

INOVALIS REIT
CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS (unaudited)

Three and six-months periods ended June 30, 2014

The attached unaudited condensed interim consolidated financial statements have been prepared by management of Inovalis Real Estate Investment Trust and have not been reviewed by the auditors of the Company.

INOVALIS REIT
Condensed Interim Consolidated Balance Sheet as at June 30, 2014

(in thousands of Canadian dollars)

| Assets | Note | As at June 30, 2014 | As at December 31, 2013 ¹ |
|--|------|------------------------|---|
| Non-current assets | | | |
| Investment properties | 4 | 247,320 | 244,900 |
| Derivative financial instruments | 7 | 771 | |
| Restricted cash and other financial assets | | 320 | 2,058 |
| Total non-current assets | | 248,411 | 246,958 |
| Current assets | | | |
| Trade and other receivables | | 2,981 | 1,746 |
| Derivative financial instruments | 7 | 435 | |
| Restricted cash | | 283 | 1,236 |
| Cash and cash equivalents | | 47,774 | 6,120 |
| Total current assets | | 51,473 | 9,102 |
| Total assets | | 299,884 | 256,060 |
| Liabilities and unitholders' equity | | | |
| Liabilities | | | |
| Non-current liabilities | | | |
| Mortgage loans | 5 | 48,913 | - |
| Finance lease liabilities | 5 | 100,008 | 102,573 |
| Lease equalization loan | | 2,477 | 1,470 |
| Tenant deposits | | 1,017 | 1,189 |
| Exchangeable securities | 6 | 13,354 | 11,648 |
| Derivative financial instruments | 7 | 448 | 1,469 |
| Total non-current liabilities | | 166,217 | 118,349 |
| Current liabilities | | | |
| Finance lease liabilities | 5 | 3,907 | 9,055 |
| Tenant deposits | | 263 | - |
| Exchangeable securities | 6 | 1,097 | 586 |
| Derivative financial instruments | 7 | 286 | 1,002 |
| Trade and other payables | | 16,845 | 4,068 |
| Total Current liabilities | | 22,398 | 14,711 |
| Total liabilities | | 188,615 | 133,060 |
| Unitholders' equity | | | |
| Unitholders' equity | | 98,750 | 98,719 |
| Retained earnings | | (1,034) | 10,610 |
| Accumulated other comprehensive income | | 13,553 | 13,671 |
| Total Unitholders' equity | | 111,269 | 123,000 |
| Total liabilities and unitholders' equity | | 299,884 | 256,060 |

See accompanying notes to condensed interim consolidated financial statements

On behalf of the Board of Trustees of Inovalis Real Estate Investment Trust:

Stéphane Amine
Chairman and Trustee

Daniel Argiros
Lead Trustee

INOVALIS REIT Condensed Interim Consolidated Statement of Income

(in thousands of Canadian dollars)

| | Note | 3 months ended June 30th | | Year to date | |
|---|------|--------------------------|-------------------|------------------------------|--|
| | | 2014 | 2013 ¹ | 6 months ended June 30, 2014 | Period from February 8, 2013 to June 30, 2013 ¹ |
| Rental income | | 4,658 | 3,485 | 9,545 | 3,485 |
| Service charge income | | 1,115 | 1,197 | 2,222 | 1,197 |
| Service charge expense | | (786) | (2,104) | (3,645) | (2,104) |
| Other property operating expense | | 52 | (221) | 29 | (221) |
| Net rental income | | 5,039 | 2,357 | 8,151 | 2,357 |
| Administration expenses | 8 | (837) | (831) | (1,866) | (831) |
| Foreign exchange loss | | (19) | - | 19 | - |
| Net change in fair value of investment properties | 4 | (1,693) | 1,596 | (556) | 1,596 |
| Gain on bargain purchase | | - | 9,677 | - | 9,677 |
| Acquisition costs | | (361) | (3,419) | (413) | (3,419) |
| Operating profit | | 2,129 | 9,380 | 5,335 | 9,380 |
| Gain (loss) on financial instruments at fair value through profit or loss | 7 | 30 | (1,323) | (710) | (1,323) |
| Loss recognized on exercise of early payment option on finance leases | 5 | (7,972) | - | (7,972) | - |
| Finance costs | 9 | (847) | (664) | (1,704) | (664) |
| Distributions recognized on exchangeable securities | 6 | (297) | - | (584) | - |
| Net change in fair value of exchangeable securities | 6 | 73 | 339 | (1,325) | 339 |
| Profit (loss) before tax | | (6,884) | 7,732 | (6,960) | 7,732 |
| Current income tax expense | | (13) | (4) | (27) | (4) |
| Profit (loss) for the period | | (6,897) | 7,728 | (6,987) | 7,728 |
| Earnings per Unit: | | | | | |
| Basic earnings per unit from profit (loss) for the period | | (0.61) | 0.68 | (0.62) | 0.68 |
| Diluted earnings per unit from profit (loss) for the period | | (0.61) | 0.59 | (0.62) | 0.59 |

¹Service charge expense and Net change in fair value of investment properties for prior year have been adjusted to comply with IFRIC 21

See accompanying notes to condensed interim consolidated financial statements

Condensed Interim Consolidated Statement of Comprehensive Income

(in thousands of Canadian dollars)

| | Note | 3 months ended June 30th | | Year to date | |
|---|------|--------------------------|---------------|------------------------------|--|
| | | 2014 | 2013 | 6 months ended June 30, 2014 | Period from February 8, 2013 to June 30, 2013 ¹ |
| Profit (loss) for the period | | (6,897) | 7,728 | (6,987) | 7,728 |
| Items that will be reclassified subsequently to profit or loss | | | | | |
| Derivatives designated as a hedge in the net investment in a foreign entity | 8 | | | | |
| Current year gains and (losses) | | 989 | | 989 | - |
| Reclassification of net losses to net income | | | | - | - |
| Derivatives designated as cash flow hedges | 8 | | | | |
| Current year gains and (losses) | | (1,001) | | (1,001) | |
| Reclassification of net losses to net income | | - | | - | |
| Change in cumulative translation adjustment account | | (5,368) | 4,850 | (106) | 4,850 |
| Total comprehensive income (loss) for the period | | (12,277) | 12,578 | (7,105) | 12,578 |

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT
Condensed Interim Consolidated Statement of changes in Unitholders' Equity

(in thousands of Canadian dollars, except number of Units)

| Statement of changes in equity | Note | Number of Units issued and outstanding | Attributable to Unitholders of the Trust | | | |
|---|------|--|--|-------------------|--|----------------|
| | | | Unitholders' equity | Retained earnings | Accumulated other comprehensive income (Cumulative translation adjustment account) | Total |
| As at December 31, 2013 | | 11,285,087 | 98,719 | 10,610 | 13,671 | 123,000 |
| Distribution Reinvestment Plan | | 7,141 | 65 | (65) | | - |
| Issue costs | | | (34) | | | (34) |
| Distributions paid | 11 | | | (3,816) | | (3,816) |
| Distributions payable | 11 | | | (776) | | (776) |
| Transactions with owners | | 7,141 | 31 | (4,657) | - | (4,626) |
| Profit (loss) for the period | | | | (6,987) | | (6,987) |
| Other comprehensive income | | | | | | |
| Net changes in unrealized gains (losses) on derivatives designated as a hedge in the net investment in a foreign entity | | | | | 989 | 989 |
| Net changes in unrealized gains (losses) on interest rate derivatives designated as a cash flow hedge | | | | | (1,001) | (1,001) |
| Change in cumulative translation adjustment account | | | | | (106) | (106) |
| Total comprehensive loss for the period | | - | - | (6,987) | (118) | (7,105) |
| As at June 30, 2014 | | 11,292,228 | 98,750 | (1,034) | 13,553 | 111,269 |
| As at February 8, 2013 | | - | - | - | - | - |
| Public offering of Units | | 11,370,000 | 113,700 | | | 113,700 |
| Issue costs | | | (13,569) | | | (13,569) |
| Distributions paid | 11 | | | (1,329) | | (1,329) |
| Distributions payable | 11 | | | (782) | | (782) |
| Transactions with owners | | 11,370,000 | 100,131 | (2,111) | - | 98,020 |
| Profit for the period | | | | 7,728 | | 7,728 |
| Other comprehensive income | | | | | | |
| Change in cumulative translation adjustment account | | | | | 4,850 | 4,850 |
| Total comprehensive income for the period | | - | - | 7,728 | 4,850 | 12,578 |
| As at June 30, 2013 | | 11,370,000 | 100,131 | 5,617 | 4,850 | 110,598 |

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Condensed Interim Consolidated Statement of Cash Flows

(in thousands of Canadian dollars)

| | Note | For the 3 months ended June 30th | | Year to date | |
|---|------|----------------------------------|----------------------|--------------------------------------|--|
| | | 2014 | 2013 ¹ | For the 6 months ended June 30, 2014 | Period from February 8, 2013 to June 30, 2013 ¹ |
| Operating activities | | | | | |
| Profit (loss) before taxes | | (6,884) | 7,732 | (6,960) | 7,732 |
| Adjustments for non-cash items: | | | | | |
| Rent free period | | (483) | (416) | (967) | (416) |
| Management fees paid in Exchangeable securities | | 437 | 327 | 892 | 327 |
| Net change in fair value of investment properties | | 1,693 | (496) | 556 | (496) |
| Loss on financial instruments at fair value through profit or loss | | (30) | 1,323 | 710 | 1,323 |
| Distributions recognized on Exchangeable securities | 6 | 297 | - | 584 | - |
| Net change in fair value of Exchangeable securities | 6 | (73) | (339) | 1,325 | (339) |
| Interest expense | | 619 | 673 | 1,066 | 673 |
| Amortization of fair value adjustment on assumed debt | | 30 | - | 424 | - |
| Amortization of transaction fees on mortgage loans | | 71 | - | 71 | - |
| Interest paid | | (511) | (294) | (956) | (294) |
| Income taxes paid | | (15) | - | (20) | - |
| Loss recognized on exercise of early payment option on finance leases | | 7,972 | - | 7,972 | - |
| Gain on bargain purchase | | - | (9,677) | - | (9,677) |
| Unrealized exchange gains (losses) | | (65) | - | (53) | - |
| | | <u>3,056</u> | <u>(1,167)</u> | <u>4,643</u> | <u>(1,167)</u> |
| Working capital adjustments: | | | | | |
| Increase in trade and other receivables | | 178 | (2,634) | (1,691) | (2,634) |
| Increase in tenant deposits | | 3 | 1,083 | 98 | 1,083 |
| Increase in trade and other payables | | 8,776 | 7,128 | 13,518 | 7,128 |
| Settlement of derivative financial instruments | | (2,825) | - | (3,123) | - |
| Net cash flow related to operating activities | | <u>9,188</u> | <u>4,410</u> | <u>13,445</u> | <u>4,410</u> |
| Investing activities | | | | | |
| Business acquisition | | - | (96,348) | - | (96,348) |
| Finance lease debt reimbursement and SWAP settlement | | - | (5,498) | - | (5,498) |
| Additions to investment properties | | (60) | - | (60) | - |
| Decrease (increase) in other financial assets | | 2,973 | (2,259) | 2,703 | (2,259) |
| Net cash flow related to investing activities | | <u>2,913</u> | <u>(104,105)</u> | <u>2,643</u> | <u>(104,105)</u> |
| Financing activities | | | | | |
| Units issued for cash | | - | 113,700 | - | 113,700 |
| Issue costs | | (34) | (13,569) | (34) | (13,569) |
| Exchangeable securities issued for cash | 6 | - | 11,688 | - | 11,688 |
| Distributions on Units paid in cash | 8 | (2,294) | (1,329) | (4,592) | (1,329) |
| Distributions on Exchangeable securities paid in the form of interest on notes issued by a subsidiary | 6 | (147) | - | (296) | - |
| Distributions on Exchangeable securities paid in the form of repayment of interest bearing notes issued by a subsidiary | 6 | (113) | - | (474) | - |
| Proceeds from new mortgage loans, net of transaction costs | 5 | 50,838 | - | 50,838 | - |
| Proceeds from new sale-leaseback, net of initial down payment | 5 | 85,708 | - | 85,708 | - |
| Transaction fees related to new lease | | (2,633) | - | (2,633) | - |
| Repayment of lease liability upon exercise of early payment option at BBA SCI | | (55,808) | - | (55,810) | - |
| Repayment of lease liability upon exercise of early payment option at Jeuners and Véronèse SCI | | (44,285) | - | (44,285) | - |
| Regular repayment of finance lease liabilities | | (1,086) | (1,402) | (3,057) | (1,402) |
| Purchase of derivative financial instrument - CAP on mortgage loan interest | | (529) | - | (529) | - |
| Lease equalization loan | | 483 | 501 | 967 | 501 |
| Net cash flow related to financing activities | | <u>30,100</u> | <u>109,589</u> | <u>25,803</u> | <u>109,589</u> |
| Net increase in cash | | <u>42,201</u> | <u>9,894</u> | <u>41,891</u> | <u>9,894</u> |
| Effects of foreign exchange adjustments | | (294) | 3,003 | (237) | 3,003 |
| Cash at the beginning of the period | | <u>5,867</u> | <u>-</u> | <u>6,120</u> | <u>-</u> |
| Cash and cash equivalents | | <u>47,774</u> | <u>12,897</u> | <u>47,774</u> | <u>12,897</u> |
| Cash and cash equivalents at the end of the period: | | | | | |
| Cash | | 47,530 | 12,897 | 47,530 | 12,897 |
| Cash equivalents | | 244 | - | 244 | - |
| | | <u>47,774</u> | <u>12,897</u> | <u>47,774</u> | <u>12,897</u> |

¹Interest paid in prior year has been reclassified as an operating activity

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 1 – Organization

Inovalis Real Estate Investment Trust (the “Trust”) is an open-ended real estate investment trust created pursuant to a Declaration of Trust dated February 8, 2013, under the laws of the Province of Ontario, Canada. These condensed interim consolidated financial statements include the accounts of the REIT and its subsidiaries (together the “REIT”). The REIT’s investment property portfolio is comprised of office rental properties located in France and Germany.

The REIT’s head and registered office is located at 151 Yonge Street, 11th floor, Toronto, Ontario, M5C 2W7. The REIT’s units are listed on the Toronto Stock Exchange (“TSX”) under the symbol INO.UN.

The REIT’s condensed interim consolidated financial statements for the three and six-month periods ended June 30, 2014, were authorized for issuance by the Board of Trustees on August 8th, 2014.

Note 2 – Basis of preparation of condensed interim consolidated financial statements

Statement of compliance

These unaudited condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*. They are condensed and do not include all disclosures that would otherwise be required in a complete set of financial statements and should be read in conjunction with the 2013 audited consolidated annual financial statements.

Basis of presentation

The unaudited condensed interim consolidated financial statements are prepared on a going concern basis and have been presented in Canadian dollars for reporting to the REIT’s Canadian Unitholders. All financial information has been rounded to the nearest thousand (CAD\$ 000) except when otherwise indicated.

Note 3 – Significant accounting policies

The condensed interim consolidated financial statements have been prepared in accordance with the accounting policies adopted in the REIT’s most recent annual financial statements for the year ended December 31, 2013, except for the application of newly applicable standards such as IFRIC 21 Levies (IFRIC 21) and for the application of the standards surrounding hedge accounting.

New policies applied in 2014

IFRIC 21 is applicable for all years starting on or after January 1, 2014. IFRIC 21 clarifies that the obligating event that gives rise to a liability is the activity that triggers the payment of the levy, as identified by the government’s legislation. If this activity arises on specific dates within the accounting period then the entire obligation is recognized on that date. IFRIC 21 has no material effect on the REIT’s annual financial statements but it affects the timing of recognition of property taxes between interim periods. Prior to the implementation of IFRIC 21, property taxes expense was recognized gradually over the year, resulting in the recognition of a liability or a prepaid expense at interim reporting dates. The application of IFRIC 21 requires the REIT to recognize the entire obligation at the beginning of the period, which is the date specified in the relevant legislation. The relevant legislation for the REIT is the legislation pertaining to property and office tax in France and Germany. To avoid double-counting however, this expense must be removed from the discounted cash flows that are used to determine the fair value of the related investment properties, resulting in a compensating variance.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

| | <u>Q1</u> | <u>Q2</u> | <u>Q3</u> | <u>Q4</u> | <u>Total for year</u> |
|--|-----------|-----------|-----------|-----------|-----------------------|
| Impact on Balance sheet | | | | | |
| Increase in fair value of Investment properties | 1,659 | 1,123 | 553 | - | |
| Increase in Trade and other payables | (1,659) | (1,123) | (553) | - | |
| Net change to retained earnings | - | - | - | - | |
| Impact on Quarterly Income Statement | | | | | |
| Decrease (Increase) in service charge expense | (1,659) | 536 | 570 | 553 | - |
| Increase (decrease) in Net change in fair value of investment properties | 1,659 | (536) | (570) | (553) | - |
| Net change to profit for the period | - | - | - | - | - |

IFRIC 21 has been applied retrospectively in accordance with its transitional provisions.

Derivative financial instruments and hedge accounting – initial recognition and subsequent measurement

On April 22, 2014, the REIT entered into a new series of foreign exchange contracts that were designated as hedges of the REIT's net investment in a foreign operation.

On May 5, 2014, and on June 20, 2014, concurrent with the implementation of the new financing arrangements described in Note 5 – Mortgage loans and finance lease liabilities, the REIT entered into SWAP and CAP contracts that were designated as cash flow hedges aimed at mitigating the impacts of unfavorable variations in interest rates.

At that time that each of these contracts was entered in to, the REIT started applying the applicable standards related to hedge accounting. According to these standards, all these contracts are considered to be derivative financial instruments. Derivative financial instruments are initially recognized at their fair values on the date at which a derivative contract is entered into and are subsequently measured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. At the inception of a hedge relationship, the REIT formally designates and documents the hedge relationship to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated. The effective portion of the gain or loss on the hedging instruments is recognized in other comprehensive income, while any ineffective portion is recognized immediately in profit or loss. Amounts recognized in other comprehensive income are transferred to profit or loss when the hedged item affects profit or loss, for example: when the net investment in a foreign operation is disposed of resulting in a gain or loss or, in the case of an interest rate hedge, when interest payments associated with the contract are settled.

Accounting policies issued but not yet applied

The following paragraphs present new or amended accounting standards that have relevance to the REIT but that have not yet been adopted at the date of authorisation of these condensed interim consolidated financial statements.

Management anticipate that all of the relevant pronouncements will be adopted in the REIT's accounting policies for the first period beginning after the effective date of the pronouncement. Certain other standards and interpretations have been issued but are not expected to have an impact on the REIT's consolidated financial statements.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

IFRS 9, Financial instruments

The IASB aims to replace IAS 39, *Financial Instruments: Recognition and Measurement* in its entirety. The replacement standard (IFRS 9) is being issued in phases. To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities and the chapters dealing with hedge accounting have been issued. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification

depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. Further chapters dealing with impairment methodology are still being developed. The effective date for IFRS 9 has yet to be determined, and implementation is not expected to be required before all chapters are completed and not for annual periods beginning prior to January 1, 2018. The REIT has yet to assess the impact that this standard will have on its consolidated financial statements. However, it does not expect to implement it until all chapters have been published and the implementation is required.

Estimates

When preparing the condensed interim consolidated financial statements, management uses a number of judgements, estimates and assumptions about the recognition and measurement of assets, liabilities, income and expenses. The actual results may differ from the judgements, estimates and assumptions used by management and will seldom equal the estimated results.

The judgements, estimates and assumptions used in the condensed interim consolidated financial statements including the key sources of estimation uncertainty are the same as those used in the preparation of the REIT's last audited annual consolidated financial statements for the year ended December 31, 2013.

Note 4 – Investment properties

| Investment properties | Period from January 1, 2014 to June 30, 2014 | Period from February 8, 2013 to December 31, 2013 |
|---|--|--|
| Beginning of period | 244,900 | - |
| Additions (regular) | 60 | 36 |
| Acquisitions through business combination | - | 217,519 |
| Amount derecognized upon entry into new sales-leaseback arrangement - see note 5 | (122,420) | - |
| Amount recognized upon entry into new sales-leaseback arrangement - see note 5 | 122,420 | - |
| Transaction and transfer fees related to new sales-leaseback arrangement - see note 5 | 2,633 | - |
| Rent free period | 964 | 1,389 |
| IFRIC 21 adjustment (Note 3) | 1,123 | - |
| Valuation gains (losses) from fair value adjustment on investment properties | (1,679) | 5,894 |
| Net change in fair value of investment properties | (556) | - |
| Foreign currency translation adjustment | (681) | 20,062 |
| End of period | 247,320 | 244,900 |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 5 – Mortgage loans and finance lease liabilities

(in thousands of CAD\$)

| Entity | Nominal value | Interest rate | Maturity | As at June 30, 2014 | | |
|--|----------------|---------------------------------|------------|---------------------|----------------|--------------|
| | | | | Total | Non-current | Current |
| Mortgage loan - Véronèse SCI | 21,192 | Euribor 3M + 1,75% ¹ | 2019-05-05 | 20,884 | 20,884 | - |
| Mortgage loan - Jeûneurs SCI | 28,499 | Euribor 3M + 1,75% ¹ | 2019-05-05 | 28,029 | 28,029 | - |
| Mortgage loans | 49,691 | | | 48,913 | 48,913 | - |
| Finance lease liabilities - BBA SCI | 85,644 | Euribor 3M + 2% ² | 2026-06-20 | 85,559 | 82,533 | 3,026 |
| Finance lease liabilities - CanCorpHanover | 19,226 | Euribor 3M + 0.82% | 2023-06-30 | 18,356 | 17,475 | 881 |
| Finance lease liabilities | 104,870 | | | 103,915 | 100,008 | 3,907 |
| Total lease and loan financing | 154,561 | | | 152,828 | 148,921 | 3,907 |

Note 1 : Interest rate is subject to a CAP - see note 7 *Financial derivatives and hedging activities*

Note 2 : Interest rate is subject to SWAP - see note 7 *Financial derivatives and hedging activities*

| Entity | Nominal value | Interest rate | Maturity | As at December 31, 2013 | | |
|--|----------------|--|------------|-------------------------|----------------|--------------|
| | | | | Total | Non-current | Current |
| Finance lease liabilities - BBA SCI | 56,746 | Euribor 3M + 1.15% | 2016-12-02 | 54,645 | 50,011 | 4,634 |
| Finance lease liabilities - Véronèse SCI | 17,825 | Euribor 3M + 1.20% & Euribor 3M + 2.20% | 2015-10-16 | 17,624 | 15,767 | 1,857 |
| Finance lease liabilities - Jeûneurs SCI | 22,170 | Euribor 3M + 1.05% | 2019-01-13 | 20,882 | 18,951 | 1,931 |
| Finance lease liabilities - CanCorpHanover | 19,597 | Euribor 3M + 0.82% | 2023-06-30 | 18,477 | 17,844 | 633 |
| Total finance lease liabilities | 116,338 | | | 111,628 | 102,573 | 9,055 |

The REIT holds certain leasehold properties that it classifies as investment properties (See Note 4 - Investment properties). The leases are accounted for as finance leases.

In these leases, the REIT has the option to purchase each of the properties at the end of their respective leases. The fixed price of the option to purchase is expected to be lower than the fair value at the date the option becomes exercisable.

At the inception of the leases, the REIT as lessee paid a down payment to the lessor. The financial lease liability is presented net of this down payment.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Reconciliation of mortgage loans and finance lease liabilities

| Movement in debt financing | For the six month period ended June 30, 2014 | | | | | Period from February 8, 2013 to December 31, 2013 |
|---|--|---------------|----------------|--------------------|-----------------|---|
| | Legacy leases | New lease | Total leases | New Mortgage loans | Total financing | |
| Balance - debt financing - beginning of the period | 111,628 | - | 111,628 | | 111,628 | - |
| Business acquisitions | - | - | - | - | - | 109,866 |
| Partial early payment of Hanover finance lease | - | - | - | - | - | (3,764) |
| Regular repayment of principal | (3,064) | (83) | (3,147) | - | (3,147) | (4,952) |
| Regular amortization of fair value adjustment on assumed debt | 423 | - | 423 | - | 423 | 1,093 |
| Variance in accrued interest included in lease balance | 56 | - | 56 | - | 56 | - |
| Exercise of early payment option at BBA SCI | (54,856) | - | (54,856) | - | (54,856) | - |
| Exercise of early payment option at Jeuneurs and Véronèse SCI | (40,567) | - | (40,567) | - | (40,567) | - |
| Write-off of unamortized fair value adjustment on debt assumed in a business combination - write-off as a result of the exercise of the early purchase option | 3,280 | - | 3,280 | - | 3,280 | - |
| Proceeds from new leases and mortgages | - | 85,708 | 85,708 | 51,714 | 137,422 | - |
| Transaction costs related to loan | - | - | - | (876) | (876) | - |
| Amortization of transaction costs using the effective interest method | - | - | - | 71 | 71 | - |
| Foreign currency translation adjustment | 1,456 | (66) | 1,390 | (1,996) | (606) | 9,385 |
| Balance - debt financing - end of the period | 18,356 | 85,559 | 103,915 | 48,913 | 152,828 | 111,628 |

Explanation of principal changes during the period

In preparation for its planned acquisition of a 50% interest in a new investment property in Duisburg, Germany, the REIT refinanced its existing investment properties in France. This was done in two steps as follows:

Firstly, on May 5, 2014, the REIT exercised its option to purchase the Jeuneurs and Courbevoie investment properties that had, up to the moment of the transaction, been leased by its Jeuneurs SCI and Véronèse SCI subsidiaries respectively. Concurrently, the REIT entered into a mortgage loan agreement with ING Bank. The mortgage loan, which had a principal amount of 34 million Euros, is comprised of two tranches – one of 19.5 million Euros for the Jeuneurs property and one of 14.5 million Euros for the Courbevoie property. The mortgage loan has a term of five years maturing on May 5, 2019. The loan agreement does not specify any requirements for principal repayments, except at maturity or in exception circumstances. Interest payments, which will be made quarterly on March 31, June 30, September 30, and December 31, will be variable, based on the 3 Month EURIBOR rate plus a spread of 1.75%. The EURIBOR portion of the interest payments have been hedged using an interest rate cap with a strike price of 2%. For more information regarding the hedges, refer to note 7 - Financial derivatives and hedging activities.

Secondly, on June 20, 2014, the REIT exercised its option to purchase the Vanves investment property that had, up to the moment of the transaction, been leased by its BBA SCI subsidiary. Concurrently, the REIT entered into a sale-leaseback arrangement with CMCIC LEASE S.A. The lease is for a total amount of 83.7 million Euros, less a down-payment of 25.1 million Euros giving a net lease amount of 58.6 million Euros. The lease has a term of twelve years maturing on June 20, 2026. The rent, which is paid quarterly in advance, includes a component representing the repayment of capital and a component representing the repayment of interest. The interest charges will be variable, based on the 3 Month EURIBOR rate plus a spread of 2%. The EURIBOR portion of the interest charges have been hedged using an interest rate swap with a fixed rate of 0.685%. For more information regarding the hedges, refer to note 7 - Financial derivatives and hedging activities.

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The impact of each the repayment and financing transactions is outlined below:

Summary of repayment transactions

| Summary of early purchase option transaction | Jeûneurs & Véronèse SCI | BBA | Total |
|---|-------------------------|---------|---------|
| Payment amount | | | |
| Purchase option exercise price | 42,498 | 57,498 | 99,996 |
| Less: amount of down payment | (1,036) | (2,642) | (3,678) |
| Net exercise price | 41,462 | 54,856 | 96,318 |
| Plus: transaction costs | 2,823 | 954 | 3,777 |
| Total cash outflow | 44,285 | 55,810 | 100,095 |
| Accounting distribution | | | |
| Reduction of lease liability | 40,547 | 54,856 | 95,403 |
| Amounts included in loss detailed below | 3,738 | 954 | 4,692 |
| Total payment amount | 44,285 | 55,810 | 100,095 |
| Loss on exercise of early purchase of option | | | |
| Transaction costs | 2,823 | 954 | 3,777 |
| Contractual compensation to lender & Other | 915 | - | 915 |
| | 3,738 | 954 | 4,692 |
| Write-off of unamortized discount on lease liabilities ² | 1,398 | 1,882 | 3,280 |
| Total loss on exercise of early purchase option | 5,136 | 2,836 | 7,972 |

Note 1 : The transaction fees related to the BBA SCI transaction were allocated to the cost of the investment property

Note 2 : When the REIT acquired these properties in 2013, it accounted for the acquisition as a business combination and recognized the lease liabilities at their fair value which was less than their actual outstanding amount at the time due to the effect of discounting using current interest rates. This discount has been amortized using the effective interest method

Summary of new financing transactions

| Summary of new financing transactions | Jeûneurs & Véronèse SCI | BBA | Total |
|--|-------------------------|----------|----------|
| Mortgage loans | | | |
| Proceeds received from new loan | 51,714 | - | 51,714 |
| Less: transaction costs related to loan ¹ | (876) | - | (876) |
| Total cash inflow | 50,838 | - | 50,838 |
| Financial Lease | | | |
| Total amount of finance lease | - | 122,420 | 122,420 |
| Less: initial down payment amount | - | (36,712) | (36,712) |
| Net amount of financing received | - | 85,708 | 85,708 |
| Investment properties | | | |
| Total amount of finance lease | - | 122,420 | 122,420 |
| Transaction fees related to new lease | - | 1,274 | 1,274 |
| Transfer fees related to new lease | - | 1,359 | 1,359 |
| Total transaction and transfer fees ² | - | 2,633 | 2,633 |
| Amount recognized as investment properties | - | 125,053 | 125,053 |

Note 1 : The transaction costs for the loan were recognized in the carrying amount of the loan and amortized using the effective interest method

Note 2 : The transaction and transfer costs for the sale-leaseback were capitalized as part of the cost of the investment property

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Minimum lease payments and the present value of finance lease liabilities are as follows:

(in thousands of CAD\$)

| Carrying value and minimum lease payments | As at June 30, 2014 | | As at December 31, 2013 | |
|--|---------------------|------------------------|-------------------------|------------------------|
| | Carrying value | Minimum lease payments | Carrying value | Minimum lease payments |
| Within 1 year | 3,907 | 6,575 | 9,055 | 9,567 |
| After 1 year, but not more than 5 years | 18,791 | 28,691 | 76,380 | 84,756 |
| More than 5 years | 81,217 | 95,056 | 26,193 | 31,054 |
| Total carrying value and minimum lease payments | 103,915 | 130,322 | 111,628 | 125,377 |
| Less : future interest costs | | (26,407) | | (13,749) |
| Total carrying value | 103,915 | 103,915 | 111,628 | 111,628 |
| Of which is non-current | 100,008 | | 102,573 | |
| Of which is current | 3,907 | | 9,055 | |

(in thousands of CAD\$)

| Carrying value and minimum mortgage loan payments | As at June 30, 2014 | | As at December 31, 2013 | |
|--|---------------------|---------------------------------------|-------------------------|---------------------------------------|
| | Carrying value | Minimum capital and interest payments | Carrying value | Minimum capital and interest payments |
| Within 1 year | - | 1,013 | - | - |
| After 1 year, but not more than 5 years | 48,913 | 54,949 | - | - |
| More than 5 years | - | - | - | - |
| Total carrying value and minimum lease payments | 48,913 | 55,962 | - | - |
| Less : future interest costs | | (7,049) | | - |
| Total carrying value | 48,913 | 48,913 | - | - |
| Of which is non-current | 48,913 | | - | |
| Of which is current | - | | - | |

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Note 6 – Exchangeable Securities

(in thousands of CAD\$)

| Exchangeable securities issued and outstanding | Investment by Inovalis S.A. in CanCorpEurope S.A. | | | | Exchangeable securities | |
|--|---|--------------------------------------|---|------------------|-----------------------------------|--|
| | Common shares (number) | Investment in shares & share premium | Investment in Debt instruments ¹ | Total investment | Number of Exchangeable securities | Carrying amount of Exchangeable securities |
| Balance - February 8, 2013 | | | | | - | - |
| Transactions in 2013 | | | | | | |
| Initial investment at the time of the IPO | 170 | 1,115 | 10,573 | 11,688 | 1,168,762 | 11,688 |
| Additional investment related to over-allotment | - | 83 | 787 | 870 | 87,000 | 870 |
| Asset management fees paid in exchangeable securities | - | 113 | 1,085 | 1,198 | 132,923 | 1,198 |
| Distribution of Exchangeable securities paid in the form of reimbursement of notes | | | (161) | (161) | - | - |
| Net change in fair value of Exchangeable securities | | | | | - | (1,522) |
| Foreign Currency translation adjustment | | | 1,214 | 1,214 | - | - |
| Balance - December 31, 2013 | 170 | 1,311 | 13,498 | 14,809 | 1,388,685 | 12,234 |
| Transactions in 2014 | | | | | | |
| Asset management fees paid in Exchangeable securities | | 86 | 806 | 892 | 91,984 | 892 |
| Distribution of Exchangeable securities paid in the form of reimbursement of notes | | | (476) | (476) | - | - |
| Net change in fair value of Exchangeable securities | | | - | - | - | 1,325 |
| Foreign Currency translation adjustment | | | (35) | (35) | - | - |
| Balance - June 30, 2014 | 170 | 1,397 | 13,793 | 15,190 | 1,480,669 | 14,451 |

At the end of the period, the outstanding balances of the debt instruments payable by CanCorpEurope to Inovalis S.A. were as follows:

| Debt instruments | Nominal interest rate | Maturity date | Amount as at June 30, 2014 | Amount as at December 31, 2013 |
|---------------------------|-----------------------|---------------|----------------------------|--------------------------------|
| Interest bearing note | 9.00% | 10 April 2028 | 5,869 | 5,988 |
| Interest bearing note | 4.50% | 10 April 2028 | 1,661 | 1,575 |
| | | | 7,530 | 7,563 |
| Non-interest bearing note | | 10 April 2028 | 6,263 | 5,935 |
| | | | 13,793 | 13,498 |

¹The debt instruments issued by CanCorpEurope in favour of Inovalis S.A. mature on April 10, 2028, unless Inovalis S.A. exercises its exchange privileges prior to that date. The difference between the carrying amount of the Exchangeable securities at the end of the current reporting period and the amount that the REIT would be contractually required to pay at maturity to the holder of the debt instruments is \$658. The REIT would not be required to pay any amount for the Investment in shares & share premium.

According to the amended and restated exchange agreement, if upon maturity of the debt instruments, the unit price of the REIT's units are less than \$10 per unit (the price at which the Exchangeable securities were initially issued), the REIT has the right to exchange the Exchangeable securities for units of the REIT rather than reimburse the debt.

As part of the Initial Public Offering ("IPO") that the REIT realized in April 2013, Inovalis S.A, who acts as the manager of the REIT, purchased, at the offering price of \$10 per unit, an approximate 10% ownership interest in the REIT on a fully exchangeable basis. This ownership interest was exercised through the purchase of interest bearing notes, non-interest bearing notes and common shares of CanCorpEurope S.A., the REIT's holding company for its European assets. These instruments, which are collectively referred to as the Exchangeable securities, are economically equivalent to and exchangeable at the option of Inovalis S.A. for units of the Trust.

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When the overallotment option was exercised by the Underwriters shortly after the Initial Public Offering in April 2013, Inovalis S.A. purchased 10% of the units in order to maintain its overall 10% ownership in the REIT. Subsequently, to convert these units into Exchangeable Securities, 10% of the units issued in the overallotment, or in other words the 87,000 units purchased during the overallotment by Inovalis S.A., were cancelled by the REIT. Concurrently, the proceeds of \$870,000 related to those units were transferred by the REIT to CanCorpEurope S.A., where they were invested in Exchangeable securities in favour of Inovalis S.A..

In performing its obligations under the Management Agreement, Inovalis S.A., is entitled to receive asset management fees. These asset management fees earned by Inovalis S.A., in its role as manager of the REIT, are payable quarterly in arrears, entirely in Exchangeable securities.

Notwithstanding the form of the Exchangeable securities, the number of Exchangeable securities issued in favour of Inovalis S.A. for eventual conversion is determined based on the amount of funds invested in the above-mentioned instruments and a per-unit value determined for the transaction in question. The per-unit value of the Exchangeable securities issued at the time of the Initial Public Offering, including the overallotment, was based on the offering price. The per-unit value of Exchangeable securities issued by CanCorpEurope S.A. in lieu of payment for annual management fees is determined using the average quoted market price of the REIT's units on the Toronto stock exchange for the five days immediately preceding the transaction.

The Exchangeable securities acquired at the time of the Initial Public Offering are subject to the Initial Retained Interest Escrow whereby they will be automatically released from escrow to Inovalis S.A. on the third anniversary of the closing. During the Initial Retained Interest Escrow period, Inovalis S.A. is restricted from selling its Initial Retained Interest but will retain all ownership rights. Further, 50% of the Exchangeable securities issued for payment of management fees are subject to an escrow arrangement that only releases the Exchangeable securities after the termination of the Management agreement or after the internalisation of Management to the REIT. In the case of internalization, one third of the latter securities will be released immediately and one third will be released on the first and second anniversary of internalization. Once the Exchangeable securities are released from escrow, it will be possible for Inovalis S.A. to receive one of the REIT's units for each of its Exchangeable securities.

| | As at June 30, 2014 | | | |
|--|--|--|--|---|
| Exchangeable securities in escrow until internalization of management | Number in escrow - presented as non-current | Number not in escrow - presented as current | Total number of Exchangeable securities | Carrying amount of Exchangeable securities |
| Securities issued at the time of the IPO | 1,168,762 | | 1,168,762 | 11,408 |
| Securities issued in connection with the overallotment | 87,000 | | 87,000 | 849 |
| Securities issued in lieu of asset management fees | 112,454 | 112,453 | 224,907 | 2,194 |
| Total number of Exchangeable securities outstanding | <u>1,368,216</u> | <u>112,453</u> | <u>1,480,669</u> | <u>14,451</u> |
| Classification of liability for Exchangeable securities (000'\$) | <u>13,354</u> | <u>1,097</u> | | <u>14,451</u> |
| | As at December 31, 2013 | | | |
| Exchangeable securities in escrow until internalization of management | Number in escrow - presented as non-current | Number not in escrow - presented as current | Total number of Exchangeable securities | Carrying amount of Exchangeable securities |
| Securities issued at the time of the IPO | 1,168,762 | | 1,168,762 | 10,297 |
| Securities issued in connection with the overallotment | 87,000 | | 87,000 | 766 |
| Securities issued in lieu of asset management fees | 66,462 | 66,461 | 132,923 | 1,171 |
| Total number of Exchangeable securities outstanding | <u>1,322,224</u> | <u>66,461</u> | <u>1,388,685</u> | <u>12,234</u> |
| Classification of liability for Exchangeable securities | <u>11,648</u> | <u>586</u> | | <u>12,234</u> |

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The Exchangeable securities issued by CanCorpEurope S.A. are exchangeable into Units of the Trust by virtue of the Exchange Agreement. The Exchangeable securities are accompanied by Special Voting Units issued by the Trust, which have no economic interest but provide the Exchangeable securities holder with the same voting rights in the Trust as a Unit. Special Voting Units may only be issued in connection with or in relation to Exchangeable securities for the purpose of providing voting rights with respect to the Trust to the holders of such securities.

For a period of three years following the IPO, payment of initial interest related to the interest bearing Notes and repayment of the initial non-interest bearing notes are subordinated to the payment of cash distributions to the Unitholders, with the effect that distributions will only be paid on the Exchangeable securities held by Inovalis S.A. on a distribution date if the REIT has paid a distribution of at least \$0.06875 per Unit to Unitholders in respect of the applicable month in which the applicable distribution date falls.

During the period from January 1, 2014 to June 30, 2014, the REIT made a repayment of the interest bearing notes in the amount of \$476. By mutual agreement between Inovalis S.A. and the REIT, this amount was considered to be a distribution related to the Exchangeable securities rather than a reimbursement of Exchangeable securities.

In the event that, on or after April 10, 2028, the units of the REIT have a current market price of less than \$10, the REIT shall have the right to require Inovalis S.A. to exchange all of its Exchangeable securities for units of the REIT at a price determined using the average quoted market price of the REIT's units on the Toronto stock exchange for the five days immediately preceding the transaction.

The Exchangeable securities represent a financial liability and were designated at fair value through profit or loss.

Distributions in respect of Exchangeable securities:

The Exchangeable securities entitle the holders to cash distributions from CanCorpEurope S.A. equal, on a per Unit basis, to the distributions paid to holders of Units by the REIT.

The following table breaks down distribution payments:

| <i>(in thousands of CAD\$)</i> | Three months ended June 30, | | Year to date | |
|--|-----------------------------|------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Distributions in respect of exchangeable securities | | | | |
| Amount payable at the beginning of the period | (17) | - | 213 | - |
| Declared and recognized during the period | 297 | 217 | 584 | 217 |
| Accrued or paid in cash in the form of interest on interest bearing notes issued by CanCorpEurope S.A. | (144) | - | (296) | - |
| Paid in cash in the form of repayment of interest bearing notes issued by CanCorpEurope S.A. | (111) | - | (476) | - |
| Amount payable at the end of the period | 25 | 217 | 25 | 217 |
| Total distributions on Exchangeable securities recognized in profit or loss | 297 | 217 | 584 | 217 |
| Weighted average number of Exchangeable securities outstanding..... | 1,436,513 | 1,169,194 | 1,412,992 | 1,169,194 |
| Distributions paid per unit (based on weighted average Exchangeable securities outstanding)..... | (0.1775) | - | (0.5464) | - |

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Note 7 – Financial derivatives and hedging activities

On April 22, 2014, the REIT proceeded with the settlement of the 24 hedge contracts still outstanding from its original hedging strategy entered into shortly after the initial public offering in April 2013. These contracts provided for the monthly purchase of \$721,875 Canadian at an exchange rate of 1.3211 Canadian dollars per euro. The settled contracts covered monthly periods up to and including April 16, 2016. A loss of approximately \$2.8 million was realized at the time of settlement. This loss had been previously recognized in profit or loss, since the hedges were presented as derivative financial instruments classified as at fair value through profit or loss.

Subsequent to this settlement, the REIT entered into a series of 36 monthly foreign currency hedge contracts whereby the REIT can purchase \$750,000 each month at an exchange rate of 1.54374 Canadian dollars per euro. The new contracts cover monthly periods up to and including April 13, 2017. These contracts have been designated as hedges of the REIT's net investment in a foreign operation.

Included in the new financing arrangements described in Note 5, are an interest Rate SWAP and an interest rate CAP. These features of the new financing arrangements have been separated from the main contracts and accounted for and measured separately. These arrangements are settled on a net basis at every interest payment date.

A summary of the derivative financial instruments held by the REIT is outlined below:

| Classification and type | Number of contracts | Period covered | | Conversion from/to | | Rate | As at June 30, 2014 | | As at December 31, 2013 | |
|-------------------------|---------------------|----------------|------------|--------------------|------------|---------|-----------------------------|------------------|-----------------------------|------------------|
| | | From | To | Euros or rate | \$ or rate | | Total notional amount in \$ | Fair value in \$ | Total notional amount in \$ | Fair value in \$ |
| Foreign exchange - new | 34 | 2014-07-14 | 2017-04-13 | 486 | 750 | 1.54374 | 25,500 | 931 | | |
| SWAP | 1 | 2014-06-20 | 2019-07-01 | Variable | Fixed | 0.685% | 85,559 | (734) | | |
| CAP | 2 | 2014-05-05 | 2019-04-01 | Variable | Capped | 2.000% | 49,691 | 275 | | |
| Foreign exchange - old | 28 | 2014-01-14 | 2016-04-14 | 546 | 721 | 1.3211 | | | 20,188 | (2,471) |
| | | | | | | | | 472 | | (2,471) |

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| Period-to-period reconciliation | Interest rate hedges | Previous Foreign exchange contracts | New Foreign exchange contracts | Sub-Total |
|---|----------------------|-------------------------------------|--------------------------------|-----------|
| Balance - Beginning of period | - | (2,471) | - | (2,471) |
| Gains (losses) recognized in profit or loss | - | (710) | - | (710) |
| Purchase of CAP | 529 | - | - | 529 |
| Settlement of contracts | - | 3,181 | (58) | 3,123 |
| Gains (losses) recognized in Other comprehensive income | (1,001) | - | 989 | (12) |
| Exchange variation | 13 | - | - | 13 |
| Balance - End of period | (459) | - | 931 | 472 |
| Presented as: | | | | |
| Current assets | - | - | 435 | 435 |
| Non-current assets | 275 | - | 496 | 771 |
| Current liabilities | (286) | - | - | (286) |
| Non-current liabilities | (448) | - | - | (448) |
| | (459) | - | 931 | 472 |

Note 8 – Administration expenses

(in thousands of CAD\$)

| Administration expenses | Three months ended June 30, | | Year to date | |
|---|-----------------------------|--------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Asset management fees - related parties | (437) | (320) | (892) | (320) |
| Other general and administrative expenses | (400) | (500) | (974) | (500) |
| Other general and administrative expenses - related parties | - | (11) | - | (11) |
| Total administration expenses | (837) | (831) | (1,866) | (831) |

Other general and administrative expenses include accounting and bookkeeping fees, legal and consulting fees, statutory auditors' fees, costs related to shareholder relations and, where applicable, non-refundable VAT.

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Note 9 – Finance costs

(in thousands of CAD\$)

| Finance costs | Three months ended June 30, | | Year to date | |
|---|-----------------------------|--------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Interest costs related to finance leases | (404) | (294) | (851) | (294) |
| Interest costs related to mortgage loans | (162) | - | (162) | - |
| Interest costs related to lease equalisation loan | (30) | - | (53) | - |
| | (596) | (294) | (1,066) | (294) |
| Other finance costs | (23) | 1 | (6) | 1 |
| Standby charge on finance lease during approval period | (144) | - | (144) | - |
| Other interest paid to a related party | (14) | - | (29) | - |
| Finance costs of derivatives, net | 21 | - | 21 | - |
| | (756) | (293) | (1,224) | (293) |
| Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition | (28) | (379) | (424) | (379) |
| Amortization of transaction costs on mortgage loans | (71) | - | (71) | - |
| | (855) | (672) | (1,719) | (672) |
| Finance income | 8 | 8 | 15 | 8 |
| Total Finance costs | (847) | (664) | (1,704) | (664) |

Note 10 – Earnings per Unit

The REIT has classified the Units that it issued as equity pursuant to the provisions of IAS 32, Financial Instruments: Presentation, on the basis that the Units meet all of the criteria in IAS 32 for such classification, also referred to as the “puttable exemption”.

(a) Basic earnings per Unit

Basic earnings per unit is calculated by dividing the profit attributable to the Unitholders of the REIT by the weighted average number of Units outstanding during the period.

(in thousands of CAD\$)

| Basic earnings per Unit | Three months ended June 30, | | Year to date | |
|---|-----------------------------|-------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Net profit (loss) attributable to unitholders | (6,897) | 7,728 | (6,987) | 7,728 |
| Weighted average number of units outstanding | 11,290,383 | 11,370,000 | 11,288,451 | 11,370,000 |
| Basic earnings per unit | (0.61) | 0.68 | (0.62) | 0.68 |

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(b) Diluted earnings per Unit

Diluted earnings per unit is calculated by adjusting the weighted average number of Units outstanding to assume conversion of all dilutive potential Units. The REIT has one category of dilutive potential Units: the Exchangeable Securities. Refer to Note 6 - Exchangeable Securities for the number of Exchangeable Securities outstanding. When dilution does not result in a reduction in earnings per unit or an increase in loss per share unit, the diluted earnings per share is identical to basic earnings per unit.

| (in thousands of CAD\$) | Three months ended June 30, | | Year to date | |
|---|-----------------------------|--------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Diluted earnings per Unit | | | | |
| Net profit attributable to unitholders | (6,897) | 7,728 | (6,987) | 7,728 |
| Distributions recognized on Exchangeable securities | 297 | - | 584 | 0 |
| Net change in fair value of Exchangeable securities | (73) | (339) | 1,325 | (339) |
| Net profitable attributable to diluted unitholders | (6,673) | 7,389 | (5,078) | 7,389 |
| Weighted average number of units outstanding | 11,290,383 | 11,370,000 | 11,288,451 | 11,370,000 |
| Weighted average number of Exchangeable securities outstanding | 1,436,513 | 1,169,194 | 1,412,992 | 1,169,194 |
| Weighted average number of units used for diluted earnings per unit | 12,726,896 | 12,539,194 | 12,701,443 | 12,539,194 |
| Diluted earnings per unit¹ | (0.61) | 0.59 | (0.62) | 0.59 |

¹ Diluted earnings per unit is identical to basic earnings per unit when the dilution does not result in a reduction of earnings per unit or an increase in loss per unit

Note 11 – Distributions

| (in thousands of CAD\$) | Three months ended June 30, | | Year to date | |
|---|-----------------------------|--------------|--|---|
| | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Distributions | | | | |
| Amount payable at the beginning of the period | 776 | - | 776 | - |
| Declared and recognised during the period | 2,329 | 2,111 | 4,657 | 2,111 |
| Distributions paid in units (Distribution Reinvestment Plan) | (35) | - | (65) | - |
| Paid in cash | (2,294) | (1,329) | (4,592) | (1,329) |
| Amount payable at the end of the period | 776 | 782 | 776 | 782 |
| Total distributions | 2,329 | 2,111 | 4,657 | 2,111 |
| Distributions paid per unit (based on weighted average number of units outstanding) | 0.21 | 0.19 | 0.41 | 0.19 |

A Distribution Reinvestment Plan (“DRIP”) has been put in place starting from the July, 2013 distribution, providing Unitholders with the opportunity to accumulate additional Units plus additional bonus Units in an amount equal to three percent of the distributions reinvested by the Unitholders. The DRIP provides an efficient and cost-effective way for the REIT to issue additional equity to existing Unitholders.

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(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

On June 23, 2014, the distribution for the month of June was declared, amounting to a total distribution of \$776. This amount was paid on July 15, 2014.

The REIT's Declaration of Trust endeavours to maintain monthly distribution payments to Unitholders payable on or about the 15th day of the following month. In addition, on December 31 of each year, having regard to the present intention of the Trustees, the REIT intends to make payable to such Unitholders, a distribution of sufficient net realized capital gains and net income for the taxation year ended on that date, net of any capital losses or non-capital losses recognized on or before the end of such year such that the REIT will not be liable for ordinary income taxes for such year, net of tax refunds. The payment of such amounts shall be made on or before the following January 15. Notwithstanding the REIT's distribution policy, the Trustees retain full discretion with respect to timing and quantum of distributions, if declared.

Distributions in respect of Exchangeable securities are detailed in Note 6 – Exchangeable securities.

Note 12 – Transactions with related parties

Pursuant to the Management Agreement, Inovalis S.A. provides the strategic, advisory, asset management, project management, construction management, property management and administrative services necessary to manage the operations of the REIT and its subsidiaries.

Unless otherwise stated, none of these transactions incorporated special terms and conditions. Outstanding balances are usually settled in cash, with exception of management fees that are settled quarterly through the issue of Exchangeable securities. No guarantees were given.

| <i>(in thousands of CAD\$)</i> | | | 3 months ended June 30, 2014 | | Year to date | |
|---|---|------|------------------------------|--------------------------------|--|---|
| Related parties (Inovalis S.A. and subsidiaries) | Income statement line item | Note | 2014 | 2013 | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
| Fees | | | | | | |
| Asset management fees | Administration expenses | A | 437 | 320 | 892 | 320 |
| Property management expenses | Service charge expense | B | 435 | 203 | 844 | 203 |
| Facilities management fees | Service charge expense | C | 153 | - | 322 | - |
| Interest on lease equalization loan | Finance costs | | 30 | - | 53 | - |
| Commitment fees for revolving credit facility | Administration expense | D | 14 | 11 | 29 | 11 |
| Reimbursement of acquisition costs | | | - | 929 | - | 929 |
| | | | <u>1,069</u> | <u>1,463</u> | <u>2,140</u> | <u>1,463</u> |
| Distributions paid on Exchangeable securities | | | | | | |
| Paid and payable in the form of interest on notes | Distributions recognized on Exchangeable securities | 6 | 144 | 296 | 296 | 296 |
| Paid in the form of reimbursement of debt | Exchangeable securities | 6 | 111 | 476 | 476 | 476 |
| Total distributions on Exchangeable securities recognized in profit or loss | | | <u>255</u> | <u>772</u> | <u>772</u> | <u>772</u> |
| Due to (from) Inovalis S.A. | | | | | | |
| | | | As at June 30, 20014 | As at December 31, 2013 | | |
| Trade receivables | | | - | (346) | | |
| Trade and other payables | | | 543 | 1,049 | | |
| Distributions payable | | | 25 | 213 | | |
| Lease equalization loan | | | 2,477 | 1,470 | | |
| | | | <u>3,045</u> | <u>2,386</u> | | |

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In performing its obligations under the Management Agreement, Inovalis S.A. is entitled to receive the following fees from the relevant subsidiary of the REIT:

- A. An annual asset management fee (the “Annual Asset Management Fee”) in the amount of 0.75% of the Historical Gross Purchase Price of the REIT’s properties;
- B. An annual property management fee (the “Property Management Fee”) in an amount equal to 3.5% of the Gross Paid Revenue from the REIT’s properties, payable quarterly in arrears;
- C. A facility management fee related to the management of service charges;
- D. Commitment fee for the revolving credit facility – see following paragraph.

Revolving credit facility

CanCorpEurope S.A., a subsidiary of the REIT, obtained a revolving credit facility from Inovalis S.A. with a maximum aggregate amount of capital available of \$10,000,000 at an effective rate of 8.25%. This revolving credit facility expires on April 10, 2015. CanCorpEurope S.A. pays Inovalis S.A. a yearly commitment fee at the rate of 0.5 % payable quarterly for the facility. The proceeds of this facility shall be used for working capital, capital expenditures, reimbursement of existing loans and general corporate purposes of CanCorpEurope S.A. and/or to finance any affiliated company. As at June 30, 2014, the REIT has not drawn on this facility.

Note 13 – Capital management

The REIT’s objectives when managing capital are to safeguard the REIT’s ability to continue as a going concern in order to provide returns for Unitholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The REIT considers its capital to include its Unitholders’ equity, its Finance lease liabilities, and the Exchangeable securities.

The REIT’s Unitholders’ equity consists of units in which the carrying value is impacted by earnings and Unitholders’ distributions.

The terms of the REIT’s Declaration Of Trust stipulates that the REIT shall not incur or assume any Indebtedness if, after giving effect to the incurrence or assumption of the Indebtedness, the total Indebtedness of the REIT would be more than 55% of the REIT’s Gross Book Value (GBV) or 60% of Gross Book Value including any convertible debentures excluding Exchangeable securities. These stipulated limits are taken into consideration principally when planning the financing of acquisitions and when preparing corporate plans and budgets.

As shown in the following table, the objective was exceeded at period-end because the REIT had just increased its indebtedness to accumulate the cash necessary for its planned acquisition of an investment property in Duisburg. As at June 30, 2014, the REIT held \$47,530 in cash, but the asset to be acquired had not yet been recognized as part of the REIT’s Gross Book Value.

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(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

(in thousands of CAD\$)

| Total indebtedness as a % of Gross Book Value | As at June 30, 2014 | As at December 31, 2013 |
|---|---------------------|-------------------------|
| Investment properties | 247,320 | 244,900 |
| Gross book value | 247,320 | 244,900 |
| Mortgage loans - non-current | 48,913 | - |
| Finance lease liabilities - non-current | 100,008 | 102,573 |
| Lease equalization loan | 2,477 | 1,470 |
| Finance lease liabilities - current | 3,907 | 9,055 |
| Total indebtedness | 155,305 | 113,098 |
| Total indebtedness as a % of Gross Book Value | 62.8% | 46.2% |

Note 14 – Geographical information

(in thousands of CAD\$)

| Total revenue by geographic region | Rental Income | Service Charge Income | For the three months ended June 30, 2014 | For the three months ended June 30, 2013 |
|------------------------------------|---------------|-----------------------|--|--|
| France | 4,123 | 1,095 | 5,218 | 4,270 |
| Germany | 535 | 20 | 555 | 412 |
| Total revenue | 4,658 | 1,115 | 5,773 | 4,682 |

| Total revenue by geographic region | Rental Income | Service Charge Income | For the six months ended June 30, 2014 | For the period from February 8, 2013 to June 30, 2013 |
|------------------------------------|---------------|-----------------------|--|---|
| France | 8,476 | 2,184 | 9,545 | 4,270 |
| Germany | 1,069 | 38 | 2,222 | 412 |
| Total revenue | 9,545 | 2,222 | 11,767 | 4,682 |

| Investment properties by geographic region | As at June 30, 2014 | As at December 31, 2013 |
|--|---------------------|-------------------------|
| France | 217,780 | 215,279 |
| Germany | 29,540 | 29,621 |
| Total investment properties | 247,320 | 244,900 |

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Three and six-months periods ended June 30, 2014

(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 15 – Fair value measurements

The following table shows an analysis of the fair values of assets and liabilities measured at fair value on a recurring basis in the consolidated balance sheet by level of the fair value hierarchy:

(in thousands of CAD\$)

| | As at June 30, 2014 | | | |
|--|----------------------------|----------------|----------------|----------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Investment properties | | | 247,320 | 247,320 |
| Derivative financial instruments - assets | | 1,206 | | 1,206 |
| Derivative financial instruments - liabilities | | (734) | | (734) |
| Exchangeable securities | 14,451 | | | 14,451 |
| Total fair value | 14,451 | 472 | 247,320 | 262,243 |

| | As at December 31, 2013 | | | |
|----------------------------------|--------------------------------|----------------|----------------|----------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Investment properties | | | 244,900 | 244,900 |
| Derivative financial instruments | | 2,471 | | 2,471 |
| Exchangeable securities | 12,234 | | | 12,234 |
| Total fair value | 12,234 | 2,471 | 244,900 | 259,605 |

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2 - use of a model with inputs (other than quoted prices included in level 1) that are directly or indirectly observable market data.
- Level 3 - use of a model with inputs that are not based on observable market data.

There were no transfers between Level 1 and Level 2 during the period.

The reconciliation of the carrying amounts classified within Level 3 is presented in Note 4 – Investment properties. The gains or losses relating to the Investment properties are recognized in profit or loss on the income statement line entitled “Net change in fair value of investment properties”. The entire amount of the gain or loss reported on this line in the reporting period is unrealized.

The following methods, valuation techniques, and inputs were used to estimate the above-mentioned fair values:

- The fair value of the REIT’s investment property is based on appraisals performed by independent, professionally-qualified property appraisers annually in Germany and semi-annually in France. These appraisals are updated by internal resources at interim reporting dates. The significant inputs and assumptions are developed taking into account local market conditions, in consultation with management. The valuation process and fair value changes are reviewed by the Board of Trustees at each reporting date.

INOVALIS REIT

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(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

- The fair value of derivative financial instruments is determined based on discounted cash flows using interest rate yield curves and forward exchange rates that are observable on an active market, as at the balance sheet date.
- The fair value of the Exchangeable securities is based on the quoted price of the REIT's own units, on the basis that they carry substantially the same rights and obligations as a regular unit and that they are exchangeable on a one for one basis throughout their life at the request of the unit holders, and upon maturity of the underlying notes, at the request of the REIT.

The following table provides a comparison of the carrying amounts and fair value of the REIT's finance leases and financial assets and liabilities that are not carried at fair value in the condensed interim consolidated financial statements and for which the carrying values are not reasonable approximations of their fair value.

(in thousands of CAD\$)

| As at June 30, 2014 | | | |
|------------------------------|-----------------------------------|------------------------|-------------------|
| As at June 30, 2014 | Fair value hierarchy level | Carrying amount | Fair value |
| Financial liabilities | | | |
| Mortgage loans | 3 | 48,913 | 48,913 |
| Finance lease | 3 | 103,915 | 103,915 |
| Lease equalization loan | 3 | 2,477 | 2,477 |
| Tenant deposits | 3 | 1,280 | 1,242 |

| As at December 31, 2013 | | | |
|--------------------------------|-----------------------------------|------------------------|-------------------|
| As at December 31, 2013 | Fair value hierarchy level | Carrying amount | Fair value |
| Financial liabilities | | | |
| Finance lease | 3 | 111,628 | 111,001 |
| Lease equalization loan | 3 | 1,470 | 1,470 |
| Tenant deposits | 3 | 1,189 | 961 |

The following methods and assumptions were used to estimate the above-mentioned fair values:

- The fair value of floating rate finance lease liabilities is estimated by discounting future cash flows using rates currently available for debt with similar terms and remaining maturities. The fair value approximates their carrying values gross of unamortized transaction costs only if credit spread has not changed significantly.
- The fair values of the finance leases, the lease equalization loan and the tenant deposits are estimated using the nominal amounts expected to be repaid at maturity and a discount rate based on prevailing market interest rates adjusted by an internally determined credit spread.

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Notes to the Condensed Interim Consolidated Financial Statements (Unaudited)

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(All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 16 – Subsequent events

New acquisition

On July 11, 2014 the REIT ceded a 50% interest in its Duisburg subsidiary, thus forming a joint venture. This joint venture then proceeded immediately thereafter with the purchase of an office property located in Duisburg, Germany. The Property, which is an eight-storey office building developed in 2008, is fully leased until December 31, 2020. The joint venture purchased the investment property for approximately \$65.7 million, and financed the purchase using a first mortgage of \$35.8 million and equity investments of \$29.9 million. The REIT's 50% share of the equity investment, which is \$14.95 million, came from existing cash on hand and increased financing on the REIT's existing French properties. This investment will be accounted for using the equity method of accounting.

Corporate information

Head office

Inovalis REIT
151 Yonge Street, 11th floor
Toronto, Ontario, M5C 2W7
Phone: (647) 775-8431
Fax: (647) 775-8301

Investor relations

Phone: (647) 775-8432
E-mail: info@inovalis.com
Website: www.inovalisreit.com

Stock exchange listing

The Toronto Stock Exchange
Listing symbol: INO.UN

Distribution Reinvestment Plan

Inovalis has implemented a Distribution Reinvestment Plan (“**DRIP**”). By participating in the Plan, Unitholders have cash distributions from Inovalis REIT reinvested in additional Units as and when cash distributions are made with a “bonus” distribution of Units equal to 3% of the amount of the cash distribution reinvested pursuant to the Plan.

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INOVALIS REIT
151 Yonge Street, 11th floor
Toronto, Ontario, M5C 2W7
www.inovalisreit.com