

INOVALIS REAL ESTATE INVESTMENT TRUST 2017 Third Quarter Report

**INOVALIS REAL ESTATE INVESTMENT TRUST
CONDENSED INTERIM CONSOLIDATED FINANCIAL
STATEMENTS (unaudited)**

Three-month and nine-month periods ended September 30, 2017

INOVALIS REIT

Interim Consolidated Balance Sheets

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

Assets	Note	As at September 30, 2017	As at December 31, 2016
Non-current assets			
Investment properties	4	429,160	412,232
Investments accounted for using the equity method	5	66,437	43,887
Acquisition loans and deposit	6	20,160	8,906
Derivative financial instruments	7	20	590
Total non-current assets		515,777	465,615
Current assets			
Trade and other receivables		4,922	3,368
Derivative financial instruments	7	129	520
Other current assets		2,131	1,638
Other financial current assets	8	1,210	27,910
Cash		19,957	11,074
Total current assets		28,349	44,510
Total assets		544,126	510,125
Liabilities and Unitholders' equity			
Liabilities			
Non-current liabilities			
Promissory Notes	9	12,338	-
Mortgage loans	10	86,962	83,998
Finance lease liabilities	10	121,323	120,891
Lease equalization loans		3,394	4,051
Tenant deposits		2,248	2,178
Exchangeable securities	11	6,532	4,603
Derivative financial instruments	7	847	1,616
Deferred tax liabilities		2,587	2,236
Deferred income		3,144	-
Total non-current liabilities		239,375	219,573
Current liabilities			
Mortgage loans	10	900	541
Finance lease liabilities	10	24,426	24,179
Lease equalization loans		1,224	1,184
Tenant deposits		292	198
Exchangeable securities	11	14,642	11,995
Derivative financial instruments	7	1,113	1,225
Trade and other payables		9,260	7,392
Other current liabilities		753	734
Deferred income		5,485	1,975
Total current liabilities		58,095	49,423
Total liabilities		297,470	268,996
Equity			
Trust units		190,408	189,158
Retained earnings		35,610	43,455
Accumulated other comprehensive income	15	20,435	8,395
		246,453	241,008
Non-controlling interest		203	121
Total equity		246,656	241,129
Total liabilities and equity		544,126	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 September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Rental income		6,323	6,172	18,565	17,698
Service charge income		2,067	1,819	5,275	4,594
Service charge expenses		(1,622)	(1,506)	(7,404)	(6,980)
Other revenues		(19)	130	419	172
Other property operating expenses		(20)	(59)	(135)	(126)
Net rental earnings		6,729	6,556	16,720	15,358
Administration expenses		(1,301)	(1,229)	(3,873)	(3,953)
Foreign exchange (loss) gain		(178)	(46)	(241)	61
Net change in fair value of investment properties		(1,120)	6,559	(1,011)	7,203
Option fair value related to the acquisition of the Metropolitan property		-	-	-	9,213
Acquisition costs		(24)	(49)	(196)	(738)
Share of net earnings from investments accounted for using the equity method	5	(1,328)	218	(937)	(140)
Operating earnings		2,778	12,009	10,462	27,004
Gain (loss) on financial instruments at fair value through profit or loss		178	(110)	(1,602)	(2,347)
Loss recognized on exercise of early payment option on finance leases		-	-	-	(1,242)
Loss on refinancing of a debt		-	-	-	(605)
Finance income	12	1,737	2,217	5,044	5,053
Finance costs	12	(1,900)	(1,670)	(4,957)	(4,809)
Distributions on Exchangeable securities	11	(411)	(592)	(1,187)	(1,526)
Net change in fair value of Exchangeable securities	11	(144)	181	(1,843)	(838)
Earnings before income taxes		2,238	12,035	5,917	20,690
Current income tax expense		18	4	(79)	(104)
Deferred income tax recovery (expense)		(36)	(207)	(259)	(330)
Earnings for the period		2,220	11,832	5,579	20,256
Earnings for the period attributable to:					
Non-controlling interest		4	(1)	63	(43)
Unitholders' of the Trust		2,216	11,833	5,516	20,299
		2,220	11,832	5,579	20,256
Earnings per unit attributable to unit holders:	13				
Basic earnings per unit		0.10	0.59	0.26	1.18
Diluted earnings per unit		0.10	0.55	0.26	1.17

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 September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Earnings for the period	2,220	11,832	5,579	20,256
Other comprehensive income (loss)				
Derivatives designated as a hedge of the net investment in a foreign entity				
Net gains / loss	(144)	(798)	1,146	880
Derivatives designated as cash flow hedges	195	585	667	158
Change in cumulative translation adjustment account	(1,348)	5,726	10,246	(3,950)
Total other comprehensive income (loss)	(1,297)	5,513	12,059	(2,912)
Total comprehensive income for the period	923	17,345	17,638	17,344
Total comprehensive income (loss) for the period attributable to :				
Non-controlling interest	1	-	82	-
Unitholders of the Trust	922	17,345	17,556	17,344
Total comprehensive income for the period	923	17,345	17,638	17,344

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	14	-	-	(13,361)	-	(13,361)	-	(13,361)
Distributions reinvestment Plan	14	131,944	1,250	-	-	1,250	-	1,250
Transactions with owners		131,944	1,250	(13,361)	-	(12,111)	-	(12,111)
Earnings for the period		-	-	5,516	-	5,516	63	5,579
Other comprehensive loss		-	-	-	12,040	12,040	19	12,059
As at September 30, 2017		21,657,719	190,408	35,610	20,435	246,453	203	246,656
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	14	-	-	(10,820)	-	(10,820)	-	(10,820)
Distributions reinvestment Plan	14	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

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 September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Operating activities					
Earnings before income taxes for the period		2,238	12,035	5,917	20,690
Adjustments for non-cash items and other reconciling items	20	12,141	(5,887)	17,483	(7,685)
		14,379	6,148	23,400	13,005
Working capital adjustments	20	(8,476)	(2,387)	(1,411)	1,913
Net cash flows related to operating activities		5,903	3,761	21,989	14,918
Investing activities					
Business acquisition		-	-	-	(21,638)
Acquisition costs		(159)	(49)	(196)	(738)
Investments in joint-ventures	5	(8,865)	-	(21,647)	(6,189)
Distribution from (investments in) joint-ventures	5	522	550	1,151	1,075
Investment properties (additions and capitalized letting fees)	4	(1,298)	(56)	(2,182)	(1,050)
Reimbursement of (investment in) acquisition loans and deposit	6	7,939	-	(10,293)	-
Decrease in financial current assets	8	175	-	27,541	-
Net change in restricted cash		-	(1,107)	-	573
Settlement of derivative financial instruments	7	-	-	-	(1,042)
Net cash flows related to investing activities		(1,686)	(662)	(5,626)	(29,009)
Financing activities					
Units issued for cash		-	43,099	-	43,099
Distributions on Units paid in cash	14	(3,941)	(3,683)	(12,102)	(9,612)
Distributions in respect of exchangeable securities paid in cash	11	(591)	(518)	(1,861)	(1,052)
Proceeds from (interest paid on) promissory notes	9	(944)	-	12,773	-
Proceeds from new mortgage loans, net of transaction costs	10	-	252	-	19,047
Proceeds from new finance lease liabilities, net of transaction costs	10	-	-	-	52,654
Transaction fees related to the exercise of early payment option on finance leases		-	-	-	(1,242)
Repayment of mortgage loans and finance lease liabilities	10	(1,498)	(1,475)	(5,433)	(47,016)
Repayment of promissory notes	9	(640)	-	(640)	-
Net change on lease equalization loans		(388)	(375)	(814)	(685)
Net cash flows related to financing activities		(8,003)	37,299	(8,077)	55,192
Net (decrease) increase in cash		(3,786)	40,398	8,286	41,101
Effects of foreign exchange adjustments on cash		224	(154)	597	(73)
Cash at the beginning of the year		23,519	7,679	11,074	6,895
Cash at the end of the year		19,957	47,923	19,957	47,923
Cash and cash equivalent at the end of the period					
Cash		19,957	47,923	19,957	47,923
Cash equivalent		-	-	-	-
Cash and cash equivalent at the end of the period		19,957	47,923	19,957	47,923

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, 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 nine-month period ended September 30, 2017, were authorized for issuance by the Board of Trustees on November 14, 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 6 – Acquisition loans 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 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 September 30, 2016 have been reclassified, when appropriate, in order to ensure comparability with the figures for the period ending September 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 nine-month periods ended September 30, 2017

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

Note 4 – Investment properties

	For the nine months ended September 30, 2017	For the year ended December 31, 2016
Investment properties		
Beginning of period	412,232	355,704
Additions	1,420	862
Capitalized letting fees	762	119
Acquisitions through business combinations	-	78,731
Partial disposal	-	(3,576)
Rent free periods	(628)	84
Net change in fair value of investment properties ¹	(1,011)	3,632
Foreign currency translation adjustment	16,385	(23,324)
End of period	429,160	412,232

Note 1 : Including the increase of 833 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	Delizy Diamant	For the nine months ended September 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	-	-	-	-	13,027	8,620	21,647	6,189
Share of net earnings from investments accounted for using the equity method ⁽¹⁾	110	182	(2,609)	36	1,608	(264)	(937)	830
Loan repayments	-	-	-	-	-	-	-	(200)
Exchange differences	743	275	489	207	21	105	1,840	(2,344)
Balance at the end of the period	19,537	7,322	11,029	5,432	14,656	8,461	66,437	43,887

- (1) The share of net earnings regarding Arcueil property includes the variance of the foreign exchange derivative (conversion from € to KRW). The REIT is entitled to receive a 25% share of the net earnings and, upon asset disposal, 75% of the variance of fair value of investment properties, reduced by 100% of foreign exchange derivative costs. As at September 30, 2017 the fair value of the forward is \$(5,173).

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 € 8,955 (\$13,027). This consideration is composed of equity and a 6.5% interest-bearing loan.

SCI Delizy Diamants (“Pantin Investment”)

During the 3-month period ending September 30, 2017, the REIT, through its subsidiary INOPCI 1, completed its 50% interest in SCI Delizy Diamants (“Pantin Investment”), a joint venture which acquired an office property located in France for a total cash consideration of € 5,926 (\$8,620). This consideration is composed of a cash consideration paid of €1 (\$1) for the equity interest and a 9% interest-bearing loan of € 5,925 (\$8,619).

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 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 loans and deposit” were as follows :

	As at September 30, 2017	As at December 31, 2016
Ingolstadt Deposit	1,377	1,255
Rueil loan	18,783	7,651
Acquisition loans and deposit	20,160	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 €1.5 million (\$ 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 8).

As at September 30, 2017, the carrying value of the investment includes a deposit of € 750 (\$ 1,105) and cumulated acquisition costs of € 185 (\$ 272).

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 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 (\$18.78 million) was funded by the REIT as a loan. The loan is secured by a share pledge.

As at September 30, 2017, an amount of €3.9 million (\$ 5.8 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) 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 has generated 9.5% interest income until the acquisition date for the property.

The acquisition loan has been repaid by AREF Diamants Sarl to the REIT on August 28, 2017 (please refer to Note 5 for further details of the acquisition).

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 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 September 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
Foreign exchange	19	2017/10/12	2019/04/12	664	1,000	1.5053	19,000	149	28,000	1,028
Foreign exchange	19	2017/10/12	2019/04/10	205	300	1.4629	5,700	(122)	8,400	72
Interest rate SWAP	1	2017/10/01	2019/07/01	Variable	Fixed	0.685%	76,438	(1,217)	76,180	(1,685)
Interest rate CAP	2	2017/09/30	2019/05/05	Variable	Capped	2.000%	50,089	-	48,175	9
Interest rate SWAP	1	2017/10/01	2021/12/23	Variable	Fixed	0.394%	19,118	(284)	18,746	(413)
Interest rate SWAP	1	2017/10/01	2023/01/10	Variable	Fixed	0.282%	51,790	(337)	50,560	(743)
								<u>(1,811)</u>		<u>(1,731)</u>

On July 1st, 2017, the REIT discontinued the application of the hedge accounting to its interest rate swap and cap relationships. Hedge accounting for foreign exchange has been maintained. Accordingly, the cumulative gain or loss on the interest rate swaps or caps that has been recognised in other comprehensive income from the period when the hedge was effective shall remain separately in equity until the forecast transaction occurs or is no longer expected to occur. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognised in other comprehensive income shall be reclassified from equity to profit or loss as a reclassification adjustment. In Q3, an amount of 195 was reclassified from OCI to Profit and Loss statement for a total amount of \$ 1,459.

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 sale 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 of €1,500 (\$2,210) pertaining to the Ingolstadt forward purchase that will be borne by the partner on this transaction (see details in Note 6) amounting to \$ 1,210. 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 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 September 30, 2017, the carrying value of the promissory notes amounts to \$12,338.

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

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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

Note 10 – Mortgage loans and finance lease liabilities

					As at September 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	28,925	28,798	127
Mortgage loan - Véronèse SCI	14,500	21,479	Euribor 3M + 1.75% ¹	05/05/2019	21,524	21,387	136
Mortgage loan - Sablière SCI	12,977	19,223	Euribor 3M + 1.59% ²	23/12/2025	18,984	18,435	549
Mortgage loan - CanCorpHanover GmbH KG	12,600	18,664	Euribor 3M + 1.45%	31/12/2022	18,430	18,342	88
Mortgage loans	59,577	88,251			87,863	86,962	900
Finance lease liabilities - BBA SCI	51,886	76,858	Euribor 3M + 2.00% ²	20/06/2026	75,311	70,630	4,681
Finance lease liabilities - Metropolitan SCI	34,600	52,340	Euribor 3M + 1.85% and Euribor 3M + 1.6% ²	20/03/2028	51,790	50,693	1,097
Finance lease liabilities - Baldi SCI	12,953	19,187	Euribor 3M + 1.00%	30/09/2017	18,647	-	18,648
Finance lease liabilities	99,439	148,385			145,748	121,323	24,426
Total mortgage loans and finance lease liabilities	159,016	236,636			233,611	208,285	25,326

					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*

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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Note 11 – 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	275,996	2,733
Net change in fair value of Exchangeable securities	-	1,843
Balance - September 30, 2017	2,084,047	21,174

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 \$21,174 are presented as non-current for \$6,532 and current for \$14,642.

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, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Amount payable at the beginning of the period	489	766	982	366
Declared and recognized in earnings during the period	411	592	1,187	1,526
Distribution on exchangeable securities paid in cash	(592)	(518)	(1,861)	(1,052)
Amount payable at the end of the period	308	840	308	840
Weighted average number of Exchangeable securities outstanding	1,992,199	2,112,746	1,900,322	2,206,669
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.2972	0.2452	0.9793	0.4767
Distributions paid per unit (based on three-month/nine-month basis)	0.2063	0.2063	0.6188	0.6188

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

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 12 – Finance costs and finance income

	For the three months ended September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Interest costs related to mortgage loans	(413)	(314)	(1,192)	(1,188)
Interest costs related to finance leases	(672)	(718)	(1,998)	(1,988)
Interest costs related to lease equalization loans	(66)	(80)	(187)	(222)
Interest costs related to promissory notes	(290)	-	(322)	-
	<u>(1,441)</u>	<u>(1,112)</u>	<u>(3,699)</u>	<u>(3,398)</u>
Interest SWAP	(313)	(300)	(919)	(768)
Other finance costs	(111)	(153)	(189)	(264)
	<u>(1,865)</u>	<u>(1,565)</u>	<u>(4,807)</u>	<u>(4,430)</u>
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(19)	(46)	(63)	(145)
Amortization of transaction costs on mortgage loans	(16)	(59)	(87)	(234)
Finance costs	<u>(1,900)</u>	<u>(1,670)</u>	<u>(4,957)</u>	<u>(4,809)</u>
Finance income from Inovalis relating to the acquisition loan	188	3	1,162	1,171
Finance income from joint ventures	1,187	2,336	3,337	3,882
Other finance income	362	-	545	-
Finance income	<u>1,737</u>	<u>2,339</u>	<u>5,044</u>	<u>5,053</u>
Net finance income, (costs)	<u>(163)</u>	<u>669</u>	<u>37</u>	<u>244</u>

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 September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Basic earnings per unit				
Earnings attributable to unitholders	2,216	11,833	5,516	20,299
Weighted average number of units outstanding	21,627,530	20,183,520	21,585,811	17,194,747
Basic earnings per unit	<u>0.10</u>	<u>0.59</u>	<u>0.26</u>	<u>1.18</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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

Note 13 – Earnings per Unit (cont.)

(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 September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Diluted earnings per unit				
Earnings attributable to unitholders	2,216	11,833	5,516	20,299
Distributions recognized on Exchangeable securities	411	592	1,187	1,526
Net change in fair value of Exchangeable securities	144	(181)	1,843	838
Earnings attributable to diluted unitholders	2,771	12,244	8,546	22,663
Weighted average number of units outstanding	21,627,530	20,183,520	21,585,811	17,194,747
Weighted average number of Exchangeable securities outstanding	1,992,199	2,112,746	1,900,322	2,206,669
Weighted average number of units used for diluted earnings per unit	23,619,729	22,296,266	23,486,133	19,401,416
Diluted earnings per unit	0.12	0.55	0.36	1.17

When dilution does not result in a reduction in earnings per unit, the diluted earnings per share is identical to basic earnings per unit.

Note 14 – Distributions

	For the three months ended September 30, 2017	For the three months ended September 30, 2016	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Amount payable at the beginning of the period	1,486	1,107	1,479	1,075
Declared and recognised during the period	4,461	4,327	13,361	10,820
Distributions paid in units (Distribution Reinvestment Plan)	(518)	(308)	(1,250)	(840)
Distributions paid in cash	(3,941)	(3,683)	(12,102)	(9,612)
Amount payable at the end of the period	1,488	1,443	1,488	1,443
Total distributions	4,461	4,327	13,361	10,820
Distributions paid per unit (based on weighted average number of units outstanding)	0.2062	0.1977	0.6186	0.6079
Distributions paid per unit (based on three-month/nine-month basis)	0.2063	0.2063	0.6188	0.6188

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

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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

Note 15 – Accumulated other comprehensive income

	As at September 30, 2017	As at December 31, 2016
Net unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	3,995	2,849
Net unrealized losses on interest rate derivatives designated as a cash flow hedge	(1,264)	(1,931)
Cumulative translation adjustment account	17,704	7,477
Accumulated other comprehensive income	20,435	8,395

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.

Inovalis and its subsidiaries	Financial statement line item	Period to date	
		For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
Revenues			
Rental income	Rental income		234
Service charge income	Service charge income	10	(35)
Other revenues	Other revenues	407	172
Interest income from acquisition loan	Finance income	1,434	1,155
		<u>1,851</u>	<u>1,526</u>
Expenses			
Asset management fees	Administration expenses	(2,695)	(2,609)
less portion invoiced to joint-ventures	Administration expenses	522	550
Facilities management fees	Service charge expenses	(374)	(267)
Property management Fees	Service charge expenses	(1,118)	(951)
Letting fees invoiced	Service charge expenses	(89)	(250)
less portion accounted for over the lease term	Service charge expenses	38	208
Reimbursement of travel expenses	Acquisition costs	(58)	(113)
Interest expense on lease equalization loans	Finance costs	(179)	(211)
Other finance costs	Finance costs	-	(4)
Reimbursement of travel expenses	Administration expenses	(85)	(221)
Trustee fees	Administration expenses	(215)	(209)
Reimbursement of travel expenses	Finance costs	(96)	-
		<u>(4,349)</u>	<u>(4,077)</u>
Exchangeable securities			
Interest on notes	Distributions recognized on Exchangeable securities	(625)	(739)
Reimbursement of debt		<u>(1,236)</u>	<u>313</u>
Total distributions on Exchangeable securities		<u>(1,861)</u>	<u>(426)</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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

Note 16 – Transactions with related parties (cont.)

	Period to date	
	Due from (to) Inovalis	
	As at Septembre 30, 2017	As at December 31, 2016
Trade and other receivables	406	176
Trade and other payables	(1,490)	(1,615)
Acquisition loans	18,783	7,651
Distributions payable	(308)	(982)
Lease equalization loans	(4,618)	(5,235)
	<u>12,773</u>	<u>(5)</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, 2017	For the nine months ended September 30, 2016
Management fees invoiced to joint ventures	Administration expenses	(522)	(550)
Finance income	Finance income	3,337	3,882
		<u>2,815</u>	<u>3,332</u>
		Due from joint ventures	
		As at September 30, 2017	As at December 31, 2016
Loan receivable	Investments accounted for using the equity method	57,624	38,242
Accounts receivable	Trade and other receivables	351	189
		<u>57,975</u>	<u>38,431</u>

INOVALIS REIT**Notes to the Condensed Interim Consolidated Financial Statements**

Three-month and nine-month periods ended September 30, 2017

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

Note 17 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended September 30, 2017	For the three months ended September 30, 2016
France	5,799	2,016	7,815	7,448
Germany	524	51	575	543
Total revenue	6,323	2,067	8,390	7,991

Total revenue by geographic region	Rental Income	Service Charge Income	For the nine months ended September 30, 2017	For the nine months ended September 30, 2016
France	17,013	5,199	22,212	20,660
Germany	1,552	76	1,628	1,632
	18,565	5,275	23,840	22,292

Investment properties, investments in joint ventures and provision relating to investments in joint ventures by geographic region	As at September 30, 2017	As at September 30, 2016
France	403,952	415,985
Germany	91,645	65,873
	495,597	481,858

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

(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 September 30, 2017			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	429,160	429,160
Derivative financial instruments - assets	-	149	-	149
Derivative financial instruments - liabilities	-	(1,960)	-	(1,960)
Exchangeable securities	-	(21,174)	-	(21,174)

	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)

- 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, 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 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.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month and nine-month periods ended September 30, 2017

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

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 19 – Cash flow information

	Note	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
Adjustments for non-cash items and other reconciling items:					
Rent free period	4	323	(98)	628	125
Management fees paid in Exchangeable securities	16	634	910	2,072	2,359
Net change in fair value of investment properties	4	1,120	(6,559)	1,011	(7,203)
Net change in fair value of financial instruments at fair value through profit or loss		(179)	110	1,602	2,347
Distributions recognized on Exchangeable securities	11	410	592	1,187	1,526
Net change in fair value of Exchangeable securities	11	144	(181)	1,843	838
Loss on refinancing of a debt		-	-	-	605
Finance income	12	(1,736)	(2,217)	(5,044)	(5,053)
Finance costs	12	1,900	1,670	4,957	4,809
Income tax paid		18	4	(79)	(104)
Loss recognized on exercise of early payment option on finance leases		-	-	-	1,242
Gain on bargain purchase		-	-	-	(9,213)
Other items		(30)	59	(30)	126
Share of net earnings from investments accounted for using the equity method	5	1,328	(218)	937	140
Net unrealized exchange loss (gain)		179	46	241	(61)
Cash items classified as operating activities					
Interest received		9,550	1,072	11,568	2,011
Interest paid		(1,679)	(1,126)	(3,606)	(2,917)
Acquisition costs classified in investing activities		159	49	196	738
		<u>12,141</u>	<u>(5,887)</u>	<u>17,483</u>	<u>(7,685)</u>
Working capital adjustments					
Decrease (increase) in trade and other receivables		1	(622)	(1,935)	(1,309)
Increase in tenant deposits		93	35	69	286
(Decrease) increase in trade and other payables		(8,570)	(1,800)	455	2,936
		<u>(8,476)</u>	<u>(2,387)</u>	<u>(1,411)</u>	<u>1,913</u>

Note 20 – Subsequent events

On October 4, 2017, the REIT completed the issuance of a €7.3 million (\$10.8 million) a second convertible promissory note on the same terms as the promissory note issued on June 26, 2017. The convertible promissory note has a fixed interest rate of 8.13%, which is equivalent to the distribution yield on REIT units on October 4, 2017, the date of issuance of the convertible promissory note.

On October 26, 2017; the REIT completed the refinancing of the Baldi and Jeuneurs properties, securing loans of €44.5 million (\$65.6 million). After the reimbursement of the existing loans amounting to €39.0 million (\$57.5 million), which includes a €6.9million (\$10.2 million) partial early repayment of the loan associated with the Courbevoie property, the proceeds from refinancing were €4.8 million (\$7.1 million) before a cash reserve of €0.9 million (\$1.3 million) and associated refinancing costs. Under the terms of the refinancing, the Baldi property is now financed with a mortgage loan.

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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