

INOVALIS REIT 2017 First Quarter Report

INOVALIS REIT
CONDENSED INTERIM CONSOLIDATED FINANCIAL
STATEMENTS (unaudited)
Three-month period ended March 31, 2017

INOVALIS REIT
Interim Consolidated Balance Sheets
(Unaudited - All dollar amounts in thousands of Canadian dollars)

Assets	Note	As at March 31, 2017	As at December 31, 2016
Non-current assets			
Investment properties	4	417,009	412,232
Investments accounted for using the equity method	5	43,410	43,887
Acquisition loan and deposit	6	19,440	8,906
Derivative financial instruments	7	492	590
Total non-current assets		480,351	465,615
Current assets			
Trade and other receivables		3,743	3,368
Derivative financial instruments	7	500	520
Other current assets		2,307	1,638
Other financial current assets	8	7,388	27,910
Cash		24,508	11,074
Total current assets		38,446	44,510
Total assets		518,797	510,125
Liabilities and Unitholders' equity			
Liabilities			
Non-current liabilities			
Mortgage loans	9	84,390	83,998
Finance lease liabilities	9	120,214	120,891
Lease equalization loans		3,811	4,051
Tenant deposits		2,152	2,178
Exchangeable securities	10	5,206	4,603
Derivative financial instruments	7	1,025	1,616
Deferred tax liabilities		2,283	2,236
Total non-current liabilities		219,081	219,573
Current liabilities			
Mortgage loans	9	566	541
Finance lease liabilities	9	24,250	24,179
Lease equalization loans		1,192	1,184
Tenant deposits		227	198
Exchangeable securities	10	12,888	11,995
Derivative financial instruments	7	1,178	1,225
Trade and other payables		8,525	7,392
Other current liabilities		725	734
Deferred income	6	8,339	1,975
Total current liabilities		57,890	49,423
Total liabilities		276,971	268,996
Equity			
Trust units		189,508	189,158
Retained earnings		42,152	43,455
Accumulated other comprehensive income	14	10,038	8,395
		241,698	241,008
Non-controlling interest		128	121
Total equity		241,826	241,129
Total liabilities and equity		518,797	510,125

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 Statements of Earnings

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

(in thousands of Canadian dollars, except per unit amounts)

	<i>Note</i>	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Rental income		5,970	5,673
Service charge income		1,850	1,590
Service charge expenses		(4,617)	(4,485)
Other revenues		85	-
Other property operating expenses		(41)	(41)
Net rental earnings		3,247	2,737
Administration expenses		(1,245)	(1,218)
Foreign exchange gain		-	94
Net change in fair value of investment properties		2,290	(2,907)
Gain resulting from exercise of the purchase option			9,877
Acquisition costs		(37)	(659)
Share of net earnings from investments accounted for using the equity method	5	(724)	(2,358)
Operating earnings		3,531	5,567
Gain (loss) on financial instruments at fair value through profit or loss		571	(144)
Loss recognized on exercise of early payment option on finance lease		-	(1,920)
Loss on refinancing of a debt		-	(605)
Finance income	11	1,783	2,205
Finance costs	11	(1,653)	(1,516)
Distributions on Exchangeable securities	10	(379)	(452)
Net change in fair value of Exchangeable securities	10	(664)	(616)
Earnings before income taxes		3,189	2,519
Current income tax expense		(10)	(85)
Deferred income tax recovery (expense)		(33)	153
Earnings for the period		3,146	2,587
Earnings for the period attributable to :			
Non-controlling interest		5	(41)
Unitholders' of the Trust		3,141	2,628
		3,146	2,587
Earnings per unit attributable to unit holders:	12		
Basic earnings per unit		0.15	0.17
Diluted earnings per unit		0.18	0.21

See accompanying notes to condensed interim consolidated financial statements

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Interim Consolidated Statements of Comprehensive Income (loss)

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

	For the 3 months ended March 31, 2017	For the 3 months ended March 31, 2016
Earnings for the year	3,146	2,587
Other comprehensive income (loss)		
Items that may be reclassified subsequently to net earnings, net of tax :		
Derivatives designated as a hedge of the net investment in a foreign entity		
Net gains (losses)	(141)	402
Derivatives designated as cash flow hedges		
Net gains (losses)	239	(422)
Reclassification of net losses to earnings	32	20
Items that are not to be reclassified subsequently to net earnings, net of tax :		
Change in cumulative translation adjustment account	1,513	(3,529)
Total other comprehensive income (loss)	1,643	(3,529)
Total comprehensive income (loss) for the year	4,789	(942)
Total comprehensive income (loss) for the year attributable to :		
Non-controlling interest	7	-
Unitholders of the Trust	4,782	(942)
Total comprehensive income (loss) for the year	4,789	(942)

Interim Consolidated Statements of changes in Unitholders' Equity

	Note	Number of Units issued and outstanding	Trust Units	Retained earnings	Accumulated other comprehensive income	Total attributable to the Unitholders' of the Trust	Non-controlling interest	Total equity
As at December 31, 2016		21,525,775	189,158	43,455	8,395	241,008	121	241,129
Issuance of units		-	-	-	-	-	-	-
Distributions earned by Unitholders	12	-	-	(4,444)	-	(4,444)	-	(4,444)
Distributions reinvestment Plan	12	38,797	350	-	-	350	-	350
Transactions with owners		38,797	350	(4,444)	-	(4,094)	-	(4,094)
Earnings for the period		-	-	3,141	-	3,141	5	3,146
Other comprehensive loss		-	-	-	1,643	1,643	2	1,645
As at March 31, 2017		21,564,572	189,508	42,152	10,038	241,698	128	241,826
As at December 31, 2015		15,637,019	136,365	35,359	19,925	191,649	-	191,649
Issuance of units		-	-	-	-	-	-	-
Distributions earned by Unitholders	12	-	-	(3,229)	-	(3,229)	-	(3,229)
Distributions payable		-	-	74	-	74	-	74
Distributions reinvestment Plan	12	28,468	257	-	-	257	-	257
Transactions with owners		28,468	257	(3,155)	-	(2,898)	-	(2,898)
Earnings for the period		-	-	2,586	-	2,586	-	2,586
Other comprehensive loss		-	-	-	(3,529)	(3,529)	-	(3,529)
As at March 31, 2016		15,665,487	136,622	34,790	16,396	187,808	-	187,808

See accompanying notes to condensed interim consolidated financial statements

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

	Note	Three months ended March 31, 2017	Three months ended March 31, 2016
Operating activities			
Earnings before income taxes for the period		3,189	2,519
Adjustments for non-cash items and other reconciling items	18	(404)	(689)
		2,785	1,830
Working capital adjustments	18	7,019	3,469
Net cash flows related to operating activities		9,804	5,299
Investing activities			
Business acquisition		-	(20,778)
Acquisition costs		(37)	(659)
Distribution from (investments in) joint-ventures	5	618	525
Additions to investment properties	4	(156)	(865)
Acquisition loan and deposit	6	(10,326)	(1,514)
Decrease in financial current assets	8	20,492	-
Net change in restricted cash		-	680
Net cash flows related to investing activities		10,591	(22,611)
Financing activities			
Distributions on Units paid in cash	13	(4,091)	(2,970)
Distributions in respect of Exchangeable securities paid in cash	10	(1,037)	(323)
Proceeds from new mortgage loans, net of transaction costs	9	-	18,795
Proceeds from new finance liabilities, net of transaction costs	9	-	52,654
Transaction fees related to the exercise of early payment option on finance leases		-	(1,920)
Repayment of mortgage loans and finance lease liabilities	9	(1,922)	(44,887)
Net change on lease equalization loans		(236)	(315)
Settlement of derivative financial instruments	8	-	(25)
Net cash flows related to financing activities		(7,286)	21,009
Net increase in cash		13,108	3,697
Effects of foreign exchange adjustments on cash		326	1,259
Cash at the beginning of the year		11,074	6,895
Cash at the end of the year		24,508	11,851
Cash and cash equivalent at the end of the period		24,508	11,851

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

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, owned directly or through joint arrangements, 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 period ended March 31, 2017, were authorized for issuance by the Board of Trustees on May 9, 2017.

The REIT has hired Inovalis S.A. (“Inovalis”), a real estate asset manager having operations in France and Germany, to manage certain functions. Refer to Note 3 – Significant accounting policies, Note 6 – Acquisition loan and deposit, and Note 10 – Exchangeable securities, for more information about the relationship between Inovalis and the REIT, and to Note 15 – Transactions with related parties, for information regarding the services provided by Inovalis to the REIT.

Inovalis S.A. is considered as a related party of the REIT as they share the same management (Chairman of the Board, CIO and CEO).

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 2016 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 or EUR€ 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.

The figures presented for the period ended March 31, 2016 have been reclassified, when appropriate, in order to ensure comparability with the figures for the period ending March 31, 2017.

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, 2016.

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, 2016.

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 4 – Investment properties

Investment properties	For the three months ended March 31, 2017	For the year ended December 31, 2016
Beginning of period	412,232	355,704
Additions	166	862
Capitalized letting fees	(10)	119
Acquisitions through business combinations	-	78,731
Partial Disposal	-	(3,576)
Rent free periods	(79)	84
Net change in fair value of investment properties ⁽¹⁾	2,290	3,632
Foreign currency translation adjustment	2,410	(23,324)
End of period	417,009	412,232

⁽¹⁾ : Including the increase of 2 411 K\$ (nil as at December 31, 2016) related to the impact of IFRIC 21 for recoverable French property taxes, which has a similar impact on service charge expenses.

Note 5 – Investments accounted for using the equity method

Outlined below is a breakdown of the carrying amounts of the components of the investments in the joint ventures:

Carrying amount of investment in joint ventures	CCD	Walpur	Arcueil	Cologne	For the three months ended March 31, 2017	For the year ended December 31, 2016
Balance at the beginning of the period	18,684	6,865	13,149	5,189	43,887	40,337
Reclassified to (from) liabilities	-	-	-	-	-	(925)
Share of net earnings from investments accounted for using the equity method	25	90	(865)	26	(724)	830
Additional investment of the year	-	-	-	-	-	6,189
Loan repayments	-	-	-	-	-	(200)
Exchange differences	108	42	67	30	247	(2,344)
Balance at the end of the period	18,817	6,997	12,351	5,245	43,410	43,887

In February 2017, the REIT has entered into exclusivity on the acquisition of two assets located in Pantin (Paris North-Eastern periphery) and Stuttgart (Germany). Both acquisitions will be done under the form of a joint venture and closed in the course of the second quarter of 2017.

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 6 – Acquisition loan and deposit

At the end of the period, the outstanding balances of the “acquisition loan and deposit” were as follows :

	As at March 31, 2017	As at December 31, 2016
Ingolstadt deposit	1,270	1,255
Rueil loan	18,170	7,651
Acquisition loan and deposit	19,440	8,906

Ingolstadt investment

On September 15, 2016, the REIT entered into an agreement for the forward purchase of an office property to be developed in Ingolstadt, Germany. A deposit of €1.5million (\$ 2.2 million) has already been paid upon signature of the forward purchase agreement. In addition to its share of the deposit of €750 (\$ 1.063), the REIT incurred acquisition costs related to the investment for an amount of €136 (\$ 192) which have been included in the carrying value of the deposit. The share of the deposit of €750 (\$ 1.063) of the co-investor has been paid by the REIT on behalf of the co-investor. This advance to the co-investor is disclosed under the caption other financial current assets (see details in Note 12).

Rueil investment

During the year 2016, the REIT has committed to fund a €21.7 million (\$32.1 million) acquisition and redevelopment loan to a company 80% owned by Inovalis SA related to a property located in Rueil, in Paris Western periphery. The facility amount will be drawn in several installments by completion of the project in 2019. The loan bears an annual interest rate of 8.50%, gives the REIT 20% of the profit generated upon the sale of the underlying investment property and also gives the REIT an option for the purchase of up to 50% of the property once it meets the REIT’s investment criteria. To date, €12.7 million (\$18.170 million) was funded by the REIT as a loan. The loan is secured by a share pledge.

As at March 31, 2017, an amount of €4,5 million (\$6,4 million) of interest on this deposit has been paid in advance and is disclosed under the caption “Deferred income”.

Note 7 – Financial derivatives and hedging activities

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 March 31, 2017		As at December 31, 2016	
		From	To	Euros or rate	\$ or rate		Total notional amount	Fair value	Total notional amount	Fair value
Derivatives classified for hedge accounting										
Foreign exchange	25	2017/04/12	2019/04/12	666	1,000	1.5007	25,000	919	28,000	1,028
Foreign exchange	25	2017/04/12	2019/04/10	206	300	1.4587	7,500	65	8,400	72
Interest rate SWAP	1	2017/04/01	2019/07/01	Variable	Fixed	0.685%	75,825	(1,452)	76,180	(1,685)
Interest rate CAP	2	2017/03/31	2019/05/05	Variable	Capped	2.000%	48,453	8	48,175	9
Other derivatives										
Interest rate SWAP	1	2017/04/01	2021/12/23	Variable	Fixed	0.394%	18,734	(302)	18,746	(413)
Interest rate SWAP	1	2017/04/01	2023/01/10	Variable	Fixed	0.282%	50,606	(449)	50,560	(743)
								(1,211)		(1,731)

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 8 – Other financial current assets

On November 15, 2016, the REIT invested, indirectly through a subsidiary, in units of a French euro money market mutual fund, which are accounted for as financial current assets. During the quarter ended March 31, 2017, the REIT proceeded to the sale of 42.30 units for an amount of €14.5 million. As at March 31, 2017, the fair value of the units invested has been estimated to \$6,268 (€4,398) based on its quoted price on French market.

The other financial current assets also includes the 50% share of the deposit pertaining to the Ingolstadt forward purchase that will be borne by the partner on this transaction (see details in note 6) amounting to \$1.120. This amount includes accrued interest computed at a rate of 9.5%.

Note 9 – Mortgage loans and finance lease liabilities

							As at March 31, 2017		
Entity	Nominal value (in 000's of €)	Nominal value (in 000's of \$)	Interest rate	Maturity	Total	Non-current	Current		
Mortgage loan - Jeûneurs SCI	19,500	27,789	Euribor 3M + 1.75% ¹	05/05/2019	27,839	27,839	-		
Mortgage loan - Véronèse SCI	14,500	20,664	Euribor 3M + 1.75% ¹	05/05/2019	20,719	20,719	-		
Mortgage loan - Sablière SCI	13,146	18,734	Euribor 3M + 1.59% ²	23/12/2025	18,591	18,108	483		
Mortgage loan - CanCorpHanover GmbH KG	12,600	17,956	Euribor 3M + 1.45%	31/12/2022	17,807	17,724	83		
Mortgage loans	59,746	85,143			84,956	84,390	566		
Finance lease liabilities - BBA SCI	52,643	75,022	Euribor 3M + 2.00% ²	20/06/2026	75,022	70,637	4,384		
Finance lease liabilities - Metropolitan SCI	35,510	50,606	Euribor 3M + 1.85% and Euribor 3M + 1.6% ²	20/03/2028	50,606	49,577	1,029		
Finance lease liabilities - Baldi SCI	13,246	18,877	Euribor 3M + 1.00%	30/09/2017	18,837	-	18,837		
Finance lease liabilities	101,399	144,505			144,465	120,214	24,250		
Total mortgage loans and finance lease liabilities	161,145	229,648			229,421	204,604	24,816		

							As at December 31, 2016		
Entity	Nominal value (in 000's of €)	Nominal value (in 000's of \$)	Interest rate	Maturity	Total	Non-current	Current		
Mortgage loan - Jeûneurs SCI	19,500	27,630	Euribor 3M + 1.75% ¹	05/05/2019	27,658	27,658	-		
Mortgage loan - Véronèse SCI	14,500	20,545	Euribor 3M + 1.75% ¹	05/05/2019	20,587	20,587	-		
Mortgage loan - Sablière SCI	13,230	18,746	Euribor 3M + 1.59% ²	23/12/2025	18,597	18,140	457		
Mortgage loan - CanCorpHanover GmbH KG	12,600	17,853	Euribor 3M + 1.45%	31/12/2022	17,697	17,613	84		
Mortgage loans	59,830	84,774			84,539	83,998	541		
Finance lease liabilities - BBA SCI	53,207	75,389	Euribor 3M + 2.00% ²	20/06/2026	75,389	71,338	4,051		
Finance lease liabilities - Metropolitan SCI	35,684	50,560	Euribor 3M + 1.85% and Euribor 3M + 1.6% ²	20/06/2028	50,560	49,553	1,007		
Finance lease liabilities - Baldi SCI	13,539	19,184	Euribor 3M + 1.00%	30/09/2017	19,121	-	19,121		
Finance lease liabilities	102,430	145,133			145,070	120,891	24,179		
Total mortgage loans and finance lease liabilities	162,260	229,907			229,609	204,889	24,720		

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*

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 10 – Exchangeable securities

	Exchangeable securities	
	Number of Exchangeable securities	Carrying amount of Exchangeable securities
Exchangeable securities issued and outstanding		
Transactions in 2016		
Asset management fees paid in Exchangeable securities	361,617	3,450
Distribution in respect of Exchangeable securities	296,036	2,943
Conversion of Exchangeable securities into units of the REIT	(920,000)	(8,606)
Net change in fair value of Exchangeable securities	-	(589)
Balance -December 31, 2016	1,808,051	16,598
Transactions in 2017		
Asset management fees paid in Exchangeable securities	88,625	832
Net change in fair value of Exchangeable securities	-	664
Balance - March 31, 2017	1,896,676	18,094

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 March 31, 2017	For the three months ended March 31, 2016
Amount payable at the beginning of the period	982	366
Declared and recognized in earnings during the period	379	452
Distribution on exchangeable securities paid	(1,037)	(323)
Amount payable at the end of the period	324	495
Weighted average number of Exchangeable securities outstanding	1,809,036	2,103,276
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.5732	0.1536
Distributions paid per unit (based on three-month)	0.2063	0.2063

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 11 – Finance costs and finance income

	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Interest costs related to mortgage loans	(384)	(462)
Interest costs related to finance leases	(648)	(551)
Interest costs related to lease equalization loans	(60)	(73)
	(1,092)	(1,086)
Interest SWAP	(290)	(198)
Other finance costs	(208)	(87)
	(1,590)	(1,371)
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(22)	(51)
Amortization of transaction costs on mortgage loans	(41)	(94)
Finance costs	(1,653)	(1,516)
Finance income	195	3
Finance income from Inovalis relating to the acquisition loan	362	1,163
Finance income from joint ventures	1,226	1,039
Finance income	1,783	2,205
Net Finance costs	130	689

Note 12 – 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.

	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Basic earnings per unit		
Earnings attributable to unitholders	3,141	2,628
Weighted average number of units outstanding	21,544,979	15,650,522
Basic earnings per unit	0.15	0.17

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

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 12 – Earnings per Unit (Cont'd)

	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Diluted earnings per unit		
Earnings attributable to unitholders	3,141	2,628
Distributions recognized on Exchangeable securities	379	452
Net change in fair value of Exchangeable securities	664	616
Earnings attributable to diluted unitholders	4,184	3,696
Weighted average number of units outstanding	21,544,979	15,650,522
Weighted average number of Exchangeable securities outstanding	1,809,036	2,103,276
Weighted average number of units used for diluted earnings per unit	23,354,015	17,753,798
Diluted earnings per unit	0.18	0.21

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.

Note 13 – Distributions

	For the three months ended March 31, 2017	For the three months ended March 31, 2016
Amount payable at the beginning of the period	1,479	1,075
Declared and recognised during the period	4,444	3,229
Distributions paid in units (Distribution Reinvestment Plan)	(350)	(257)
Distributions paid in cash	(4,091)	(2,970)
Amount payable at the end of the period	1,482	1,077
Total distributions	4,444	3,229
Distributions paid per unit (based on weighted average number of units outstanding)	0.2063	0.2063
Distributions paid per unit (based on an annual basis)	0.2063	0.2063

Distributions in respect of Exchangeable securities are detailed in Note 10 – Exchangeable securities.

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 14 – Accumulated other comprehensive income

	As at March 31, 2017	As at March 31, 2016
Net unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	2,708	1,084
Net unrealized losses on interest rate derivatives designated as a cash flow hedge	(1,660)	(2,560)
Cumulative translation adjustment account	8,990	17,872
Accumulated other comprehensive income	10,038	16,396

Note 15 – Transactions with related parties

Inovalis Asset manager

Pursuant to the Management agreement, Inovalis is the Asset manager of the REIT and 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 the exception of management fees to Inovalis that are settled quarterly through the issuance of Exchangeable securities (cf Note 10). No guarantees were given.

Inovalis and its subsidiaries	Financial statement line item	Year to date	
		For the three months ended March 31, 2017	For the three months ended March 31, 2016
Revenues			
Rental income	Rental income	-	65
Service charge income	Service charge income	-	(18)
Interest income from acquisition loan	Finance income	362	1,163
Other revenues	Other income	40	
		<u>402</u>	<u>1,210</u>
Expenses			
Asset management fees	Administration expenses	(838)	(718)
less portion invoiced to joint-ventures	Administration expenses	138	143
Facilities management fees	Service charge expenses	(937)	(905)
Property management Fees	Service charge expenses	(327)	(248)
Reimbursement of travel expenses	Acquisition costs	(37)	(3)
Interest expense on lease equalization loans	Finance costs	(60)	(73)
Reimbursement of travel expenses	Administration expenses	(22)	(21)
Trustee fees	Administration expenses	(62)	(62)
		<u>(2,145)</u>	<u>(1,887)</u>
Exchangeable securities			
Interest on notes	Distributions recognized on Exchangeable securities	(191)	(158)
Reimbursement of debt		(846)	(165)
Total distributions on Exchangeable securities		<u>(1,037)</u>	<u>(323)</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 15 – Transactions with related parties (Cont'd)

	Year to date	
	Due from (to) Inovalis	
	As at March 31, 2017	As at March 31, 2016
Trade and other receivables	117	161
Trade and other payables	(2,357)	(2,422)
Acquisition loan	18,170	-
Distributions payable	(982)	(495)
Lease equalization loans	(5,003)	(6,012)
Deferred income	(6,358)	-
	<u>3,587</u>	<u>(8,768)</u>

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 three months ended March 31, 2017	For the three months ended March 31, 2016
Management fees invoiced to joint ventures	Administration expenses	138	143
Earnings from joint ventures	Share of net earnings from investments accounted for using the equity method	(724)	(2,358)
Finance income	Finance income	1,226	1,039
		<u>640</u>	<u>(1,175)</u>

		Due from joint ventures	
		As at March 31, 2017	As at December 31, 2016
Loan receivable	Investments accounted for using the equity method	37,384	38,242
Accounts receivable	Trade and other receivables	256	189
		<u>37,640</u>	<u>38,431</u>

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Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 16 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended March 31, 2017	For the three months ended March 31, 2016
France	5,469	1,828	7,297	6,709
Germany	501	22	523	554
Total revenue	5,970	1,850	7,820	7,263

Investment properties, investments in joint ventures and provision relating to investments in joint ventures by geographic region	As at March 31, 2017	As at March 31, 2016
France	395,015	403,028
Germany	65,404	59,665
	460,419	462,693

Note 17 – 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 March 31, 2017			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	417,009	417,009
Derivative financial instruments - assets	-	992	-	992
Financial current assets	6,268	-	-	6,268
Derivative financial instruments - liabilities	-	(2,202)	-	(2,202)
Exchangeable securities	-	(18,094)	-	(18,094)

	As at December 31, 2016			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	412,232	412,232
Derivative financial instruments - assets	-	1,110	-	1,110
Financial current assets	26,822	-	-	26,822
Derivative financial instruments - liabilities	-	(2,841)	-	(2,841)
Exchangeable securities	-	(16,598)	-	(16,598)

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 17 – Fair value measurements (Cont'd)

- 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 March 31, 2017 (none in 2016).

The REIT's management is responsible for determining fair value measurements included in the condensed interim consolidated financial statements, including Level 3 fair values. The inputs, processes and results for recurring measurements, including those valuations calculated by an independent appraiser, 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 the units held in a French euro money market mutual fund which are accounted for as financial current assets, is determined based on its quoted price at the end of each period.
- 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 period ended March 31, 2017

(Unaudited - All dollar amounts are in thousands of Canadian dollars, unless otherwise stated)

Note 18 – Cash flow information

	Note	Three months ended March 31, 2017	Three months ended March 31, 2016
Adjustments for non-cash items and other reconciling items:			
Rent free period	4	79	323
Management fees paid in Exchangeable securities	15	838	718
less portion invoiced to joint-ventures	15	(138)	(143)
Net change in fair value of investment properties	4	(2,290)	2,907
Net change in fair value of financial instruments at fair value through profit or loss		(571)	144
Distributions recognized on Exchangeable securities	10	379	452
Net change in fair value of Exchangeable securities	10	664	616
Loss on refinancing of a debt		-	605
Finance income	11	(1,783)	(2,205)
Finance costs	11	1,653	1,516
Income taxes paid		(10)	(85)
Loss recognized on exercise of early payment option on finance leases		-	1,920
Gain on bargain purchase		-	(9,877)
Other items		-	15
Share of net earnings from investments accounted for using the equity method	5	724	2,358
Net unrealized exchange gains		-	(39)
Cash items classified as operating activities			
Interest received		1,035	486
Interest paid		(1,021)	(1,058)
Acquisition costs classified in investing activities		37	659
		<u>(404)</u>	<u>(689)</u>
Working capital adjustments			
Increase in trade and other receivables		(996)	(1,198)
Increase (decrease) in tenant deposits		(7)	117
Increase in trade and other payables		8,022	4,550
		<u>7,019</u>	<u>3,469</u>

Note 19 – Subsequent events

New acquisitions

On April 13, 2017 the REIT committed €5.3 million (\$7.6 million) in a short term acquisition loan to the Aref Diamants Sarl (100%-owned by Inovalis SA) as a first step to the Pantin (Paris North-Eastern periphery) asset acquisition announced in Q4 2016. The loan will generate 9% interest income until the acquisition date, which is expected to occur in Q2 2017. The Stuttgart (Germany) acquisition is also expected to close in Q2 2017.

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.

INOVALIS

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