

INOVALIS REIT 2016 Third Quarter Report

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

Three-month and nine-month periods ended September 30, 2016

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 Trust.

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

Assets	Note	As at September 30, 2016	As at December 31, 2015
Non-current assets			
Investment properties	5	435 865	355 704
Investments accounted for using the equity method	6	45 796	40 337
Acquisition loan		-	18 786
Derivative financial instruments	8	7	92
Restricted cash		1 105	1 375
Total non-current assets		482 773	416 294
Current assets			
Trade and other receivables		3 930	4 803
Derivative financial instruments	8	24	197
Other current assets		2 149	1 333
Restricted cash		-	305
Cash		47 923	6 895
Total current assets		54 026	13 533
Total assets		536 799	429 827
Liabilities and Unitholders' equity			
Liabilities			
Non-current liabilities			
Mortgage loans	7	87 439	70 779
Finance lease liabilities	7	148 695	120 285
Lease equalization loans		4 663	5 090
Tenant deposits		2 518	1 746
Exchangeable securities	9	19 024	18 034
Provision relating to an investment accounted for using the equity method	6	-	925
Derivative financial instruments	8	3 096	2 698
Deferred tax liabilities		1 706	1 651
Total non-current liabilities		267 141	221 208
Current liabilities			
Mortgage loans	7	562	415
Finance lease liabilities	7	7 112	6 217
Lease equalization loans		956	1 335
Tenant deposits		206	116
Exchangeable securities	9	2 785	1 366
Derivative financial instruments	8	1 355	878
Trade and other payables		9 650	6 174
Other current liabilities		939	469
Total current liabilities		23 565	16 970
Total liabilities		290 706	238 178
Equity			
Trust units		184 285	136 365
Retained earnings		44 838	35 359
Accumulated other comprehensive income	13	17 013	19 925
		246 136	191 649
Non-controlling interest		(43)	-
Total equity		246 093	191 649
Total liabilities and equity		536 799	429 827

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 September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Rental income		6 172	5 543	17 698	16 133
Service charge income		1 819	1 665	4 594	5 324
Service charge expenses		(1 506)	(1 469)	(6 980)	(6 613)
Other revenues	14	130	-	172	1 240
Other property operating expenses		(59)	(232)	(126)	(279)
Net rental earnings		6 556	5 507	15 358	15 805
Administration expenses		(1 229)	(941)	(3 953)	(3 059)
Foreign exchange (loss) gain		(46)	(23)	61	51
Net change in fair value of investment properties		6 559	(443)	7 203	12 723
Option fair value related to the acquisition of the Metropolitan property	4	-	-	9 213	-
Acquisition costs		(49)	(402)	(738)	(456)
Share of net earnings from investments accounted for using the equity method		218	519	(140)	640
Operating earnings		12 009	4 217	27 004	25 704
Gain (loss) on financial instruments at fair value through profit or loss		(110)	(1 407)	(2 347)	(1 028)
Gain (loss) recognized on exercise of early payment option on finance leases	4	-	-	(1 242)	-
Loss on refinancing of a debt	7	-	-	(605)	-
Finance income	10	2 217	2 860	5 053	4 424
Finance costs	10	(1 670)	(1 223)	(4 809)	(3 666)
Distributions on Exchangeable securities	9	(592)	(408)	(1 526)	(1 265)
Net change in fair value of Exchangeable securities	9	181	406	(838)	71
Earnings before income taxes		12 035	4 445	20 690	24 240
Current income tax expense		4	(52)	(104)	(60)
Deferred income tax recovery (expense)		(207)	86	(330)	(21)
Earnings for the period		11 832	4 479	20 256	24 159
Earnings for the period attributable to :					
Non-controlling interest		(1)	-	(43)	-
Unit holders' of the Trust		11 833	4 479	20 299	24 159
		11 832	4 479	20 256	24 159
Earnings per unit attributable to unit holders:	11				
Basic earnings per unit		0,60	0,29	1,20	1,57
Diluted earnings per unit		0,56	0,26	1,19	1,46

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Interim Consolidated Statements of Comprehensive Income (loss)

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

(in thousands of Canadian dollars)

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Earnings for the period	11 832	4 479	20 256	24 159
Other comprehensive income (loss)				
Derivatives designated as a hedge of the net investment in a foreign entity				
Net gains (losses)	(798)	(1 207)	880	(837)
Derivatives designated as cash flow hedges				
Net gains (losses)	652	(385)	158	15
Reclassification of net losses to earnings	(67)	28	-	73
Change in cumulative translation adjustment account	5 726	13 103	(3 950)	11 566
Total other comprehensive income (loss)	5 513	11 539	(2 912)	10 817
Total comprehensive income (loss) for the period	17 345	16 018	(2 912)	34 976

See accompanying notes to condensed interim consolidated financial statements

Interim Consolidated Statements of changes in Unitholders' Equity

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

(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 attributable to the Unitholders' of the Trust	Non-controlling interest	Total equity
As at December 31, 2015		15 637 019	136 365	35 359	19 925	191 649	-	191 649
Issuance of units		5 262 190	47 080	-	-	47 080	-	47 080
Distributions earned by Unitholders	12	-	-	(10 820)	-	(10 820)	-	(10 820)
Distributions reinvestment Plan	12	90 607	840	-	-	840	-	840
Transactions with owners		5 352 797	47 920	(10 820)	-	37 100	-	37 100
Earnings for the period		-	-	20 299	-	20 299	(43)	20 256
Other comprehensive loss		-	-	-	(2 912)	(2 912)	-	(2 912)
As at September 30, 2016		20 989 816	184 285	44 838	17 013	246 136	(43)	246 093
As at December 31, 2014		15 278 536	133 010	17 291	7 316	157 617	-	157 617
Issuance of units		200 000	1 887	-	-	1 887	-	1 887
Distributions earned by Unitholders	12	-	-	(9 516)	-	(9 516)	-	(9 516)
Distributions reinvestment Plan	12	67 370	590	-	-	590	-	590
Transactions with owners		267 370	2 477	(9 516)	-	(7 039)	-	(7 039)
Earnings for the period		-	-	24 159	-	24 159	-	24 159
Other comprehensive loss		-	-	-	10 817	10 817	-	10 817
As at September 30, 2015		15 545 906	135 487	31 934	18 133	185 554	-	185 554

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)

(in thousands of Canadian dollars)

	<i>Note</i>	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Operating activities					
Earnings before income taxes for the period		12 035	4 445	20 690	24 240
Adjustments for non-cash items and other reconciling items	17	(5 887)	247	(7 685)	(12 526)
		6 148	4 692	13 005	11 714
Working capital adjustments	17	(2 387)	1 284	1 913	1 248
Net cash flows related to operating activities		3 761	5 976	14 918	12 962
Investing activities					
Business acquisition	4	-	-	(21 638)	-
Acquisition costs		(49)	(402)	(738)	(456)
Investment in a joint-venture - Walpur Four		-	-	-	(5 143)
Investment in a joint-venture - Cologne		-	-	(6 189)	-
Investment in a joint-venture - Arcueil		-	(692)	-	(14 607)
Distribution from (investment in) a joint-venture - Arcueil		550	-	1 075	-
Additions to investment properties	5	(56)	53	(1 050)	(186)
Loan repayments received from joint ventures		-	166	-	1 011
Net changes in restricted cash		(1 107)	(747)	573	(847)
Settlement of derivative financial instruments		-	158	(1 042)	749
Net cash flows related to investing activities		(662)	(1 464)	(29 009)	(19 479)
Financing activities					
Units issued for cash	18	43 099	-	43 099	-
Distributions on Units paid in cash	12	(3 683)	(2 976)	(9 612)	(8 907)
Distributions in respect of Exchangeable securities paid in cash	9	(518)	(331)	(1 052)	(1 127)
Proceeds from new mortgage loans, net of transaction costs	7	252	-	19 047	-
Proceeds from new finance liabilities, net of transaction costs	7	-	-	52 654	-
Transaction fees related to the exercise of early payment option on finance leases	4	-	-	(1 242)	-
Repayment of mortgage loans and finance lease liabilities		(1 475)	(1 869)	(47 016)	(4 995)
Lease equalization loan		(375)	756	(685)	2 357
Net cash flows related to financing activities		37 299	(4 420)	55 192	(12 672)
Net increase (decrease) in cash and cash equivalents		40 398	92	41 101	(19 189)
Effects of foreign exchange adjustments on cash and cash equivalent		(154)	578	(73)	174
Cash at the beginning of the period		7 679	4 500	6 895	24 185
Cash at the end of the period		47 923	5 170	47 923	5 170

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

(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 and nine-month periods ended September 30, 2016, were authorized for issuance by the Board of Trustees on November 14, 2016.

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 14 – 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 2015 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.

The figures presented for the period ended September 30, 2015 have been reclassified, when appropriate, in order to ensure comparability with the figures for the period ending September 30, 2016.

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, 2015.

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, 2015.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 4 – Business combination

On March 21, 2016, the REIT completed the acquisition from Inovalis of a property located at 35 rue Greneta, 75002 Paris, France (the “Metropolitan property”), together with the related tenant portfolio and the management contract. The Acquisition loan made to Inovalis in 2014 was considered as part of the consideration paid for this acquisition.

This acquisition is accounted for as a business combination. The identifiable assets and liabilities of the acquired business were recognized based upon their respective fair values as of the transaction date and revised during the quarter ended June 30, 2016. A summary is provided below:

Purchase price allocation	As at March 21, 2016
<i>Recognized amounts of identifiable assets acquired and liabilities assumed</i>	
Investment property	78 068
Finance lease liability	(23 166)
Other liabilities (tenant deposits)	(602)
Total liabilities assumed	(23 768)
Fair value of net asset acquired	54 300
Consideration transferred by the REIT for the acquisition consists of the following:	
Cash	21 638
Acquisition loan including related interest receivable and trade and other receivables	23 449
Consideration transferred by the REIT	45 087
Option fair value related to the acquisition of the Metropolitan property	9 213

The excess of the fair value of the net assets acquired at the acquisition date over the consideration transferred by the REIT has been recognized in earnings as a gain disclosed in the caption “Option fair value related to the acquisition of the Metropolitan property”. This gain is principally due to the fact that the REIT bought the properties at a discount to its market value as a consequence of a profit sharing mechanism featured in the Acquisition loan granted by Inovalis REIT to Inovalis SA when the latter bought the Metropolitan property in 2014.

Acquisition costs related to the acquisition amounting to \$396 (€267) have been recognized in earnings for the nine-month period ended September 30, 2016.

Immediately following the acquisition, the REIT exercised its option to purchase the investment property that was leased and concomitantly, closed a new finance lease contract to replace the finance lease assumed as part of the transaction. Therefore, finance lease liability amounting to \$23,166 (€15,742) was derecognized and a loss on the exercise of early payment option of finance lease of \$1,242 (€844) was recognized in the condensed interim consolidated statement of earnings for the nine-month period ended September 30, 2016, which includes an adjustment of \$664 (€451) with counterpart to the gain recognized in the second quarter following revision of the purchase price allocation. Costs related to setting up the new finance lease after the business combination transaction amounted to \$856 (€580) and were subsequently capitalized to the investment property.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 5 – Investment properties

	For the nine months ended September 30, 2016	For the year ended December 31, 2015
Investment properties		
Beginning of period	355 704	308 596
Additions, capitalized letting fees and change in initial direct costs	1 050	98
		-
Acquisitions through business combinations	78 068	-
Amount derecognized upon exercise of early purchase option on lease		(14 377)
Amount recognized upon acquisition of the property		14 377
Rent free periods	(98)	2 281
Net change in fair value of investment properties ⁽¹⁾	7 203	21 523
Foreign currency translation adjustment	(6 062)	23 206
End of period	435 865	355 704

⁽¹⁾ : Including the increase of 806 K\$ (nil as at December 31, 2015) related to the impact of IFRIC 21 for recoverable French property taxes, which has a similar impact on service charge expenses.

Note 6 – 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:

	CCD	Walpur	Arcueil	Cologne	For the nine months ended September 30, 2016	For the year ended December 31, 2015
Carrying amount of investment in joint ventures						
Balance at the beginning of the period	19 188	6 918	14 231	(926)	39 411	18 307
Net change in equity investment in joint ventures	3	(382)	1 259	(210)	671	2 244
Net change in loans to joint ventures	(287)	(95)	(260)	6 356	5 715	18 861
Reclassified to liabilities	-	-	-	-	-	925
Balance at the end of the period	18 904	6 442	15 230	5 220	45 796	40 337
Provision relating to an investment accounted for using the equity method	-	-	-	-	-	(925)

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 7 – Mortgage loans and finance lease liabilities

								As at September 30, 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	28 745	Euribor 3M + 1.75% ¹	2019-05-05	28 745	28 745	-			
Mortgage loan - Véronèse SCI	14 500	21 374	Euribor 3M + 1.75% ¹	2019-05-05	21 398	21 398	-			
Mortgage loan - Sablière SCI	13 183	19 433	Euribor 3M + 1.59% ²	2025-12-23	19 439	18 989	449			
Mortgage loan - CanCorpHanover	12 660	18 661	Euribor 3M + 1.45%	2022-12-31	18 420	18 307	113			
Mortgage loans	59 843	88 213			88 002	87 439	562			
Finance lease liabilities - BBA SCI	53 765	79 255	Euribor 3M + 2.00% ²	2026-06-20	79 255	75 358	3 899			
Finance lease liabilities - Metropolitain	35 772	52 731	Euribor 3M + 1.85% and Euribor 3M + 1.6% ²	2028-03-20	52 731	51 822	909			
Finance lease liabilities - Baldi SCI	16 159	23 819	Euribor 3M + 1.00%	2017-09-30	23 819	21 515	2 304			
Finance lease liabilities	105 696	155 805			155 805	148 695	7 112			
Total mortgage loans and finance lease liabilities	165 539	244 018			243 807	236 134	7 674			

								As at December 31, 2015		
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	29 307	Euribor 3M + 1.75% ¹	2019-05-05	29 175	29 175	-			
Mortgage loan - Véronèse SCI	14 500	21 792	Euribor 3M + 1.75% ¹	2019-05-05	21 721	21 721	-			
Mortgage loan - Sablière SCI	13 500	20 289	Euribor 3M + 1.72% ²	2025-12-23	20 298	19 883	415			
Mortgage loans	47 500	71 388			71 194	70 779	415			
Finance lease liabilities - BBA SCI	55 406	83 270	Euribor 3M + 2.00% ²	2026-06-20	83 270	79 965	3 305			
Finance lease liabilities - CanCorpHanover	12 337	18 541	Euribor 3M + 0.82%	2023-06-30	17 635	16 965	670			
Finance lease liabilities - Baldi SCI	17 235	25 902	Euribor 3M + 1.00%	2017-09-30	25 597	23 355	2 242			
Finance lease liabilities	84 978	127 713			126 502	120 285	6 217			
Total mortgage loans and finance lease liabilities	132 478	199 101			197 696	191 064	6 632			

Note 1 : Interest rate is subject to a CAP - see note 8 *Financial derivatives and hedging activities*

Note 2 : Interest rate is subject to SWAP - see note 8 *Financial derivatives and hedging activities*

During the quarter ended March 31, 2016, the REIT refinanced its debt on the Hanover investment property through a series of transactions, including the acquisition of a 94% interest in the entity holding the Hanover property. The new mortgage loan contracted during the three-month period ended March 31, 2016 as the replacement of a finance lease that was terminated has a principal amount of 12,489 Euros as at June 30, 2016 (12,600 Euros at inception), a term of seven years maturing on December 31, 2022 and bears interest at variable rate, based on the 3 month EURIBOR rate plus a spread of 1.45%. Interest are due and payable quarterly on March 31, June 30, September 31, and December 31. Principal is payable on maturity.

The impact of the derecognition of the finance lease amounting to \$605 (400€) was recognized in the condensed interim consolidated statement of earnings for the nine-month period ended September 30, 2016 under the caption "Loss on refinancing of a debt".

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 8 – Financial derivatives and hedging activities

During the three-month period ended March 31, 2016, the REIT entered into 2 new monthly foreign currency hedge contracts whereby the REIT was entitled to purchase \$1,000 each month at a weighted average exchange rate of 1.5996 Canadian dollars per euro. The new contracts were covering 2 monthly periods from December 14, 2018 to February 14, 2019.

On May 4, 2016, the REIT proceeded with the settlement of the 25 foreign exchange contracts and 21 option contracts still outstanding from its original economic hedging strategy. The settled contracts covered monthly periods up to and including February 14, 2019. A loss of approximately \$467 was realized at the time of settlement. Of this loss of \$467, an unrealized loss of approximately \$675 had been previously recognized in earnings regarding the contracts not accounted for as hedging instruments and an unrealized gain of approximately \$208 had been previously recognized in other comprehensive income (loss) regarding the contracts accounted for as hedging instruments.

Subsequent to this settlement, the REIT entered into a series of 36 monthly foreign currency hedge contracts whereby the REIT can purchase \$ 1,000 each month at a weighted average exchange rate of 1.4927 Canadian dollars per Euro. The new contracts cover 36 monthly periods from May 4, 2016 to April 12, 2019. These contracts have been designated as hedges of the REIT's net investment in a foreign operation and changes in fair value are recognized in other comprehensive income (loss). As at September 31, 2016, 31 foreign currency hedge contracts at a weighted average exchange rate of 1.4962 covering the period from October 2016 to April 2019 were still applicable.

Moreover, following the new financing arrangement concluded in the three-month period ended March 31, 2016 as part of the acquisition of the Metropolitan property described in Note 4, an interest SWAP arrangement was contracted on April 10, 2016. This arrangement is settled on a net basis at every interest payment date. This contract is not designated as part of a hedging relationship. Accordingly, it is classified as financial instrument at fair value through profit or loss, with changes in fair value recognized in profit or loss.

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 September 30, 2016		As at December 31, 2015	
		From	To	Euros or rate	\$ or rate		Total notional amount	Fair value	Total notional amount	Fair value
Derivatives classified for hedge accounting										
Foreign exchange	11	2018-02-14	2018-12-14	677	1 000	1,4762	-	-	11 000	(525)
Foreign exchange	16	2016-01-01	2017-04-13	486	750	1,5437	-	-	12 000	241
Foreign exchange	31	2016-10-01	2019-04-12	668	1 000	1,4962	31 000	(30)	-	-
Interest rate SWAP	1	2016-10-01	2019-07-01	Variable	Fixed	0,685%	80 070	(2 133)	83 270	(1 924)
Interest rate CAP	2	2016-09-30	2019-05-05	Variable	Capped	2,000%	50 119	7	51 099	48
Other derivatives										
Option contracts on foreign exchange										
Put options purchased	16	2016-01-12	2017-04-11	167	250	1,4956	-	-	4 000	-
Call options sold	16	2016-01-12	2017-04-11	334	500	1,4956	-	-	8 000	-
Put options purchased	9	2017-05-10	2018-01-10	669	1 000	1,4956	-	-	9 000	-
Call options sold	9	2017-05-10	2018-01-10	1 337	2 000	1,4956	-	-	18 000	-
Option contracts on foreign exchange - fair value										
Interest rate SWAP	1	2016-10-01	2021-12-23	Variable	Fixed	0,394%	19 602	(675)	20 289	(85)
Interest rate SWAP	1	2016-10-01	2023-01-10	Variable	Fixed	0,282%	52 731	(1 589)	-	-
								<u>(4 420)</u>		<u>(3 287)</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 9 – Exchangeable securities

	Exchangeable securities	
	Number of Exchangeable securities	Carrying amount of Exchangeable securities
Exchangeable securities issued and outstanding		
Balance - December 31, 2014	2 043 347	18 145
Transactions in 2015		
Asset management fees paid in Exchangeable securities	291 551	2 666
Conversion of Exchangeable securities into units of the REIT	(264 500)	(2 529)
Net change in fair value of Exchangeable securities	-	1 118
Balance - December 31, 2015	2 070 398	19 400
Transactions in 2016		
Asset management fees paid in Exchangeable securities	269 985	2 609
Distribution in respect of Exchangeable securities	296 036	2 943
Conversion of Exchangeable securities into units of the REIT	(420 000)	(3 981)
Net change in fair value of Exchangeable securities	-	838
Balance -September 30, 2016	2 216 419	21 809
	As at September 30, 2016	As at December 31, 2015
Exchangeable securities	21 809	19 400
Less current portion	(2 785)	(1 366)
Non-current portion of Exchangeable securities	19 024	18 034

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 September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Amount payable at the beginning of the period	766	96	366	35
Declared and recognized in earnings during the period	592	408	1 526	1 265
Distribution on exchangeable securities paid in cash	(518)	(331)	(1 052)	(1 127)
Amount payable at the end of the period	840	173	840	173
Weighted average number of Exchangeable securities outstanding	2 112 746	2 027 952	2 206 669	2 062 039
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0,2452	0,1632	0,4767	0,5465
Distributions paid per unit (based on three-month/nine-month basis)	0,2063	0,2063	0,6189	0,6189

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 10 – Finance costs and finance income

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Interest costs related to mortgage loans	(314)	(222)	(1 188)	(646)
Interest costs related to finance leases	(718)	(609)	(1 988)	(1 806)
Interest costs related to lease equalization loans	(80)	(62)	(222)	(149)
	(1 112)	(893)	(3 398)	(2 601)
Interest SWAP	(300)	(146)	(768)	(393)
Other finance costs	(153)	27	(264)	(46)
	(1 565)	(1 012)	(4 430)	(3 040)
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(46)	(110)	(145)	(324)
Amortization of transaction costs on mortgage loans	(59)	(101)	(234)	(302)
Finance costs	(1 670)	(1 223)	(4 809)	(3 666)
Finance income from Inovalis relating to the acquisition loan	3	403	1 171	1 154
Finance income from joint ventures	2 336	2 457	3 882	3 270
Finance income	2 339	2 860	5 053	4 424
Net Finance costs	669	1 637	244	758

Note 11 – 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 September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Basic earnings per unit				
Earnings attributable to unitholders	11 833	4 479	20 299	24 159
Weighted average number of units outstanding	20 183 520	15 485 358	17 194 747	15 362 088
Basic earnings per unit	0,59	0,29	1,18	1,57

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

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 11 – Earnings per Unit (Cont'd)

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Diluted earnings per unit				
Earnings attributable to unitholders	11 833	4 479	20 299	24 159
Distributions recognized on Exchangeable securities	592	408	1 526	1 265
Net change in fair value of Exchangeable securities	(181)	(406)	838	(71)
Earnings attributable to diluted unitholders	12 244	4 481	22 663	25 353
Weighted average number of units outstanding	20 183 520	15 485 358	17 194 747	15 362 088
Weighted average number of Exchangeable securities outstanding	2 112 746	2 027 952	2 206 669	2 062 039
Weighted average number of units used for diluted earnings per unit	22 296 266	17 513 310	19 401 416	17 424 127
Diluted earnings per unit	0,55	0,26	1,17	1,46

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 12 – Distributions

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Amount payable at the beginning of the period	1 107	1 053	1 075	1 050
Declared and recognised during the period	4 327	3 205	10 820	9 516
Distributions paid in units (Distribution Reinvestment Plan)	(308)	(213)	(840)	(590)
Distributions paid in cash	(3 683)	(2 976)	(9 612)	(8 907)
Amount payable at the end of the period	1 443	1 069	1 443	1 069
Total distributions	4 327	3 205	10 820	9 516
Distributions paid per unit (based on weighted average number of units outstanding)	0,1977	0,2083	0,6079	0,6182
Distributions paid per unit (based on an annual basis)	0,2063	0,2063	0,6189	0,6189

Distributions in respect of Exchangeable securities are detailed in Note 9 – Exchangeable securities.

Note 13 – Accumulated other comprehensive income

	As at September 30, 2016	As at December 31, 2015
Net unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	1 562	682
Net unrealized losses on interest rate derivatives designated as a cash flow hedge	(2 000)	(2 158)
Cumulative translation adjustment account	17 451	21 401
Accumulated other comprehensive income	17 013	19 925

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 14 – 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. No guarantees were given.

Inovalis and its subsidiaries	Financial statement line item	Year to date	
		For the nine months ended September 30, 2016	For the nine months ended September 30, 2015 (1)
Revenues			
Rental income	Rental income	234	691
Service charge income	Service charge income	(35)	528
Other revenues (2)	Other revenues	172	1 240
Interest income from acquisition loan	Finance income	1 155	1 149
		<u>1 526</u>	<u>3 608</u>
Expenses			
Asset management fees	Administration expenses	(2 609)	(1 892)
less portion reinvoiced to joint-ventures	Administration expenses	550 (3)	291
Facilities management fees	Service charge expenses	(267) (1)	(233)
Property management Fees	Service charge expenses	(951)	(625)
Letting fees invoiced	Service charge expenses	(250)	-
less portion accounted for over the lease term	Service charge expenses	208	-
Reimbursement of travel expenses	Acquisition costs	(113)	(110)
Interest expense on lease equalization loans	Finance costs	(211)	(149)
Other finance costs	Finance costs	(4)	(4)
Reimbursement of travel expenses	Administration expenses	(221)	(235)
Trustee fees	Administration expenses	(209)	(189)
		<u>(4 077)</u>	<u>(3 146)</u>
Exchangeable securities			
Interest on notes	Distributions recognized on Exchangeable securities	(739)	(688)
Reimbursement of debt		313	(439)
Total distributions on Exchangeable securities		<u>(426)</u>	<u>(1 127)</u>

(1) The figures of the period ended September 30, 2015 have been reclassified in order to ensure comparability with the figures for the period ended September 30, 2016.

(2) For the nine month period ended September 30, 2015, recovery of an amount paid for anticipated repairs that are no longer required. For the nine month period ended September 30, 2016, this amount is an adjustment to broker fees invoiced to Cologne property.

(3) Including the asset management fees of the joint venture Cologne Property invoiced to the parent holding company fully owned by the REIT.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 14 – Transactions with related parties (Cont'd)

	Year to date	
	Due from (to) Inovalis	
	As at September 30, 2016	As at December 31, 2015
Trade and other receivables	415	1 200
Trade and other payables	(1 981)	(2 732)
Acquisition loan	-	18 786
Distributions payable	(840)	(366)
Lease equalization loans	(5 619)	(6 425)
	<u>(8 025)</u>	<u>10 463</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 nine months ended September 30, 2016	For the nine months ended September 30, 2015
Management fees invoiced to joint ventures	Administration expenses	550	291
Earnings from joint ventures	Share of net earnings from investments accounted for using the equity method	(71)	640
Finance income	Finance income	3 882	3 270
		<u>4 361</u>	<u>4 201</u>
		Due from joint ventures	
		As at September 30, 2016	As at December 31, 2015
Loan receivable	Investments accounted for using the equity method	39 214	33 500
Accounts receivable	Trade and other receivables	252	428
		<u>39 466</u>	<u>33 928</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 15 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended September 30, 2016	For the three months ended September 30, 2015
France	5 653	1 795	7 448	6 663
Germany	519	24	543	544
Total revenue	6 172	1 819	7 991	7 207

Total revenue by geographic region	Rental Income	Service Charge Income	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
France	16 124	4 536	20 660	19 896
Germany	1 574	58	1 632	1 561
	17 698	4 594	22 292	21 457

Investment properties, investments in joint ventures and provision relating to investments in joint ventures by geographic region	As at September 30, 2016	#REF!
France	415 985	334 385
Germany	65 873	60 731
	481 858	395 116

Note 16 – 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 September 30, 2016			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	435 865	435 865
Derivative financial instruments - assets	-	31	-	31
Derivative financial instruments - liabilities	-	(4 451)	-	(4 451)
Exchangeable securities	-	(21 809)	-	(21 809)

	As at December 31, 2015			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	355 704	355 704
Derivative financial instruments - assets	-	289	-	289
Derivative financial instruments - liabilities	-	(3 576)	-	(3 576)
Exchangeable securities	-	(19 400)	-	(19 400)

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2016

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

Note 16 – 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 September 30, 2016 (none in 2015).

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 every semester, 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 5 – 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 nine-month periods ended September 30, 2016

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

Note 17 – Cash flow information

CASH FLOW INFORMATION

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Adjustments for non-cash items and other reconciling items:				
Rent free period	(98)	(771)	125	(2 184)
Management fees paid in Exchangeable securities	1 001	649	2 609	1 892
less portion invoiced to joint-ventures	(91)	(86)	(250)	(291)
Net change in fair value of investment properties	(6 559)	443	(7 203)	(12 723)
(Gain) loss on financial instruments at fair value through profit or loss	110	1 407	2 347	1 028
Loss on refinancing of a debt	-	-	605	-
Distributions on Exchangeable securities	592	408	1 526	1 265
Net change in fair value of Exchangeable securities	(181)	(406)	838	(71)
Finance income	(2 217)	(2 860)	(5 053)	(4 424)
Finance costs	1 670	1 223	4 809	3 666
Income taxes paid	4	(52)	(104)	(60)
Loss recognized on exercise of early payment option on finance leases	-	-	1 242	-
Option cost related to the acquisition of the Metropolitan property	-	-	(9 213)	-
Other items	59	-	126	-
Share of net earnings from investment accounted for using the equity method	(218)	(519)	140	(640)
Unrealized exchange (gains) losses	46	(23)	(61)	(113)
Cash items classified as operating activities				
Interest received	1 072	1 676	2 011	2 602
Interest paid	(1 126)	(1 244)	(2 917)	(2 929)
Acquisition costs classified in investing activities	49	402	738	456
	<u>(5 887)</u>	<u>247</u>	<u>(7 685)</u>	<u>(12 526)</u>
Working capital adjustments				
(Increase) decrease in trade and other receivables	(622)	423	(1 309)	(879)
Increase (decrease) in tenant deposits	35	(204)	286	(268)
Increase (decrease) in trade and other payables	(1 800)	1 065	2 936	2 413
	<u>(2 387)</u>	<u>1 284</u>	<u>1 913</u>	<u>1 266</u>

Note 18 – Issue of new units

On July 25, 2016, the REIT closed a public offering of 4,842,190 trust units (“Units”), inclusive of 631,590 Units issued pursuant to the exercise in full of the over-allotment option, on a bought deal basis, at a price of \$9.50 per Unit for total gross proceeds to the REIT of \$46,001 reduced by the offering costs amounting to \$2,902 i.e. net proceeds of \$43,099.

The REIT intends to use the net proceeds from the sale of the Units as an available source of funding for potential future acquisitions of office properties located in France and Germany and for potential capital expenditures relating to the re-positioning and/or re-development of currently owned properties. To date, the REIT has allotted approximately \$4.0 million as deposits for two transactions, Ingolstadt and Rueil properties as described below. The balance of the proceeds from the equity offering will be used for further acquisitions, working capital and general trust purposes, as well as for the repayment of the outstanding finance lease (\$23.8 million) on the Baldi property in order to have an unencumbered asset. We will then use the Baldi property as security for a revolving line that will help underwrite and warehouse assets in the future. The repayment of the Baldi finance lease and the setting up of the revolving line are expected to take place in the course of the first quarter of 2017.

During the quarter, the REIT entered into an agreement for the forward purchase of a class-A office property to be developed in Ingolstadt, Germany. Upon completion of its development in the first quarter of 2018, the 103,000 sq.ft office property will be fully let to a leading German automotive supplier and serve as a headquarters under a 10-year firm lease. The REIT through Inovalis S.A. relations intends to share up to 50% of the asset. One of Inovalis S.A. partners has showed great interest for the project. The net purchase price of the property of approximately €23.9 million (\$35.2 million) reflects a cap rate of 6.5%.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

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

Note 19 – Subsequent events

Rueil

Subsequent to the quarter, 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. An office building complex will be re-developed with a total lettable area of approximately 260,000 sq.ft. The facility amount will be drawn in several installments by completion of the project in 2019. The loan will bear an annual interest rate of 8.50%, will give the REIT 16% of the profit generated by the transaction and will also give the REIT an option for the purchase of up to 50% of the property once it meets the REIT's investment criteria. To date, €1.0 million (\$1.5 million) was funded by the REIT as deposit. This transaction will legally be structured in a similar way to the Metropolitan transaction.

New foreign exchange contracts

Subsequent to the quarter, on October 18, 2016, the REIT entered into 30 new monthly foreign currency hedge contracts whereby the REIT is entitled to purchase \$300 each month at an average exchange rate of 1.4554 Canadian dollars per euro. The new contracts cover 30 monthly periods from November 10, 2016 to April 10, 2019. The addition of these new contracts to the already existing ones ensure the foreign exchange protection for the distribution on the entirety of the REIT's units (including the Units raised in the \$46.0 million equity offering in July 2016).

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

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