ended December 31, 2005, real estate services income was \$162.

Property Management Acquisition Benefit

The economic benefit to the REIT of the Property Management Acquisition from the effective date of July 1, 2005, to December 31, 2005, is summarized in the following table:

(In thousands)	July 1 to December 31, 2005
Increase in net rental income	\$541
Real estate service income	162
Reduction in leasing expenditures payable as leasing fees	49
Reduction in capital expenditures payable as project management fees	47
Total	\$799

This is consistent with Management’s expectations for the period in question.

Property Management Internalization Expense

The Property Management Acquisition was recorded using the very specific guidance of the Emerging Issues Committee of the Canadian Institute of Chartered Accountants in EIC-138, “Internalization of the Management Function in Royalty and Income Trusts”. Except for the portion of the acquisition cost allocated to (i) tangible assets and (ii) the component of the acquired business that relates to providing services to third-party owners, the acquisition cost was treated as a penalty cost for the early termination of the original property management agreement between the REIT and the Developer and was expensed in the year ended December 31, 2005. \$77 was allocated to tangible assets and recorded accordingly on the REIT’s balance sheet. \$959 was allocated to the third-party component of the acquired business and was recorded as acquired contracts and customer relationships on the REIT’s balance sheet. The remainder of the acquisition cost, \$7,877, was recorded as property management internalization expense in the year ended December 31, 2005.

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 \$530 in the year ended December 31, 2005.

Financing expense for the year ended December 31, 2005, increased by 36.6% to \$9,558 from \$6,997 in the year ended December 31, 2004, due to the increase in financing expense associated with properties acquired in 2005.

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, 2005, increased by 44.2% to \$6,071 from \$4,209 in the year ended December 31, 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in-place leases acquired on acquisition of a rental property on a straight-line basis over the term of the corresponding lease. Deferred financing 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, 2005, increased by 28% to \$2,001 from \$1,565 in the year ended December 31, 2004, primarily due to an increase in executive management staff, salary levels and year-end bonuses.

Leasing Activity

Leasing activity for the year ended December 31, 2005, is summarized in the following table:

	Vacant or Maturing	Leased in 2005	% Leased in 2005	Vacant End of 2005*
Vacant GLA on January 1, 2005	15,555	12,547	81	3,008
Vacant GLA on acquisition in 2005*	37,691	21,072	56	16,619
GLA that matured in 2005	207,584	158,545	77	49,039
Subtotal	260,830	192,164	74	68,666
GLA maturing in 2006		126,590		
GLA maturing in 2007		5,900		
GLA maturing in 2009		32,719		
Total		357,373		

*not including properties under development, 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto

15,555 square feet of GLA were vacant at the beginning of 2005. During the year ended December 31, 2005, the REIT

- (i) acquired properties with 37,691 square feet of vacant GLA, not including properties under development, bringing the total originally vacant GLA to 53,246 square feet and
- (ii) leased 33,619 square feet of the 53,246 square feet of originally vacant GLA, leaving 19,627 square feet of the originally vacant GLA vacant at the end of the year.

Leases for 207,584 square feet of GLA matured in 2005. During the year ended December 31, 2005, the REIT

- (i) renewed or replaced leases for 158,545 square feet of the GLA that matured in the year, leaving 49,039 square feet of the GLA that matured in the year vacant at the end of the year,

- (ii) renewed leases representing 126,590 square feet of GLA maturing in 2006,
- (iii) renewed leases representing 5,900 square feet of GLA maturing in 2007 and
- (iv) replaced a portion of a lease representing 32,719 square feet of GLA maturing in 2009.

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 year ended December 31, 2005, expenditures for capital improvements were \$1,118. The REIT incurred or committed to \$1,620 in leasing expenditures (\$8.43 per leased square foot) in connection with the lease of originally vacant space in 2005 or the renewal or replacement of leases that matured in 2005. The REIT also committed to \$1,355 in leasing expenditures (\$8.20 per leased square foot) in connection with the renewal or replacement of leases that mature in 2006, 2007 and 2009.

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 Acquisition to acquired contracts and customer relationships; and
- (viii) property management internalization expense recorded in connection with the Property Management Acquisition.

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

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

(In thousands)	2005	2004
Cash from operating activities	\$7,859	\$13,678
Amortization of deferred leasing and financing cost	(838)	(354)
Amortization of computer and office equipment	(16)	-
Change in non-cash operating items	4,200	(1,401)
Property management internalization expense	7,877	-
DI	\$19,082	\$11,923

Distributions for the year ended December 31, 2005, were \$16,761, representing a DI pay-out ratio of 87.9%, as compared to distributions for the year ended December 31, 2004, of \$10,506, representing a DI pay-out ratio of 88.1%.

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, one that is widely used by the real estate industry. The following sets out FFO, calculated in accordance with recommendations of Real Property Association of Canada in its White Paper on Funds From Operations dated November 30, 2004, and adjusted to add back the property management internalization expense recorded by the REIT in the year ended December 31, 2005.

(In thousands)	2005	2004
Net income	\$1,392	\$7,867
Amortization on rental properties	6,071	4,209
Amortization of deferred leasing expenses	622	228
Amortization of origination cost and acquired tenant relationships	5,267	1,545
Property management internalization expense	7,877	-
FFO	\$21,229	\$13,849

Distributions for the year ended December 31, 2005, represented an FFO pay-out ratio of 79.0%, as compared to distributions for the year ended December 31, 2004, which represented an FFO pay-out ratio of 75.9%.

Adjusted Funds From Operations

AFFO 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 AFFO to be an indicative measure of operating performance, one that is becoming more widely used by the real estate industry. The following sets out AFFO, calculated in accordance with what Management believes to be industry practice.

(In thousands)	2005	2004
FFO	\$21,229	\$13,849
Step-rent adjustments	(1,381)	(1,325)
M-T-M acquired leases	288	(18)
Leasing expenditures	(1,620)	(1,768)
Capital expenditures	(1,118)	(559)
AFFO	17,338	\$10,179

Distributions for the year ended December 31, 2005, represented an AFFO pay-out ratio of 96.7%, as compared to distributions for the year ended December 31, 2004, which represented an AFFO pay-out ratio of 103.2%.

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 December 31, 2005, the REIT had mortgage debt of \$198,048, bank indebtedness of \$12,045 and unitholders' equity of \$156,978.

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 pursuant to 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 and an amount equal to the property management internalization expense recorded by the REIT in the quarter ended September 30, 2005. As at December 31, 2005, the Debt Ratio was 51.0%, 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 December 31, 2005, the REIT had a market capitalization of approximately \$271,521 based on a closing unit price of \$16.95.

In the year ended December 31, 2005, the REIT issued a total of 5.63 million units for equity contributions of \$78,539. Costs incurred to issue the units were \$3,754. 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) on April 18, 2005, the REIT issued 2.15 million units at \$14.00 per unit for gross proceeds of \$30,100;
- (iii) on November 1, 2005, the REIT issued 1.3 million units at \$15.50 per unit for gross proceeds of \$20,150;
- (iv) in the year ended December 31, 2005, the REIT issued 123,000 units at \$10.00 per unit for \$1,230 to certain officers and trustees who exercised options under the REIT's Unit Option Plan;
- (v) in the year ended December 31, 2005, the REIT issued 76,224 units to certain officers and trustees under the LTIP at \$13.46 per unit for \$1,026, plus compensation costs of \$109; and
- (vi) in the year ended December 31, 2005, the REIT issued 83,649 units under its distribution re-investment plan at an average price of \$14.63 per unit for \$1,224.

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 in the year ended December 31, 2005, the trustees and officers of the REIT exercised 263,500 options in accordance with their terms. As at December 31, 2005, 81,500 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 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 year ended December 31, 2005.

Mortgages Payable

Mortgages payable as at December 31, 2005, consisted of mortgage debt of \$198,048 and premium on mortgages assumed (net of accumulated amortization) of \$828.

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
2006	\$ 5,309	\$ -	\$ 5,309	2.7%	N/A
2007	5,449	19,408	24,857	12.5%	6.44%
2008	4,735	14,404	19,139	9.7%	5.95%
2009	4,779	8,735	13,514	6.8%	6.84%
2010	4,991	1,926	6,917	3.5%	5.26%
Thereafter	22,461	105,851	128,312	64.8%	
Total	\$47,724	\$ 150,324	\$ 198,048		

Interest rates on the mortgage debt are between 4.94% and 8.10% with a weighted average interest rate of 6.03%. The weighted average term of the mortgage debt is 7.27 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 \$5,000 revolving credit facility bearing interest at bank prime plus 1.0%, which matures on February 28, 2007; and
- (ii) a \$25,000 revolving credit facility bearing interest at bank prime plus 1.0%, which matures on May 31, 2006.

The credit facilities are secured by subordinated mortgage charges, first mortgage charges and security agreements on certain of the REIT's rental properties.

In the year ended December 31, 2005, the average borrowings under the credit facilities were \$3,208. As at December 31, 2005, the borrowings under the credit facilities were \$14,119.

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 the ability of the REIT to acquire rental properties using un-utilized borrowing capacity while not exceeding the 60% Debt Ratio, is \$90,000.

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

(In thousands)	December 31, 2005
Leasing commissions	\$829
Tenant inducements	200
Building renovations	626
Expenses	349
Total	\$2,004

PART IV

Summary Information and Performance for the Quarter ended December 31, 2005

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

(In thousands except for per unit and % amounts)	Q4 2005	Q4 2004	Change	%Change
Revenue from rental properties	\$14,291	\$10,119	\$4,172	41.2%
Rental property operating cost	5,145	3,664	1,481	40.4%
Net rental income	9,146	6,455	2,691	41.7%
Real estate service income	78	-	78	
Financing expense				
Interest	2,893	2,220	673	30.3%
Amortization - Mortgage premium	(182)	(103)	(79)	76.7%
Depreciation and amortization				
Rental properties	1,692	1,194	498	41.7%
Deferred leasing costs	184	95	89	93.7%
Origination cost and acquired tenant relationships	1,943	626	1,317	210.4%
Acquired contracts and customer relationships	24	-	24	
Deferred financing cost	66	43	23	53.5%
Computer and office equipment	10	-	10	
Income from operations	2,594	2,380	214	9.0%
Trust expense	631	382	249	65.2%
Property management internalization expense	-	-	-	
Net income	1,963	1,998	(35)	(1.8%)
Amortization				
Rental properties	1,692	1,194	498	41.7%
Mortgage premium	(182)	(103)	(79)	76.7%
Acquired leases	633	308	325	105.5%
M-T-M acquired leases	181	31	150	483.9%
Acquired tenant relationships	1,311	317	994	313.6%
Acquired contracts and customer relationships	24	-	24	
Step-rent adjustments	(339)	(276)	(63)	22.8%
Property management internalization expense	-	-	-	
LTIP compensation expense	-	26	(26)	(100.0%)
DI	\$5,283	\$3,495	\$1,788	51.2%
Weighted average units outstanding (basic)	15,350	10,226	5,124	50.1%
Weighted average units outstanding (diluted)	15,606	10,389	5,217	50.2%
Distributions	4,578	2,939	1,639	55.8%
DI per unit (basic)	\$0.344	\$0.342	0.002	0.7%
DI per unit (diluted)	\$0.339	\$0.336	0.003	0.6%
DI pay-out ratio	86.7%	84.1%	2.6%	
FFO	5,782	3,913	1,869	51.7%
FFO per unit (basic)	\$0.377	\$0.383	(\$0.006)	(1.6%)
FFO per unit (diluted)	\$0.370	\$0.377	(\$0.007)	(1.8%)
FFO pay-out ratio	79.2%	75.1%	2.0%	
AFFO	4,999	3,206	1,793	55.9%
AFFO per unit (basic)	\$0.326	\$0.314	\$0.012	3.9%
AFFO per unit (diluted)	\$0.320	\$0.309	\$0.011	3.8%
AFFO pay-out ratio	91.6%	91.7%	0.1%	
Net operating income	8,988	6,210	2,778	44.7%
Same-asset net operating income	6,109	5,945	164	2.8%
Total assets	\$384,424	\$237,786	146,638	61.7%
Total debt (excludes premium on assumed debt)	\$210,093	\$126,666	83,427	65.9%
Debt to GBV	51.04%	52.30%	(1.26%)	
Total GLA (s.f., excluding properties under dev.)	2,266	1,640	626	38.2%
Leased GLA (s.f., excluding properties under dev.)	2,197	1,627	570	35.0%
Leased GLA (% total GLA)	97.0%	99.2%	(2.2%)	

Net income for the quarter ended December 31, 2005, was \$1,963, as compared to net income of \$1,998 in the quarter ended December 31, 2004. Net income per unit (basic) for the quarter was \$0.128, as compared to net income per unit (basic) of \$0.195 in the comparable quarter.

DI for the quarter ended December 31, 2005, increased by 51.2% to \$5,283 from \$3,495 for the quarter ended December 31, 2004. DI per unit (basic) for the quarter was \$0.344, as compared to \$0.342 in the comparable quarter.

Net Rental Income

Net rental income for the quarter ended December 31, 2005, increased by 44.1% to \$9,299 from \$6,455 in the quarter ended December 31, 2004, as follows:

- (i) \$87 due to the increase in same-asset net rental income from properties owned for the entire quarter and the entire comparable quarter;
- (ii) \$2,325 due to net rental income from properties not owned for the entire quarter and the entire comparable quarter; and
- (iii) \$279 due to the internalization of the property management function effective July 1, 2005.

Net rental income per occupied square foot for the quarter ended December 31, 2005, was \$4.50 (\$18.00 annualized), as compared to \$4.25 (\$17.00 annualized) in the quarter ended December 31, 2004.

Real Estate Service Income

The Property Manager provided real estate services to third-party owners of commercial real estate from an effective date of July 1, 2005. For the quarter ended December 31, 2005, real estate services income was \$78.

Property Management Acquisition Benefit

The economic benefit to the REIT of the Property Management Acquisition for the quarter ended December 31, 2005, is summarized in the following table:

(In thousands)	Q4 2005
Increase in net rental income	\$279
Real estate service income	78
Reduction in leasing expenditures payable as leasing fees	50
Reduction in capital expenditures payable as project management fees	17
Total	\$424

This is consistent with 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 \$182 in the quarter ended December 31, 2005.

Financing expense for the quarter ended December 31, 2005, increased by 28.0% to \$2,711 from \$2,117 in the quarter ended December 31, 2004, due to the increase in financing expense associated with additional properties acquired in 2004 and in the year ended December 31, 2005.

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, 2005, increased by 41.7% to \$1,692 from \$1,194 in the quarter ended December 31, 2004.

The REIT records amortization of deferred leasing costs and the assigned fair value of the origination costs and tenant relationships for in-place leases acquired on acquisition of a rental property on a

straight-line basis over the term of the corresponding lease. Deferred financing 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, 2005, increased by 65.2% to \$631 from \$382 in the quarter ended December 31, 2004, due to an increase in executive management staff, salary levels and year-end bonuses.

PART V

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 % amounts)	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004
Revenue from rental properties	\$14,291	\$12,822	\$12,260	\$11,797	\$10,119	\$9,734	\$7,933	\$6,779
Rental property operating cost	5,145	4,442	4,480	4,197	3,664	3,369	2,656	2,339
Net rental income	9,146	8,380	7,780	7,600	6,455	6,365	5,277	4,440
Real estate service income	78	84	-	-	-	-	-	-
Financing expense	2,711	2,360	2,218	2,269	2,117	1,957	1,618	1,305
Depreciation and amortization	3,919	3,075	2,910	2,336	1,958	1,855	1,354	941
Income from operations	2,594	3,029	2,652	2,995	2,380	2,553	2,305	2,194
Trust expense	631	404	469	497	382	305	527	351
Property management internalization expense	-	7,877	-	-	-	-	-	-
Net income (loss)	1,963	(5,252)	2,183	2,498	1,998	2,248	1,778	1,843
Amortization								
Rental properties	1,692	1,549	1,461	1,369	1,194	1,175	1,001	839
Mortgage premium	(182)	(145)	(99)	(104)	(103)	(113)	(120)	(108)
Acquired leases	633	535	501	413	308	267	172	73
M-T-M acquired leases	181	-	24	24	31	38	(34)	(53)
Acquired tenant relationships	1,311	720	761	393	317	291	117	-
Acquired contracts and customer relationships	24	24	-	-	-	-	-	-
Step-rent adjustments	(339)	(287)	(350)	(405)	(276)	(375)	(361)	(313)
Property management internalization expense	-	7,877	-	-	-	-	-	-
LTIP compensation expense	-	-	-	109	26	-	63	-
DI	\$5,283	\$5,021	\$4,481	\$4,297	\$3,495	3,531	\$2,616	\$2,281
Weighted average units outstanding (basic)	15,350	14,471	14,036	12,118	10,226	10,200	8,396	7,138
Weighted average units outstanding (diluted)	15,606	14,727	14,289	12,329	10,389	10,348	8,427	7,174
DI per unit (basic)	\$0.344	\$0.347	\$0.319	\$0.355	\$0.342	\$0.346	\$0.312	\$0.320
DI per unit (diluted)	\$0.339	\$0.341	\$0.314	\$0.348	\$0.336	\$0.341	\$0.310	\$0.318
Distributions	4,578	4,317	4,295	3,557	2,939	2,933	2,638	1,996
DI pay-out ratio	86.7%	86.0%	95.8%	82.7%	84.1%	83.1%	100.8%	87.5%
FFO	5,782	5,616	5,045	4,786	3,912	4,062	3,103	2,772
FFO per unit (basic)	\$0.377	\$0.388	\$0.359	\$0.395	\$0.383	\$0.398	\$0.370	\$0.388
FFO per unit (diluted)	\$0.370	\$0.381	\$0.353	\$0.388	\$0.377	\$0.393	\$0.368	\$0.386
Net operating income	8,988	8,093	7,454	7,219	6,210	6,028	4,882	4,074
Net income (loss) per unit (basic)	\$0.128	\$(0.363)	\$0.156	\$0.206	\$0.195	\$0.220	\$0.212	\$0.258
Net income (loss) per unit (diluted)	\$0.126	\$(0.363)	\$0.153	\$0.203	\$0.192	\$0.217	\$0.211	\$0.257
Total assets	\$384,538	\$321,659	309,822	284,741	266,835	237,786	236,330	165,809
Total debt	\$210,093	\$163,182	144,596	147,418	154,273	125,514	125,247	87,207
Total debt to GBV	51.04%	47.7%	44.8%	50.0%	56.3%	52.1%	52.3%	52.7%
Total GLA (sq. ft)	2,266	1,985	1,925	1,703	1,641	1,430	1,428	1,042
Leased GLA (sq. ft.)	2,197	1,933	1,885	1,687	1,627	1,410	1,407	1,017
Leased Area (%GLA)	97.0%	97.4%	97.3%	99.1%	99.2%	98.6%	98.5%	97.6%

PART VI

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 VII

Related Party Transactions

At the time of its IPO, the REIT entered into an agreement (“Property Management Agreement”) with the Developer, a company controlled by the President and CEO of the REIT. The Executive Vice President of the REIT owns a significant interest in the Developer.

Pursuant to the Property Management Agreement, the Developer was 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 space and support staff. The initial term of the Property Management Agreement was five years to February 19, 2008, and renewable by the REIT for successive two year terms.

The REIT completed the Property Management Acquisition on July 4, 2005, with an effective date of July 1, 2005. Immediately prior to the effective date of the Property Management Acquisition, the Developer ceased to provide services to the REIT under the Property Management Agreement.

Set out below are the fees paid by the REIT to the Developer in connection with the provision of services under the Property Management Agreement for the period ended June 30, 2005, the day prior to the effective date of the closing of the Property Management Acquisition.

(in thousands)	Recoverable Operating Expense	Trust Expense	Deferred Expense	Rental Properties	Commit- ments	Total
Management fee	\$ 895	\$ -	\$ -	\$ -	\$ -	\$ 895
Maintenance	510	-	-	-	-	510
On-site personnel	153	-	-	-	-	153
Disbursements	13	3	-	-	-	16
Leasing fees	-	-	72	-	55	127
Project management fees	-	-	-	10	-	10
Office and support staff	-	30	-	-	-	30
Total	\$1,571	\$33	\$72	\$10	\$55	\$1,741

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 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.

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 6.03%. The weighted average term of the REIT's mortgage debt is 7.27 years. As at December 31, 2005, the borrowings under the REIT's credit facilities were \$14,119.

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 December 31, 2005, there were 275 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 year ended December 31, 2005, and the year ended December 31, 2004.

Category	% of Rental Revenue 2005	% of Rental Revenue 2004
Service and professional	34	39
Retail (head office and storefront)	20	22
Telecommunications and information technology	15	16
Media and entertainment	13	13
Financial services	12	4
Government	2	3
Other	4	3

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, 2005, as well as the percentage of rental revenue from those tenants for the year ended December 31, 2004.

Tenant	% of Rental Revenue 2005	% of Rental Revenue 2004
Desjardins	7.9	0.9
Cossette Communications	6.0	9.1
MTS Allstream	4.3	5.3
Publicis Toronto	3.2	3.1
St. Joseph Media	3.2	2.6
Algorithmics	2.7	3.2
Indigo Books & Music	2.4	4.3
Nelvana	2.3	1.9
Blast Radius	2.3	3.4
DWL	2.2	2.7

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.

97.0% of the GLA in the REIT's portfolio was leased as at December 31, 2005 (not including 100 Lombard Street, Toronto, and 145 Berkeley Street, Toronto, properties under development). The following sets out the total GLA of the leases that mature during the period from January 1, 2006, to December 31, 2010, 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, 2006	252,103	10.9
December 31, 2007	305,999	13.2
December 31, 2008	180,062	7.8
December 31, 2009	355,653	10.4
December 31, 2010	240,614	5.4

Leases representing 50% of the GLA that matures in 2006 were renewed by December 31, 2005.

The weighted average term to maturity of the REIT's leases is five 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 IX

Subsequent Events

On January 20, 2006, the REIT placed a first mortgage on 208-210 Adelaide Street West, Toronto, 200 Adelaide Street West, Toronto and 116 Simcoe Street, Toronto, in the principal amount of \$9 million for a term of 10 year at an annual interest rate of 5.16%.

On January 20, 2006, the REIT placed a first mortgage on 579 Richmond Street West, Toronto, and 141 Bathurst Street, Toronto, in the principal amount of \$6.5 million for a term of 10 year at an annual interest rate of 5.16%.

On February 2, 2006, the REIT announced an agreement to acquire 4436-4450 Saint-Laurent Boulevard, a Class I office property located in downtown Montreal, and 5,500 square feet of adjacent land that forms the southwest corner of Saint-Laurent and Boulevard Mount-Royal for an aggregate purchase price of \$11.2 million. The acquisition is scheduled to close on or about March 31, 2006.

PART X

Property Table

The following lists the properties owned by the REIT at December 31, 2005:

Property	Office GLA	Retail GLA	Total GLA	% Total GLA	Office Vacant	Retail Vacant	Total Vacant	Vacancy Rate
Toronto Total	1,548,192	345,610	1,893,802	81.58%	42,849	10,278	53,127	2.81%
King West Total	162,056	26,394	188,450	8.12%	19,045	2,112	21,157	11.23%
<i>Phase I, The Castle</i>	59,002	16,562	75,564		-	-	-	0.00%
<i>905 King Street West</i>	103,054	9,832	112,886		19,045	2,112	21,157	18.74%
King West Central Total	538,839	119,617	658,456	28.36%	7,061	3,764	10,825	1.64%
<i>468 King Street West</i>	65,039	-	65,039		-	-	-	0.00%
<i>425-439 King Street West</i>	74,053	25,134	99,187		-	-	-	0.00%
<i>445-455 King Street West</i>	27,565	23,048	50,613		-	-	-	0.00%
<i>469 King Street West</i>	62,594	11,250	73,844		-	-	-	0.00%
<i>500-522 King Street West</i>	94,945	27,705	122,650		-	2,064	2,064	1.68%
<i>602-606 King Street West</i>	37,299	23,113	60,412		-	1,700	1,700	2.81%
<i>420 Wellington Street West</i>	33,813	3,137	36,950		-	-	-	0.00%
<i>425 Adelaide Street West</i>	74,008	4,104	78,112		3,008	-	3,008	3.85%
<i>579 Richmond Street West</i>	29,311	-	29,311		2,568	-	2,568	8.76%
<i>141 Bathurst Street</i>	10,521	-	10,521		-	-	-	0.00%
<i>662 King Street West</i>	29,691	2,126	31,817		1,485	-	1,485	4.67%
Entertainment District Total	405,342	103,516	508,858	21.92%	-	4,402	4,402	0.87%
<i>116 Simcoe Street</i>	13,819	-	13,819		-	-	-	0.00%
<i>200 Adelaide W</i>	28,024	-	28,024		-	-	-	0.00%
<i>208-210 Adelaide Street West</i>	12,330	-	12,330		-	-	-	0.00%
<i>312 Adelaide Street West</i>	63,904	7,891	71,795		-	4,402	4,402	6.13%
<i>331-333 Adelaide Street West</i>	20,951	3,209	24,160		-	-	-	0.00%
<i>358-360 Adelaide Street West</i>	35,986	18,263	54,249		-	-	-	0.00%
<i>134 Peter Street</i>	29,218	19,804	49,022		-	-	-	0.00%
<i>82 Peter Street</i>	38,623	8,287	46,910		-	-	-	0.00%
<i>388 King Street West</i>	32,529	11,765	44,294		-	-	-	0.00%
<i>99 Spadina Avenue</i>	39,267	12,613	51,880		-	-	-	0.00%
<i>185 Spadina Avenue</i>	55,814	-	55,814		-	-	-	0.00%
<i>217-225 Richmond Street West</i>	34,877	21,684	56,561		-	-	-	0.00%
Downtown Total	44,870	5,794	50,664	2.18%	6,659	-	6,659	13.14%
<i>67 Richmond Street West</i>	44,870	5,794	50,664		6,659	-	6,659	13.14%
St. Lawrence Market Total	71,754	41,390	113,144	4.87%	7,108	-	7,108	6.28%
<i>35-39 Front Street East</i>	30,811	16,606	47,417		-	-	-	0.00%
<i>41-45 Front Street East</i>	19,799	13,735	33,534		-	-	-	0.00%
<i>50 Wellington Street East</i>	21,144	11,049	32,193		7,108	-	7,108	22.08%
Queen Richmond Total	270,106	48,899	319,005	13.74%	2,976	-	2,976	0.93%
<i>Queen Richmond Centre</i>	175,000	48,899	223,899		2,976	-	2,976	1.33%
<i>230 Richmond Street East</i>	62,514	-	62,514		-	-	-	0.00%
<i>489 Queen Street East</i>	32,592	-	32,592		-	-	-	0.00%
Properties Under Development	55,225	-	55,225	2.38%				
<i>100 Lombard Street</i>	44,600	-	44,600					
<i>145 Berkeley Street</i>	10,625	-	10,625					
Montreal Total	370,111	18,284	388,395	16.73%	15,539	-	15,539	4.00%
<i>425 Viger Avenue West</i>	205,314	820	206,134		-	-	-	0.00%
<i>3575 Saint-Laurent Boulevard</i>	164,797	17,464	182,261		15,539	-	15,539	8.53%
Winnipeg Total	34,495	4,815	39,310	1.69%	-	-	-	0.00%
<i>115 Bannatyne Avenue</i>	34,495	4,815	39,310		-	-	-	0.00%
Total	1,952,798	368,709	2,321,507	100.00%	58,388	10,278	68,666	3.03%