

INOVALIS REIT 2015 Second Quarter Report

**INOVALIS REIT
CONDENSED INTERIM CONSOLIDATED FINANCIAL
STATEMENTS (unaudited)**

Three-month and six-month periods ended June 30, 2015


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
Interim Consolidated Balance Sheet
(Unaudited - All dollar amounts in thousands of Canadian dollars)

| Assets | Note | As at June 30, 2015 | As at December 31, 2014 |
|--------------------------------------------------|-------------|----------------------------|--------------------------------|
| Non-current assets | | | |
| Investment properties | 4 | 320,713 | 308,596 |
| Investment accounted for using the equity method | 5 | 36,756 | 18,307 |
| Acquisition loan | | 17,389 | 17,548 |
| Derivative financial instruments | 6 | 881 | 875 |
| Restricted cash and other financial assets | | 313 | 309 |
| Total non-current assets | | 376,052 | 345,635 |
| Current assets | | | |
| Trade and other receivables | | 4,354 | 2,852 |
| Derivative financial instruments | 6 | 1,005 | 761 |
| Other current assets | | 1,296 | 731 |
| Restricted cash | | 387 | 291 |
| Cash and cash equivalents | | 4,500 | 24,185 |
| Total current assets | | 11,542 | 28,820 |
| Total assets | | 387,594 | 374,455 |
| Liabilities and Unitholders' equity | | | |
| Liabilities | Note | As at June 30, 2015 | As at December 31, 2014 |
| Non-current liabilities | | | |
| Mortgage loans | | 46,926 | 47,150 |
| Finance lease liabilities | | 126,380 | 130,680 |
| Lease equalization loans | | 4,258 | 3,101 |
| Tenant deposits | | 1,622 | 1,626 |
| Exchangeable securities | 7 | 17,597 | 16,663 |
| Derivative financial instruments | 6 | 883 | 1,077 |
| Deferred tax liabilities | | 996 | 949 |
| Total non-current liabilities | | 198,662 | 201,246 |
| Current liabilities | | | |
| Finance lease liabilities | | 7,104 | 6,991 |
| Lease equalization loans | | 677 | 248 |
| Tenant deposits | | 291 | 380 |
| Exchangeable securities | 7 | 2,126 | 1,482 |
| Derivative financial instruments | 6 | 455 | 605 |
| Trade and other payables | | 6,421 | 5,653 |
| Other current liabilities | | 1,218 | 233 |
| Total current liabilities | | 18,292 | 15,592 |
| Total liabilities | | 216,954 | 216,838 |
| Unitholders' equity | | | |
| Trust units | | 133,386 | 133,010 |
| Retained earnings | | 30,660 | 17,291 |
| Accumulated other comprehensive income | 11 | 6,594 | 7,316 |
| Total Unitholders' equity | | 170,640 | 157,617 |
| Total liabilities and Unitholders' equity | | 387,594 | 374,455 |

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

Interim Consolidated Statement of Earnings

(Unaudited - All dollar amounts in thousands of Canadian dollars except per unit amount)

| | Note | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|---------------------------------------------------------------------------|------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Rental income | | 5,306 | 4,658 | 10,589 | 9,545 |
| Service charge income | | 1,930 | 1,115 | 3,659 | 2,222 |
| Service charge expenses | | (1,334) | (786) | (5,144) | (3,645) |
| Other revenues | 12 | 1,240 | - | 1,240 | - |
| Other property operating (expenses) revenues | | (26) | 52 | (47) | 29 |
| Net rental earnings | | 7,116 | 5,039 | 10,297 | 8,151 |
| Administration expenses | | (1,125) | (837) | (2,117) | (1,866) |
| Foreign exchange (loss) gain | | (56) | (19) | 84 | 19 |
| Net change in fair value of investment properties | | 11,416 | (1,693) | 13,166 | (556) |
| Business acquisition costs | | (54) | (361) | (54) | (413) |
| Operating earnings | | 17,297 | 2,129 | 21,376 | 5,335 |
| Gain (loss) on financial instruments at fair value through profit or loss | | (123) | 30 | 379 | (710) |
| Share of earnings from investments accounted for using the equity method | 5 | 131 | - | 121 | - |
| Loss recognized on exercise of early payment option on finance leases | | - | (7,972) | - | (7,972) |
| Finance income | 8 | 824 | 8 | 1,564 | 15 |
| Finance costs | 8 | (1,214) | (855) | (2,443) | (1,719) |
| Distributions on Exchangeable securities | 7 | (438) | (297) | (867) | (584) |
| Net change in fair value of Exchangeable securities | 7 | 217 | 73 | (335) | (1,325) |
| Earnings before income taxes | | 16,694 | (6,884) | 19,795 | (6,960) |
| Current income tax expense | | (5) | (3) | (8) | (7) |
| Deferred income tax expense | | (74) | (10) | (107) | (20) |
| Earnings for the period | | 16,615 | (6,897) | 19,680 | (6,987) |
| Earnings per unit attributable to unit holders: | 9 | | | | |
| Basic earnings per unit | | 1.09 | (0.61) | 1.29 | (0.62) |
| Diluted earnings per unit | | 0.97 | (0.61) | 1.20 | (0.62) |

See accompanying notes to condensed interim consolidated financial statements

Interim Consolidated Statement of Comprehensive Income (loss)

(Unaudited - All dollar amounts in thousands of Canadian dollars)

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|-----------------------------------------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Earnings for the period | 16,615 | (6,897) | 19,680 | (6,987) |
| Other comprehensive income (loss) | | | | |
| Derivatives designated as a hedge of the net investment in a foreign entity | | | | |
| Net gains (losses) | (280) | 989 | 370 | 989 |
| Derivatives designated as cash flow hedges | | | | |
| Net gains (losses) | 528 | (1,001) | 400 | (1,001) |
| Reclassification of net losses to earnings | 21 | - | 45 | - |
| Change in cumulative translation adjustment account | 3,650 | (5,368) | (1,537) | (106) |
| Total other comprehensive income (loss) | 3,919 | (5,380) | (722) | (118) |
| Total comprehensive income (loss) for the period | 20,534 | (12,277) | 18,958 | (7,105) |

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Interim Consolidated Statement of changes in Unitholders' Equity

(Unaudited - All dollar amounts in thousands of Canadian dollars except number of Units)

| | Note | Number of Units issued and outstanding | Trust Units | Retained earnings | Accumulated other comprehensive income | Total |
|-------------------------------------|------|-------------------------------------------------|-----------------------|----------------------|-------------------------------------------------|-----------------------|
| As at December 31, 2014 | | 15,278,536 | 133,010 | 17,291 | 7,316 | 157,617 |
| Distributions earned by Unitholders | 10 | - | - | (6,311) | - | (6,311) |
| Distributions reinvestment Plan | 10 | 42,908 | 376 | - | - | 376 |
| Transactions with owners | | <u>42,908</u> | <u>376</u> | <u>(6,311)</u> | <u>-</u> | <u>(5,935)</u> |
| Earnings for the period | | - | - | 19,680 | - | 19,680 |
| Other comprehensive loss | | - | - | - | (722) | (722) |
| As at June 30, 2015 | | <u>15,321,444</u> | <u>133,386</u> | <u>30,660</u> | <u>6,594</u> | <u>170,640</u> |
| As at December 31, 2013 | | 11,285,087 | 98,719 | 10,610 | 13,671 | 123,000 |
| Distributions earned by Unitholders | 10 | - | - | (4,657) | - | (4,657) |
| Distributions reinvestment Plan | 10 | 7,141 | 65 | - | - | 65 |
| Issue costs | | - | (34) | - | - | (34) |
| Transactions with owners | | <u>7,141</u> | <u>31</u> | <u>(4,657)</u> | <u>-</u> | <u>(4,626)</u> |
| Earnings for the period | | - | - | (6,987) | - | (6,987) |
| Other comprehensive loss | | - | - | - | (118) | (118) |
| As at June 30, 2014 | | <u>11,292,228</u> | <u>98,750</u> | <u>(1,034)</u> | <u>13,553</u> | <u>111,269</u> |

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT
Interim Consolidated Statement of Cash Flows
(Unaudited - All dollar amounts in thousands of Canadian dollars)

| | Note | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|-------------------------------------------------------------------------------------------------------------------------|------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Operating activities | | | | | |
| Earnings before income taxes | | 16,694 | (6,884) | 19,795 | (6,960) |
| Adjustments for non-cash items and other reconciling items | 15 | (11,077) | 9,942 | (12,816) | 11,603 |
| | | 5,617 | 3,058 | 6,979 | 4,643 |
| Working capital adjustments | 15 | (596) | 8,952 | (37) | 11,927 |
| Net cash flows related to operating activities | | 5,021 | 12,010 | 6,942 | 16,570 |
| Investing activities | | | | | |
| Investment in a joint-Venture - Walpur Four | 5 | (3,993) | - | (5,143) | - |
| Investment in a joint-venture - Arcueil | 5 | (13,915) | - | (13,915) | - |
| Additions to investment properties | 4 | (115) | (60) | (238) | (60) |
| Loan repayments received from joint ventures | | 845 | - | 845 | - |
| Net changes in other financial assets | | - | 2,973 | (100) | 2,703 |
| Settlement of derivative financial instruments | | 338 | (2,825) | 591 | (3,123) |
| Net cash flows related to investing activities | | (16,840) | 88 | (17,960) | (480) |
| Financing activities | | | | | |
| Unit issue costs | | - | (34) | - | (34) |
| Distributions on Units paid in cash | 10 | (2,958) | (2,294) | (5,932) | (4,592) |
| Distributions on exchangeable securities paid in the form of interest on notes issued by a subsidiary | 7 | (225) | (144) | (455) | (296) |
| Distributions on Exchangeable securities paid in the form of repayment of interest bearing notes issued by a subsidiary | 7 | (195) | (111) | (351) | (476) |
| Proceeds from new mortgage loans, net of transaction costs | | - | 50,838 | - | 50,838 |
| Proceeds from new sale-leaseback, net of initial down payment | | - | 85,708 | - | 85,708 |
| Transaction fees related to new lease | | - | (2,633) | - | (2,633) |
| Repayment of lease liability upon exercise of early payment option | | - | (100,095) | - | (100,095) |
| Regular repayment of finance lease liabilities | | (1,373) | (1,086) | (3,126) | (3,057) |
| Purchase of derivative financial instrument | | - | (529) | - | (529) |
| - CAP on mortgage loan interest | | - | (529) | - | (529) |
| Lease equalization loan | | 1,361 | 483 | 1,601 | 967 |
| Net cash flows related to financing activities | | (3,390) | 30,103 | (8,263) | 25,801 |
| Net increase (decrease) in cash and cash equivalents | | (15,209) | 42,201 | (19,281) | 41,891 |
| Effects of foreign exchange adjustments on cash and cash equivalent | | 216 | (294) | (404) | (237) |
| Cash and cash equivalents at the beginning of the period | | 19,493 | 5,867 | 24,185 | 6,120 |
| Cash and cash equivalents at the end of the period | | 4,500 | 47,774 | 4,500 | 47,774 |
| Cash and cash equivalents at the end of the period | | | | | |
| Cash | | 4,500 | 47,530 | 4,500 | 47,530 |
| Cash equivalents | | - | 244 | - | 244 |
| | | 4,500 | 47,774 | 4,500 | 47,774 |

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

(Unaudited - 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 Trust 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-month and six-month periods ended June 30, 2015, were authorized for issuance by the Board of Trustees on August 13, 2015.

The REIT has hired Inovalis S.A. (“Inovalis”), a real estate asset manager having operations in France and Germany, to manage certain functions (see note 12 – Transactions with related parties).

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 2014 audited consolidated annual financial statements.

Basis of presentation

The unaudited condensed interim consolidated financial statements are prepared on a going concern basis. All financial information has been rounded to the nearest thousand (CAD\$ 000) except when otherwise indicated.

These unaudited condensed interim consolidated financial statements have been prepared on the historical cost basis except for Investment properties, Exchangeable securities and Derivative financial instruments, which are measured at their fair values.

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, 2014.

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.

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, 2014.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 4 – Investment properties

| Investment properties | For the six months ended June 30, 2015 | For the year ended December 31, 2014 |
|--------------------------------------------------------------------------|----------------------------------------|--------------------------------------|
| Beginning of period | 308,596 | 244,900 |
| Additions, net of reimbursements | 113 | - |
| Capitalized letting fees | 125 | - |
| Acquisitions through business combinations | - | 65,142 |
| Amount derecognized upon exercise of early purchase option on lease | - | (122,420) |
| Amount recognized upon entry into new sales-leaseback arrangement | - | 122,420 |
| Transaction and transfer fees related to new sales-leaseback arrangement | - | 2,633 |
| Rent free period | 1,413 | 1,997 |
| Net change in fair value of investment properties | 13,116 | 5,248 |
| Foreign currency translation adjustment | (2,650) | (11,324) |
| End of period | 320,713 | 308,596 |

Note 5 – Investment accounted for using the equity method

Walpur

On April 8, 2015, the REIT purchased a 50% interest in Walpur Four SARL (“Walpur”), a joint venture which owns an office property located in Germany, for a total consideration of 3,832 Euros (\$5,143). This consideration is composed of a cash consideration paid of 332 Euros (\$445) for the equity interest and a 8.75% interest-bearing loan of 3,500 Euros (\$4,698), repayable the date the Joint Venture Agreement terminates.

Arcueil

At the end of June 2015, in contemplation of the acquisition described in subsequent events (note 16), the REIT proceeded with the transfer of an amount of 10,000 Euros (\$13,915) to a newly created joint venture in exchange for a 25% equity interest. The partner invested an amount of 30,000 Euros (\$41,733) for a 75% equity interest that will be classified as a debt in the financial statements of the joint venture.

Outlined below is a breakdown of the carrying amounts of the components of the investment in the CanCorp Duisburg (“CCD”), Walpur and Arcueil joint ventures:

| Carrying amount of investment in joint ventures | CCD | Walpur | Arcueil | For the six months ended June 30, 2015 | For the year ended December 31, 2014 |
|-------------------------------------------------------|---------------|--------------|---------------|----------------------------------------|--------------------------------------|
| Balance at the beginning of the period | 18,307 | - | - | 18,307 | - |
| Net change in equity investment in joint ventures | (39) | 594 | 13,915 | 14,470 | 3,668 |
| Net change in interest-bearing loan to joint ventures | (621) | 4,600 | - | 3,979 | 14,639 |
| Balance at the end of the period | <u>17,647</u> | <u>5,194</u> | <u>13,915</u> | <u>36,756</u> | <u>18,307</u> |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 5 – Investment accounted for using the equity method (continued)

| Summarized financial information of the joint ventures | CCD | Walpur | Arcueil | As at June 30, 2015 | As at December 31, 2014 |
|--------------------------------------------------------|---------------|---------------|---------------|---------------------|-------------------------|
| Balance Sheet | | | | | |
| Investment properties | 70,251 | 24,275 | - | 94,526 | 70,892 |
| Deferred tax asset | 262 | - | - | 262 | 164 |
| Cash and cash equivalents | 894 | 1,845 | 55,648 | 58,387 | 1,948 |
| Other current assets | 268 | 538 | - | 806 | 364 |
| Total assets | <u>71,675</u> | <u>26,658</u> | <u>55,648</u> | <u>153,981</u> | <u>73,368</u> |
| Non-current financial liabilities | 61,811 | 24,318 | 41,733 | 127,862 | 62,953 |
| Current liabilities | 866 | 839 | - | 1,705 | 1,436 |
| Deferred tax liability | 1,712 | 317 | - | 2,029 | 1,612 |
| Total liabilities | <u>64,389</u> | <u>25,474</u> | <u>41,733</u> | <u>131,596</u> | <u>66,001</u> |
| Equity | <u>7,286</u> | <u>1,184</u> | <u>13,915</u> | <u>22,385</u> | <u>7,367</u> |
| Total liabilities and equity | <u>71,675</u> | <u>26,658</u> | <u>55,648</u> | <u>153,981</u> | <u>73,368</u> |

| Summarized financial information of the joint ventures | CCD | Walpur | Arcueil | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|-------------------------------------------------------------------------------------------------|-------------|------------|----------|----------------------------------------|----------------------------------------|
| Income statement | | | | | |
| Net rental income | 2,276 | 669 | - | 2,945 | - |
| Operating profit | 1,861 | 488 | - | 2,349 | - |
| Finance costs | (1,856) | (124) | - | (1,980) | - |
| Earnings from continuing operations | 5 | 364 | - | 369 | - |
| Current income tax expense | (4) | - | - | (4) | - |
| Deferred income tax expense | (17) | (106) | - | (123) | - |
| Earnings for the period | (16) | 258 | - | 242 | - |
| Other comprehensive income | (65) | 35 | - | (30) | - |
| Total comprehensive income | <u>(81)</u> | <u>293</u> | <u>-</u> | <u>212</u> | <u>-</u> |
| Pro rata share of post-acquisition earnings recognized in the Consolidated financial statements | | | | | |
| 50% pro rata share of earnings for the period | <u>(8)</u> | <u>129</u> | <u>-</u> | <u>121</u> | <u>-</u> |
| Interest earned from loans to Joint ventures | <u>710</u> | <u>103</u> | <u>-</u> | <u>813</u> | <u>-</u> |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 6 – Financial derivatives and hedging activities

During the six month period ended June 30, 2015, the REIT entered into a series of 36 option contracts whereby it purchased put options and sold call options, both in Euros. These new option contracts cover monthly periods up to and including January 10, 2018. Put options purchased and call options sold have the same strike price. These contracts are not designated as part of a hedging relationship. Accordingly, they are classified at fair value through profit or loss, with changes in fair value recognized in profit or loss.

The REIT also entered into 5 new monthly foreign currency hedge contracts whereby the REIT can purchase \$1,000 each month at an exchange rate of 1.4376 Canadian dollars per euro. The new contracts cover 5 monthly periods from February 14, 2018 to June 14, 2018. These contracts have been designated as hedges of the REIT's net investment in a foreign operation.

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 | | | As at June 30, 2015 | | As at December 31, 2014 | |
|----------------------------------------------------|---------------------|----------------|-----------|--------------------|------------|--------|-----------------------|------------|-------------------------|-------------|
| | | From | To | Euros or rate | \$ or rate | Rate | Total notional amount | Fair value | Total notional amount | Fair value |
| Derivatives classified for hedge accounting | | | | | | | | | | |
| Foreign exchange | 5 | 14-Feb-18 | 14-Jun-18 | 696 | 1,000 | 1.4376 | 5,000 | (3) | - | - |
| Foreign exchange | 22 | 1-Jul-15 | 13-Apr-17 | 486 | 750 | 1.5437 | 16,500 | 1,451 | 21,000 | 1,567 |
| Interest rate SWAP | 1 | 1-Jul-15 | 1-Jul-19 | Variable | Fixed | 0.685% | 78,560 | (1,338) | 82,181 | (1,682) |
| Interest rate CAP | 2 | 30-Jun-15 | 5-May-19 | Variable | Capped | 2.000% | 47,297 | 125 | 47,729 | 69 |
| Other derivatives | | | | | | | | | | |
| Option contracts on foreign exchange | | | | | | | | | | |
| Put options purchased | 22 | 10-Jul-15 | 11-Apr-17 | 167 | 250 | 1.4956 | 5,500 | | | |
| Call options sold | 22 | 10-Jul-15 | 11-Apr-17 | 334 | 500 | 1.4956 | 11,000 | | | |
| Put options purchased | 9 | 10-May-17 | 10-Jan-18 | 669 | 1,000 | 1.4956 | 9,000 | | | |
| Call options sold | 9 | 10-May-17 | 10-Jan-18 | 1,337 | 2,000 | 1.4956 | 18,000 | | | |
| Option contracts on foreign exchange - fair value | | | | | | | | 313 | | - |
| | | | | | | | | 548 | | (46) |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 7 – Exchangeable securities

| Exchangeable securities issued and outstanding | Number of Exchangeable securities | Carrying amount of Exchangeable securities |
|-------------------------------------------------------|-----------------------------------|--------------------------------------------|
| Balance - December 31, 2014 | 2,043,347 | 18,145 |
| Transactions in 2015 | | |
| Asset management fees paid in Exchangeable securities | 135,988 | 1,243 |
| Net change in fair value of Exchangeable securities | - | 335 |
| Balance - June 30, 2015 | 2,179,335 | 19,723 |

| Exchangeable securities | As at June 30, 2015 | As at December 31, 2014 |
|------------------------------------------------|---------------------|-------------------------|
| Exchangeable securities | 19,723 | 18,145 |
| Less current portion | (2,126) | (1,482) |
| Non-current portion of Exchangeable securities | 17,597 | 16,663 |

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., a subsidiary of the Trust, equal, on a per unit basis, to the distributions paid to holders of units by the REIT.

The following table breaks down distribution payments:

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|--------------------------------------------------------------------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Amount payable at the beginning of the period | 78 | (17) | 35 | 213 |
| Declared and recognized in earnings during the period | 438 | 297 | 867 | 584 |
| Accrued or paid in cash in the form of interest on interest bearing notes issued by CanCorpEurope S.A. | (225) | (144) | (455) | (296) |
| Paid in cash in the form of repayment of interest bearing notes issued by CanCorpEurope S.A. | (195) | (111) | (351) | (476) |
| Amount payable at the end of the period | 96 | 25 | 96 | 25 |
| Weighted average number of Exchangeable securities outstanding | 2,114,218 | 1,436,513 | 2,079,367 | 1,412,992 |
| Distributions paid per unit (based on weighted average Exchangeable securities outstanding) | 0.1987 | 0.1775 | 0.3876 | 0.5464 |
| Distributions paid per unit (based on three-month/six-month basis) | 0.2063 | 0.2063 | 0.4125 | 0.4125 |

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 8 – Finance costs and finance income

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|---------------------------------------------------------------------------------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Interest costs on mortgage loans | (208) | (162) | (424) | (162) |
| Interest costs related to finance leases | (582) | (404) | (1,197) | (851) |
| Interest costs related to lease equalization loans | (45) | (30) | (87) | (53) |
| | (835) | (596) | (1,708) | (1,066) |
| Interest SWAP | (127) | - | (247) | - |
| Other finance costs | (48) | (23) | (70) | (6) |
| Standby charge on finance lease during approval period | - | (144) | - | (144) |
| Other finance costs to Inovalis | (3) | (14) | (3) | (29) |
| Net derivative finance costs | - | 21 | - | 21 |
| | (1,013) | (756) | (2,028) | (1,224) |
| Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition | (105) | (28) | (214) | (424) |
| Amortization of transaction costs on mortgage loans | (96) | (71) | (201) | (71) |
| Finance costs | (1,214) | (855) | (2,443) | (1,719) |
| Finance income | 1 | 8 | 4 | 15 |
| Finance income from Inovalis relating to the acquisition loan | 370 | - | 747 | - |
| Finance income from joint ventures | 453 | - | 813 | - |
| Finance income | 824 | 8 | 1,564 | 15 |
| Net Finance costs | (390) | (847) | (879) | (1,704) |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 9 – Earnings per Unit

(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.

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|----------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Basic earnings per unit | | | | |
| Earnings attributable to unitholders | 16,615 | (6,897) | 19,680 | (6,987) |
| Weighted average number of units outstanding | 15,310,081 | 11,290,383 | 15,299,387 | 11,288,451 |
| Basic earnings per unit | 1.09 | (0.61) | 1.29 | (0.62) |

(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 7 - Exchangeable securities for the number of Exchangeable securities outstanding.

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|---------------------------------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Diluted earnings per unit | | | | |
| Earnings attributable to unitholders | 16,615 | (6,897) | 19,680 | (6,987) |
| Distributions recognized on Exchangeable securities | 438 | 297 | 867 | 584 |
| Net change in fair value of Exchangeable securities | (217) | (73) | 335 | 1,325 |
| Earnings attributable to diluted unitholders | 16,836 | (6,673) | 20,882 | (5,078) |
| Weighted average number of units outstanding | 15,310,081 | 11,290,383 | 15,299,387 | 11,288,451 |
| Weighted average number of Exchangeable securities outstanding | 2,114,218 | 1,436,513 | 2,079,367 | 1,412,992 |
| Weighted average number of units used for diluted earnings per unit | 17,424,298 | 12,726,896 | 17,378,754 | 12,701,443 |
| Diluted earnings per unit | 0.97 | (0.61) | 1.20 | (0.62) |

When dilution does not result in a reduction in earnings per unit or an increase in loss per unit, as is the case for the prior periods, the diluted earnings per unit is identical to basic earnings per unit.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 10 – Distributions

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|-------------------------------------------------------------------------------------|------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|
| Amount payable at the beginning of the period | 1,052 | 776 | 1,050 | 776 |
| Declared and recognised during the period | 3,158 | 2,329 | 6,311 | 4,657 |
| Distributions paid in units (Distribution Reinvestment Plan) | (199) | (35) | (376) | (65) |
| Paid in cash | (2,958) | (2,294) | (5,932) | (4,592) |
| Amount payable at the end of the period | 1,053 | 776 | 1,053 | 776 |
| Total distributions | 3,158 | 2,329 | 6,311 | 4,657 |
| Distributions paid per unit (based on weighted average number of units outstanding) | 0.2062 | 0.2063 | 0.4123 | 0.4125 |
| Distributions paid per unit (based on an annualized basis) | 0.2063 | 0.2063 | 0.4125 | 0.4125 |

Distributions in respect of Exchangeable securities are detailed in Note 7 – Exchangeable securities.

Note 11 – Accumulated other comprehensive income

| | As at June 30, 2015 | As at December 31, 2014 |
|----------------------------------------------------------------------------------------------------------------|---------------------|-------------------------|
| Net changes in unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity | 2,312 | 1,942 |
| Net changes in unrealized losses on interest rate derivatives designated as a cash flow hedge | (1,670) | (2,115) |
| Cumulative translation adjustment account | 5,952 | 7,489 |
| Accumulated other comprehensive income | 6,594 | 7,316 |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 12 – Transactions with related parties

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

Asset manager

| Inovalis and its subsidiaries | Financial statement line item | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|---------------------------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------|----------------------------------------|
| Revenues and expenses | | | |
| Rental income | Rental income | 478 | - |
| Service charge income | Service charge income | 354 | - |
| Other revenue ⁽¹⁾ | Other revenue | 1,240 | - |
| Asset management fees | Administration expenses | (1,038) | (892) |
| Facilities management fees | Service charge expenses | (1,696) | (844) |
| Property management Fees | Service charge expenses | (438) | (322) |
| Interest on lease equalization loan | Finance costs | (87) | (53) |
| Other finance costs | Finance costs | (3) | (29) |
| Interest income from acquisition loan | Finance income | 747 | - |
| Reimbursement of travel expenses | Administration expenses | (190) | (123) |
| | | (633) | (2,263) |
| ⁽¹⁾ Recovery of an amount paid for anticipated repairs that are no longer required | | | |
| Reimbursement of disbursements paid to third parties on behalf of the REIT | | | |
| Interest on notes | Distributions recognized on Exchangeable securities | (455) | (296) |
| Reimbursement of debt | | (351) | (476) |
| Total distributions on Exchangeable securities recognized in earnings | | (755) | (772) |
| Due to (from) Inovalis | | | |
| | | As at June 30, 2015 | As at December 31, 2014 |
| Trade and other receivables | | (1,393) | (637) |
| Trade and other payables | | 1,487 | 1,767 |
| Acquisition loan | | (17,389) | (17,548) |
| Distributions payable | | 96 | 35 |
| Lease equalization loans | | 4,935 | 3,349 |
| | | (12,264) | (13,034) |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 12 – Transactions with related parties (continued)

Joint ventures

The transactions and balances with entities accounted for using the equity method are summarized below:

| Joint ventures | Financial statement line item | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|--------------------------------------------------|--------------------------------------------------------------------------|----------------------------------------|----------------------------------------|
| Asset management fees rebilled to joint ventures | Administration expenses | (205) | - |
| Earnings from joint ventures | Share of earnings from investments accounted for using the equity method | 121 | - |
| Interest revenues on loans | Finance income | 813 | - |
| | | 729 | - |
| Due from (to) joint ventures | | | |
| | | As at March 31, 2015 | As at December 31, 2014 |
| Investment in associates | Investment accounted for using the equity method | 18,138 | 3,668 |
| Loan receivable | Investment accounted for using the equity method | 18,618 | 14,639 |
| Accounts receivable | Trade and other receivables | 116 | 62 |
| | | 36,872 | 18,369 |

Note 13 – Geographical information

| Total revenue by geographic region | Rental Income | Service Charge Income | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 |
|------------------------------------|---------------|-----------------------|------------------------------------------|------------------------------------------|
| France | 4,808 | 1,696 | 6,504 | 5,218 |
| Germany | 498 | 18 | 516 | 555 |
| Total revenue | 5,306 | 1,714 | 7,020 | 5,773 |

| Total revenue by geographic region | Rental Income | Service Charge Income | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|------------------------------------|---------------|-----------------------|----------------------------------------|----------------------------------------|
| France | 9,609 | 3,404 | 13,013 | 9,545 |
| Germany | 980 | 39 | 1,019 | 2,222 |
| | 10,589 | 3,443 | 14,032 | 11,767 |

| Investment properties and investments in joint ventures by geographic region | As at June 30, 2015 | December 31, 2014 |
|------------------------------------------------------------------------------|---------------------|-------------------|
| France | 301,834 | 275,045 |
| Germany | 55,635 | 51,858 |
| | 357,469 | 326,903 |

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 14 – Fair value measurements

Fair value hierarchy

The following table shows an analysis of the fair values of financial instruments (including Exchangeable securities) and non-financial assets measured at fair value on a recurring basis recognized on the consolidated balance sheet by level of the fair value hierarchy:

| | As at June 30, 2015 | | | |
|------------------------------------------------|---------------------|----------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Investment properties | - | - | 320,713 | 320,713 |
| Derivative financial instruments - assets | - | 1,886 | - | 1,886 |
| Derivative financial instruments - liabilities | - | (1,338) | - | (1,338) |
| Exchangeable securities | - | (19,723) | - | (19,723) |

| | As at December 31, 2014 | | | |
|------------------------------------------------|-------------------------|----------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Investment properties | - | - | 308,596 | 308,596 |
| Derivative financial instruments - assets | - | 1,636 | - | 1,636 |
| Derivative financial instruments - liabilities | - | (1,682) | - | (1,682) |
| Exchangeable securities | - | (18,145) | - | (18,145) |

- 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 ended June 30, 2015 (none in 2014).

The REIT's management is responsible for determining fair value measurements included in the financial statements, including Level 3 fair values. The inputs, processes and results for recurring measurements, including those valuations calculated by an independent consultant, are reviewed each quarter by senior management to ensure conformity with IFRS.

The reconciliation of the carrying amounts of non-financial assets classified within Level 3 is 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 and assumptions were used to estimate the above-mentioned fair values:

- The fair value of derivative financial instruments is determined based on discounted cash flows using interest rate yield curves and volatilities 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 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. Other features of the Exchangeable securities have no significant impact on their fair value.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 15 – Cash flow information

| | For the three months ended June 30, 2015 | For the three months ended June 30, 2014 | For the six months ended June 30, 2015 | For the six months ended June 30, 2014 |
|---------------------------------------------------------------------------|------------------------------------------------|------------------------------------------------|----------------------------------------------|----------------------------------------------|
| Adjustments for non-cash items and other reconciling items: | | | | |
| Rent free period | (750) | (483) | (1,413) | (967) |
| Management fees paid in Exchangeable securities | 525 | 437 | 1,038 | 892 |
| Net change in fair value of investment properties | (11,416) | 1,693 | (13,166) | 556 |
| (Gain) loss on financial instruments at fair value through profit or loss | 123 | (30) | (379) | 710 |
| Distributions on Exchangeable securities | 438 | 297 | 867 | 584 |
| Net change in fair value of Exchangeable securities | (217) | (73) | 335 | 1,325 |
| Finance income | (824) | (8) | (1,564) | (15) |
| Finance cost | 1,215 | 855 | 2,444 | 1,719 |
| Income taxes paid | - | (15) | (8) | (20) |
| Loss recognized on exercise of early payment option on finance leases | - | 7,972 | - | 7,972 |
| Earnings from investments in joint ventures | (131) | - | (121) | - |
| Unrealized exchange (gains) losses | 67 | (65) | (90) | (54) |
| Cash items classified as operating activities | | | | |
| Interest received | 563 | - | 926 | - |
| Interest paid | (670) | (638) | (1,685) | (1,099) |
| | <u>(11,077)</u> | <u>9,942</u> | <u>(12,816)</u> | <u>11,603</u> |
| Working capital adjustments | | | | |
| (Increase) decrease in trade and other receivables | (422) | 178 | (3,092) | (1,691) |
| Increase (decrease) in tenant deposits | (62) | 3 | (65) | 98 |
| Increase (decrease) in trade and other payables | (112) | 8,771 | 3,120 | 13,520 |
| | <u>(596)</u> | <u>8,952</u> | <u>(37)</u> | <u>11,927</u> |

Note 16 – Subsequent events

Subsequent to the end of the period, on July 7, 2015, the REIT proceeded with the acquisition, on a joint venture basis, of a 25% interest in the Arcueil office property located in Greater Paris, that has an estimated value of 90,000 Euros (\$125,000) (representing 100% of the property). The REIT will have the option to purchase the other partner's interest in the joint venture on or after July 2nd, 2018. In the event that the asset is sold, the REIT will receive 75% of the profit generated from the transaction. This transaction will be accounted for as a joint venture.

Corporate information

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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.

INOVALIS

REAL ESTATE INVESTMENT TRUST

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