

INOVALIS REIT 2017 Second Quarter Report

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

Three-month and six-month periods ended June 30, 2017

INOVALIS REIT

Interim Consolidated Balance Sheets

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

Assets	Note	As at June 30, 2017	As at December 31, 2016
Non-current assets			
Investment properties	4	431,672	412,232
Investments accounted for using the equity method	5	59,381	43,887
Acquisition loans and deposit	6	28,109	8,906
Derivative financial instruments	7	-	590
Total non-current assets		519,162	465,615
Current assets			
Trade and other receivables		4,332	3,368
Derivative financial instruments	7	30	520
Other current assets		2,789	1,638
Other financial current assets		1,191	27,910
Cash		23,519	11,074
Total current assets		31,861	44,510
Total assets		551,023	510,125
Liabilities and Unitholders' equity			
Liabilities			
Non-current liabilities			
Promissory Notes	9	12,951	-
Mortgage loans	10	87,607	83,998
Finance lease liabilities	10	123,481	120,891
Lease equalization loans		3,687	4,051
Tenant deposits		2,165	2,178
Exchangeable securities	11	6,024	4,603
Derivative financial instruments	7	922	1,616
Deferred tax liabilities		2,567	2,236
Deferred income		4,487	-
Total non-current liabilities		243,891	219,573
Current liabilities			
Promissory Notes	9	28	-
Mortgage loans	10	614	541
Finance lease liabilities	10	24,884	24,179
Lease equalization loans		1,235	1,184
Tenant deposits		294	198
Exchangeable securities	11	14,087	11,995
Derivative financial instruments	7	1,149	1,225
Trade and other payables		9,496	7,392
Other current liabilities		450	734
Deferred income		5,238	1,975
Total current liabilities		57,475	49,423
Total liabilities		301,366	268,996
Equity			
Trust units		189,869	189,158
Retained earnings		37,857	43,455
Accumulated other comprehensive income	15	21,729	8,395
		249,455	241,008
Non-controlling interest		202	121
Total equity		249,657	241,129
Total liabilities and equity		551,023	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)

	Note	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Rental income		6,271	5,853	12,242	11,526
Service charge income		1,358	1,185	3,208	2,775
Service charge expenses		(1,165)	(989)	(5,782)	(5,474)
Other revenues		219	42	303	42
Other property operating expenses		(73)	(26)	(114)	(67)
Net rental earnings		6,610	6,065	9,857	8,802
Administration expenses		(1,326)	(1,505)	(2,572)	(2,724)
Foreign exchange (loss) gain		(62)	11	(62)	107
Net change in fair value of investment properties		(2,181)	3,552	108	644
Option fair value related to the acquisition of the Metropolitan property		-	(664)	-	9,213
Acquisition costs		-	(30)	(37)	(689)
Share of net earnings from investments accounted for using the equity method	5	1,114	(153)	391	(358)
Operating earnings		4,155	7,276	7,685	14,995
Loss on financial instruments at fair value through profit or loss		(2,352)	(2,093)	(1,781)	(2,237)
Gain (loss) recognized on exercise of early payment option on finance leases		-	678	-	(1,242)
Loss on refinancing of a debt		-	-	-	(605)
Finance income	12	1,524	2,784	3,308	2,836
Finance costs	12	(1,404)	(1,623)	(3,057)	(3,139)
Distributions on Exchangeable securities	11	(398)	(482)	(777)	(934)
Net change in fair value of Exchangeable securities	11	(1,034)	(403)	(1,698)	(1,019)
Earnings before income taxes		491	6,137	3,680	8,655
Current income tax expense		(87)	(23)	(97)	(108)
Deferred income tax expense		(190)	(276)	(224)	(123)
Earnings for the period		214	5,838	3,359	8,424
Earnings for the period attributable to :					
Non-controlling interest		55	(1)	59	(42)
Unitholders' of the Trust		159	5,839	3,300	8,466
		214	5,838	3,359	8,424
Earnings per unit attributable to unit holders:	13				
Basic earnings per unit		0.01	0.37	0.15	0.54
Diluted earnings per unit		0.01	0.37	0.15	0.54

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)

	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Earnings for the period	214	5,838	3,360	8,424
Other comprehensive income (loss)				
Derivatives designated as a hedge of the net investment in a foreign entity				
Net gains	1,431	1,276	1,290	1,678
Derivatives designated as cash flow hedges	233	(25)	472	(427)
Change in cumulative translation adjustment account	10,059	(6,525)	11,572	(9,676)
Total other comprehensive income (loss)	11,723	(5,274)	13,355	(8,425)
Total comprehensive income (loss) for the period	11,937	564	16,715	(1)
Total comprehensive income (loss) for the period attributable to :				
Non-controlling interest	74	-	81	-
Unitholders of the Trust	11,863	564	16,634	(1)
Total comprehensive income (loss) for the period	11,937	564	16,715	(1)

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)

	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
Distributions earned by Unitholders	13	-	-	(8,898)	-	(8,898)	-	(8,898)
Distributions reinvestment Plan	13	78,939	711	-	-	711	-	711
Transactions with owners		78,939	711	(8,898)	-	(8,187)	-	(8,187)
Earnings for the period		-	-	3,300	-	3,300	59	3,359
Other comprehensive loss		-	-	-	13,334	13,334	22	13,356
As at June 30, 2017		21,604,714	189,869	37,857	21,729	249,455	202	249,657
As at December 31, 2015		15,637,019	136,365	35,359	19,925	191,649	-	191,649
Issuance of units		420,000	3,981	-	-	3,981	-	3,981
Distributions earned by Unitholders	13	-	-	(6,493)	-	(6,493)	-	(6,493)
Distributions payable		-	-	-	-	-	-	-
Distributions reinvestment Plan	13	57,357	532	-	-	532	-	532
Transactions with owners		477,357	4,513	(6,493)	-	(1,980)	-	(1,980)
Earnings for the period		-	-	8,466	-	8,466	(42)	8,424
Other comprehensive loss		-	-	-	(8,425)	(8,425)	-	(8,425)
As at June 30, 2016		16,114,376	140,878	37,332	11,500	189,710	(42)	189,668

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	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Operating activities					
Earnings before income taxes for the period		491	6,137	3,680	8,655
Adjustments for non-cash items and other reconciling items	20	5,746	(1,263)	5,342	(1,761)
		6,237	4,873	9,022	6,894
Working capital adjustments	20	46	831	7,065	4,300
Net cash flows related to operating activities		6,283	5,704	16,087	11,194
Investing activities					
Business acquisition		-	(860)	-	(21,638)
Acquisition costs		-	(30)	(37)	(689)
Investments in joint-ventures	5	(12,782)	(6,189)	(12,782)	(6,189)
Distribution from (investments in) joint-ventures	5	11		629	525
Additions to investment properties	4	(728)	(129)	(884)	(994)
Acquisition loan and deposit	6	(7,906)		(18,232)	-
Investment in financial current assets	8	6,874	1,514	27,366	
Net change in restricted cash		-	1,000	-	1,680
Settlement of derivative financial instruments		-	(826)	-	(1,042)
Net cash flows related to investing activities		(14,531)	(5,520)	(3,940)	(28,347)
Financing activities					
Units issued for cash		-	-	-	-
Distributions on Units paid in cash	14	(4,068)	(2,959)	(8,161)	(5,929)
Distributions in respect of Exchangeable securities paid in cash	11	(233)	(211)	(1,270)	(534)
Proceeds from new promissory notes	9	13,717		13,717	-
Proceeds from new mortgage loans, net of transaction costs	10	-	-	-	18,795
Proceeds from new finance liabilities, net of transaction costs	10	-	-	-	52,654
Transaction fees related to the exercise of early payment option on finance leases		-	678	-	(1,242)
Repayment of mortgage loans and finance lease liabilities	10	(2,013)	(654)	(3,935)	(45,541)
Net change on lease equalization loans		(190)	5	(426)	(310)
Net cash flows related to financing activities		7,213	(3,142)	(75)	17,892
Net increase in cash		(1,035)	(2,958)	12,071	739
Effects of foreign exchange adjustments on cash		46	(1,214)	374	45
Cash at the beginning of the year		24,508	11,851	11,074	6,895
Cash at the end of the year		23,519	7,679	23,519	7,679

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, 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 six-month period ended June 30, 2017, were authorized for issuance by the Board of Trustees on May 8, 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 11 – Exchangeable securities, for more information about the relationship between Inovalis and the REIT, and to Note 16 – 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 June 30, 2016 have been reclassified, when appropriate, in order to ensure comparability with the figures for the period ending June 30, 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.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2017

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

Note 4 – Investment properties

Investment properties	For the six months ended June 30, 2017	For the year ended December 31, 2016
Beginning of period	412,232	355,704
Additions	884	862
Capitalized letting fees	-	119
Acquisitions through business combinations	-	78,731
Partial disposal	-	(3,576)
Rent free periods	(305)	84
Net change in fair value of investment properties ⁽¹⁾	108	3,632
Foreign currency translation adjustment	18,753	(23,324)
End of period	431,672	412,232

⁽¹⁾ : Including the increase of 1,648 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	TFI Cancorp Stuttgart	For the six months ended June 30, 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)
Additional investment of the period					12,782	12,782	6,189
Share of net earnings from investments accounted for using the equity method	69	165	(1,108)	29	1,236	391	830
Loan repayments							(200)
Exchange differences	851	316	569	237	347	2,320	(2,344)
Balance at the end of the period	19,604	7,346	12,610	5,455	14,365	59,380	43,887

TFI Cancorp Stuttgart

On June 9, 2017, the REIT, through its subsidiary CCE, purchased a 50% interest in TFI Cancorp Stuttgart, a joint venture which owns an office property located in Germany, for a total consideration of 8,843 Euros (\$12,782). This consideration is composed of equity and a 6.5% interest-bearing loan.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2017

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

Note 6 –Acquisition loans and deposit

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

	As at June 30, 2017	As at December 31, 2016
Ingolstadt Deposit	1,371	1,255
Rueil loan	18,887	7,651
Pantin loan	7,851	-
Acquisition loans and deposit	28,109	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).

As at June 30, 2017, the carrying value of the investment includes a deposit of € 750 (\$ 1.111) and cumulated acquisition costs of € 176 (\$ 260).

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, €12.75 million (\$18.87 million) was funded by the REIT as a loan. The loan is secured by a share pledge.

As at June 30, 2017, an amount of €4.19 million (\$6.21 million) of interest on this deposit has been received in advance and is disclosed under the caption “Deferred income”.

Pantin investment

On April 13, 2017 the REIT granted a short term acquisition loan to Aref Diamants Sarl (100%-owned by Inovalis SA) for an amount of €5.3 million (\$7.6 million) as a first step to the Pantin (Paris North-Eastern periphery) asset acquisition announced in Q4 2016. The loan will generate 9.5% interest income until the acquisition date for the property.

As at June 30, 2017, the acquisition loan amounts to € 5.30 million (\$7.85 million).

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2017

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

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			As at June 30, 2017		As at December 31, 2016	
		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	22	2017/07/12	2019/04/12	666	1,000	1.5007	22,000	28	28,000	1,028
Foreign exchange	22	2017/07/12	2019/04/10	206	300	1.4587	6,600	(185)	8,400	72
Interest rate SWAP	1	2017/07/01	2019/07/01	Variable	Fixed	0.685%	77,980	(1,335)	76,180	(1,685)
Interest rate CAP	2	2017/06/30	2019/05/05	Variable	Capped	2.000%	50,364	2	48,175	9
Other derivatives										
Interest rate SWAP	1	2017/07/01	2021/12/23	Variable	Fixed	0.394%	19,348	(303)	18,746	(413)
Interest rate SWAP	1	2017/07/01	2023/01/10	Variable	Fixed	0.282%	52,340	(248)	50,560	(743)
								(2,041)		(1,731)

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 period ended June 30, 2017, the REIT proceed to the sale of these units. The disposal of the investment resulted in a loss of € 6 (\$ 9) classified as “ Finance costs”.

The other financial current assets also include 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 \$1.196. This amount includes accrued interest computed at a rate of 9.5%.

Note 9 – Promissory Notes

On June 22, 2017, the REIT issued a Euro denominated promissory note (hereafter “the Note”) through its subsidiary CanCorpEurope S.A. to a single non-Canadian investor “the Investor” for €9,146 (\$13.717) paying interest at 8.18%, which amount represents the distribution yield paid on REIT units based on the five days weighted average closing price of the REIT units on June 9, 2017. The Note matures on June 22, 2020.

Concurrent with the issuance of the Note, the Investor and the REIT entered into a put/call agreement pursuant to which the REIT can satisfy its obligation to the Investor by delivering REIT units at \$10.08 per Unit (the “Conversion Price”). At any time after June 25, 2018 the Investor can transfer all or any portion of the Note to the REIT in consideration for REIT units based on the Conversion Price and the REIT can acquire the Note at any time by delivering REIT units to the Investor at the Conversion Price. The Conversion Price represents the market price of the REIT units based on the five-day weighted average closing price on June 9, 2017.

The REIT incurred transaction costs related to the issuance of the Note (\$602).

The Note is classified as other financial liabilities, recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

As at June 30, the carrying value of the promissory notes amounts to \$12.551.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2017

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

The put/call agreement has the characteristics of a derivative instrument that is embedded to the Note, and is initially recognised at its fair value and subsequently recognised at fair value through profit or loss.

As at June 30, 2017, the fair value of the put/call agreement did not change since initial recognition.

Note 10 – Mortgage loans and finance lease liabilities

								As at June 30, 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	28,885	Euribor 3M + 1.75% ¹	05/05/2019	28,950	28,950	-			
Mortgage loan - Véronèse SCI	14,500	21,479	Euribor 3M + 1.75% ¹	05/05/2019	21,545	21,545	-			
Mortgage loan - Sablière SCI	13,061	19,348	Euribor 3M + 1.59% ²	23/12/2025	19,206	18,679	527			
Mortgage loan - CanCorpHanover GmbH KG	12,600	18,664	Euribor 3M + 1.45%	31/12/2022	18,520	18,433	87			
Mortgage loans	59,661	88,376			88,221	87,607	614			
Finance lease liabilities - BBA SCI	51,886	76,858	Euribor 3M + 2.00% ²	20/06/2026	76,858	72,227	4,632			
Finance lease liabilities - Metropolitan SCI	34,600	52,340	Euribor 3M + 1.85% and Euribor 3M + 1.6% ²	20/03/2028	52,340	51,254	1,086			
Finance lease liabilities - Baldi SCI	12,953	19,187	Euribor 3M + 1.00%	30/09/2017	19,167	-	19,166			
Finance lease liabilities	99,439	148,385			148,365	123,481	24,884			
Total mortgage loans and finance lease liabilities	159,100	236,761			236,586	211,088	25,498			

								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*

Note 11 – Exchangeable securities

		Exchangeable securities	
		Number of Exchangeable securities	Carrying amount of Exchangeable securities
Exchangeable securities issued and outstanding			
Balance - December 31, 2015		2,070,398	19,400
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		192,005	1,814
Net change in fair value of Exchangeable securities		-	1,699
Balance - June 30, 2017		2,000,056	20,111

The Exchangeable securities represent a financial liability and were designated at fair value through profit or loss. The Exchangeable securities of a total amount of \$20,111 are presented as non-current for \$6,024 and current for \$14,087.

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2017

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

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, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Amount payable at the beginning of the period	324	495	982	366
Declared and recognized in earnings during the period	398	482	777	934
Distribution on exchangeable securities paid	(233)	(211)	(1,270)	(806)
Amount payable at the end of the period	489	766	489	494
Weighted average number of Exchangeable securities outstanding	1,897,715	2,405,014	1,853,621	2,254,144
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.1228	0.0877	0.6851	0.2369
Distributions paid per unit (based on three-month/nine-month basis)	0.2063	0.2063	0.4125	0.4125

The amount of distributions payable is included in “trade and other payables”.

Note 12 – Finance costs and finance income

	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Interest costs related to mortgage loans	(395)	(412)	(779)	(874)
Interest costs related to finance leases	(678)	(719)	(1,326)	(1,270)
Interest costs related to lease equalization loans	(61)	(69)	(121)	(142)
Interest costs related to promissory notes	(32)	-	(32)	-
	(1,166)	(1,200)	(2,258)	(2,286)
Interest SWAP	(316)	(270)	(606)	(468)
Other finance costs	130	(24)	(78)	(111)
	(1,352)	(1,494)	(2,942)	(2,865)
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(22)	(48)	(44)	(99)
Amortization of transaction costs on mortgage loans	(30)	(81)	(71)	(175)
Finance costs	(1,404)	(1,623)	(3,057)	(3,139)
Finance income	(12)	2	183	5
Finance income from Inovalis relating to the acquisition loan	612	-	974	1,163
Finance income from joint ventures	924	2,782	2,151	1,668
Finance income	1,524	2,784	3,308	2,836
Net Finance costs	120	1,161	251	(303)

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

Note 13 – 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 June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Basic earnings per unit				
Earnings attributable to unitholders	159	5,839	3,300	8,466
Weighted average number of units outstanding	21,584,020	15,716,519	21,564,609	15,683,938
Basic earnings per unit	0.01	0.37	0.15	0.54

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

	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Diluted earnings per unit				
Earnings attributable to unitholders	159	5,839	3,300	8,466
Distributions recognized on Exchangeable securities	398	482	777	934
Net change in fair value of Exchangeable securities	1,034	403	1,698	1,019
Earnings attributable to diluted unitholders	1,591	6,724	5,775	10,419
Weighted average number of units outstanding	21,584,020	15,716,519	21,564,609	15,683,938
Weighted average number of Exchangeable securities outstanding	1,897,715	2,405,014	1,853,621	2,254,144
Weighted average number of units used for diluted earnings per unit	23,481,735	18,121,533	23,418,230	17,938,082
Diluted earnings per unit	0.01	0.37	0.15	0.54

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.

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Note 14 – Distributions

	For the three months ended June 30, 2017	For the three months ended June 30, 2016	For the six months ended June 30, 2017	For the six months ended June 30, 2016
Amount payable at the beginning of the period	1,482	1,077	1,479	1,075
Declared and recognised during the period	4,454	3,264	8,898	6,493
Distributions paid in units (Distribution Reinvestment Plan)	(382)	(275)	(732)	(532)
Distributions paid in cash	<u>(4,068)</u>	<u>(2,959)</u>	<u>(8,161)</u>	<u>(5,929)</u>
Amount payable at the end of the period	<u>1,486</u>	<u>1,107</u>	<u>1,484</u>	<u>1,107</u>
Total distributions	<u>4,454</u>	<u>3,264</u>	<u>8,898</u>	<u>6,493</u>
Distributions paid per unit (based on weighted average number of units outstanding)	0.2062	0.2062	0.4124	0.4120
Distributions paid per unit (based on an annual basis)	0.2063	0.2063	0.4125	0.4125

Distributions in respect of Exchangeable securities are detailed in Note 11 – Exchangeable securities.

Note 15 – Accumulated other comprehensive income

	As at June 30, 2017	As at December 31, 2016
Net unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	4,139	2,849
Net unrealized losses on interest rate derivatives designated as a cash flow hedge	(1,459)	(1,931)
Cumulative translation adjustment account	<u>19,049</u>	<u>7,477</u>
Accumulated other comprehensive income	<u>21,729</u>	<u>8,395</u>

Note 16 – 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.

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

Inovalis and its subsidiaries	Financial statement line item	Year to date	
		For the six months ended June 30, 2017	For the six months ended June 30, 2016
Revenues			
Rental income	Rental income	-	242
Service charge income	Service charge income	14	(282)
Other revenues	Other revenues	405	42
Interest income from acquisition loan	Finance income	922	1,158
		<u>1,341</u>	<u>1,160</u>
Expenses			
Asset management fees	Administration expenses	(1,727)	(1,608)
less portion invoiced to joint-ventures	Administration expenses	289	216
Facilities management fees	Service charge expenses	(1,537)	(1,484)
Property management Fees	Service charge expenses	(658)	(554)
Letting fees invoiced	Service charge expenses	(36)	(180)
less portion accounted for over the lease term	Service charge expenses	(2)	148
Reimbursement of travel expenses	Acquisition costs	(49)	(88)
Interest expense on lease equalization loans	Finance costs	(121)	(142)
Reimbursement of travel expenses	Administration expenses	(72)	(190)
Trustee fees	Administration expenses	(120)	(139)
		<u>(4,033)</u>	<u>(4,021)</u>
Exchangeable securities			
Interest on notes	Distributions recognized on Exchangeable securities	(403)	(369)
Reimbursement of debt		(867)	(165)
Total distributions on Exchangeable securities		<u>(1,270)</u>	<u>(534)</u>

	Year to date	
	Due from (to) Inovalis	
	As at June 30, 2017	As at December 31, 2016
Trade and other receivables	658	176
Trade and other payables	(2,131)	(1,615)
Acquisition loans	26,738	7,651
Distributions payable	(489)	(982)
Lease equalization loans	(4,923)	(5,235)
	<u>19,853</u>	<u>(5)</u>

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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, 2017	For the six months ended June 30, 2016
Management fees invoiced to joint ventures	Administration expenses	(289)	(216)
Earnings from joint ventures	Share of net earnings from investments accounted for using the equity method	391	(358)
Finance income	Finance income	2,151	1,668
		2,253	1,094
		Due from joint ventures	
		As at June 30, 2017	As at December 31, 2016
Loan receivable	Investments accounted for using the equity method	54,053	38,242
Accounts receivable	Trade and other receivables	472	189
		54,525	38,431

Note 17 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended June 30, 2017	For the three months ended June 30, 2016
France	5,745	1,355	7,100	6,678
Germany	526	3	529	546
Total revenue	6,271	1,358	7,629	7,224

Total revenue by geographic region	Rental Income	Service Charge Income	For the six months ended June 30, 2017	For the six months ended June 30, 2016
France	11,214	3,183	14,397	13,255
Germany	1,028	25	1,053	1,089
	12,242	3,208	15,450	14,344

Investment properties, investments in joint ventures and provision relating to investments in joint ventures by geographic region	As at June 30, 2017	As at December 31, 2016
France	408,585	391,233
Germany	82,468	64,886
	491,053	456,119

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

Note 18 – 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, 2017			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	431,672	431,672
Derivative financial instruments - assets	-	59	-	59
Derivative financial instruments - liabilities	-	(2,100)	-	(2,100)
Exchangeable securities	-	(20,111)	-	(20,111)

	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)

Note 19 – 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 June 30, 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 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.

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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.

Note 20 – Cash flow information

	Note	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016
Adjustments for non-cash items and other reconciling items:					
Rent free period	4	226	(100)	305	223
Management fees paid in Exchangeable securities	16	889	890	1,727	1,608
less portion invoiced to joint-ventures	16	(151)	(16)	(289)	(159)
Net change in fair value of investment properties	4	2,181	(3,551)	(109)	(644)
Net change in fair value of financial instruments at fair value through profit or loss		2,352	2,093	1,781	2,237
Distributions recognized on Exchangeable securities	11	398	482	777	934
Net change in fair value of Exchangeable securities	11	1,035	403	1,699	1,019
Loss on refinancing of a debt		-	-	-	605
Finance income	12	(1,525)	(1,684)	(3,308)	(2,850)
Finance costs	12	1,404	509	3,057	3,139
Income taxes paid		(87)	(22)	(97)	(108)
Loss recognized on exercise of early payment option on finance leases		-	(678)	-	1,242
Gain on bargain purchase		-	664	-	(9,213)
Other items		-	19	-	34
Share of net earnings from investments accounted for using the equity method	5	(1,115)	153	(391)	358
Net unrealized exchange gains		62	2	62	(37)
		-	-	-	-
Cash items classified as operating activities					
Interest received		983	467	2,018	953
Interest paid		(906)	(924)	(1,927)	(1,791)
Acquisition costs classified in investing activities		-	30	37	689
		<u>5,746</u>	<u>(1,263)</u>	<u>5,342</u>	<u>(1,761)</u>
Working capital adjustments					
Increase in trade and other receivables		(940)	529	(1,936)	(687)
Increase (decrease) in tenant deposits		(17)	134	(24)	251
Increase in trade and other payables		1,003	186	9,025	4,736
Other		-	(18)	-	-
		<u>46</u>	<u>831</u>	<u>7,065</u>	<u>4,300</u>

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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