

# INOVALIS

---

REAL ESTATE INVESTMENT TRUST

---

## FOR IMMEDIATE RELEASE

*Not for distribution to U.S. news wire services or dissemination in the United States*

## INOVALIS REAL ESTATE INVESTMENT TRUST REPORTS FINANCIAL RESULTS FOR THE FIRST QUARTER OF 2015.

**Toronto, Ontario, May 14, 2015 – Inovalis Real Estate Investment Trust (the “REIT”) (TSX: INO.UN)** today reported its financial results for the first quarter of 2015. Inovalis REIT’s management team will be holding a conference call on Tuesday May 19, 2015 at 10:00 am EST to discuss the results. The dial-in numbers for the conference call are: in Toronto 1-416-764-8688; outside Toronto (toll free, within North America) 1-888-390-0546.

### HIGHLIGHTS

- Funds from operations (FFO) for the quarter of \$3,726 or \$0.21 per unit (fully diluted). FFO payout ratio of 96.0%
- Adjusted funds from operations (AFFO) for the quarter of \$3,702 or \$0.21 per unit (fully diluted). AFFO payout ratio of 96.6%. Our reported AFFO does not take into account an amount of \$423 receivable from the manager that is to be paid in the course of the second quarter of 2015. Taking it into account, AFFO payout ratio would be 86.7%
- These payout ratios reflect the fact that the REIT has \$19 million of cash available for future acquisitions. It will decrease when additional cash is generated from these acquisitions. AFFO payout ratio would be significantly lower if the cash available were used to buy back and cancel Units
- 80% of the leases are signed with French public agencies, guaranteed by large German or international banks or signed with an affiliate of an investment grade corporate
- During the first quarter of 2015, two new leases were signed on the Courbevoie and Vanves properties with Regus for a total of 20,818 sq.ft, increasing overall occupancy rate from 88.4% as at December 31, 2014 to 90.9% as at March 31, 2015. This occupancy rate considers that the 31,603 sq.ft vacant studios areas on Baldi (valued at one euro at acquisition) are included in the calculation. Should they be neutralized, the occupancy rate would be 94.5%
- As at March 31, 2015, the debt to book value stands at 51.4%, in line with our long-term targeted range of 50 to 55%. Net of the cash available, this debt to book value stands at 48.6%
- In January 2015, the REIT subscribed to additional foreign currency hedging contracts resulting in 100% of the monthly cash distributions being covered until January 2018 at an average rate of 1.5227. This is not reflected in our AFFO as we do not take into account any impact from foreign currency in its calculation
- Subsequent to the quarter, on April 8, 2015, the REIT completed the acquisition of a 50% interest, on a joint venture basis, in an office property located in Germany for an all-in-cost of \$24 million. The REIT’s share of the equity investment amounts to \$5 million and was funded with cash on hand. The property, located in Bad Homburg (15 km North of Frankfurt), is a five-story multi-tenanted office building developed in 2004 with 77,662 square feet of office space. The property also comprises 31,442 square feet of storage and service space as well as 204 parking spaces. The REIT acquired the property at a going-in cap rate of 7.0% and expects to

capture additional rental income through the lease-up of vacant areas as the property has an occupancy rate of 77%. The addition of the property will be immediately accretive to the REIT's AFFO per unit. The REIT will be responsible for the management of the property, a task that will initially be subcontracted to Inovalis SA, until the REIT internalizes all asset management services. This transaction in partnership with another strategic, global institutional investor that has had a long-standing relationship with Inovalis SA confirms the partnership strategy developed by the REIT as a value-enhancement and portfolio risk diversification tool for future acquisitions or existing properties

- Further to the above-mentioned acquisition, the REIT still has \$14 million of cash available for future acquisitions.

# Management's discussion and analysis

(Dollar amounts in the MD&A are presented in Canadian dollars, except rental rates, Unit or as otherwise stated)

## OVERVIEW

	March 31, 2015	March 31, 2014
<b>Operational information <sup>(1)</sup></b>		
Number of properties	7	4
Gross leasable area (sq.ft)	834,527	529,267
Occupancy rate (end of period) <sup>(2)</sup>	90.9%	96.0%
Weighted average lease term	6.4 years	7.3 years
Average capitalization rate <sup>(3)</sup>	6.9%	7.7%
<b>Financing information</b>		
Level of debt (debt-to-book value) <sup>(4)</sup>	51.4%	43.5%
Level of debt (debt-to-book value, net of cash) <sup>(4)</sup>	48.6%	42.2%
Weighted average term of principal repayments of debt	7.0 years	4.0 years
Weighted average interest rate <sup>(5)</sup>	1.95%	1.47%
Interest coverage ratio <sup>(6)</sup>	4.6 x	4.7 x

<i>(thousands of CAD\$ except per Unit and other data)</i>	3-month period ended	
	March 31, 2015	March 31, 2014
<b>Operating results</b>		
Rental income	5,283	4,887
Net rental earnings	3,189	3,112
Earnings for the period	3,065	(95)
Funds from Operations (FFO) <sup>(7)(8)</sup>	3,726	2,867
Adjusted Funds from Operations (AFFO) <sup>(7)(8)</sup>	3,702	3,041
FFO per Unit (diluted) <sup>(7)(8)</sup>	0.21	0.23
AFFO per Unit (diluted) <sup>(7)(8)</sup>	0.21	0.24
<b>Distributions</b>		
Declared distributions on Units and Exchangeable securities	3,575	2,614
Declared distribution per Unit (diluted) <sup>(8)</sup>	0.21	0.21
FFO payout ratio <sup>(7)</sup>	96.0%	91.2%
AFFO payout ratio <sup>(7)</sup>	96.6% <sup>(9)</sup>	86.0%

(1) Taking into account 50% of the Duisburg property as the REIT has a 50% interest in that property

(2) Taking into account the Vendor Lease, occupancy rate is 93.7% as of March 31, 2015

(3) Calculated on annualized rental income (based on net rental income for the quarter)

(4) Defined as total debt divided by total assets. Debt-to-book value, net of cash, is defined as total debt divided by total assets, each of which excludes \$19.5 million of cash and equivalent at March 31, 2015. Takes into account 50% interest in the Duisburg property

(5) Calculated as the weighted average interest rate paid on the finance leases and the mortgage loans

(6) Calculated as net rental earnings adjusted for IFRIC 21 plus interest, less general and administrative expenses, divided by interest expense on the financial leases and mortgage loans

(7) The reconciliation of FFO and AFFO to net income can be found under the section *Non-IFRS Financial Measures*

(8) Based on the weighted average number of Units during the period

(9) Not taking into account an amount of \$423 receivable from Inovalis SA. Taking it into account, AFFO payout ratio for the quarter ended March 31, 2015 would be 86.7%

## BASIS OF PRESENTATION

The following management's discussion and analysis ("MD&A") of the financial condition and results of operations of Inovalis REIT should be read in conjunction with the REIT's condensed interim consolidated financial statements for the period from January 1, 2015 to March 31, 2015, and the notes thereto. This MD&A has been prepared taking into account material transactions and events up to and including May 12, 2015. Financial data provided in the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. All amounts in this MD&A are in thousands of Canadian dollars, except per unit amounts and where otherwise stated. Historical results, including trends which might appear, should not be taken as indicative of future operations or results. Additional information about Inovalis REIT has been filed with applicable Canadian securities regulatory authorities and is available at [www.sedar.com](http://www.sedar.com). The exchange rate used throughout this MD&A for statement of earnings items is the average rate during the said period, i.e. 1.3955 Canadian dollars per Euro for the three-month period ended March 31, 2015. For balance sheet items, projections or market data, the exchange rate used is 1.3623 (exchange rate as of March 31, 2015).

## FORWARD-LOOKING INFORMATION

Although we believe that the expectations reflected in the forward-looking information are reasonable, we can give no assurance that these expectations will prove to have been correct, and since forward-looking information inherently involves risks and uncertainties, undue reliance should not be placed on such information. Certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from those expressed or implied in such forward-looking statements. The estimates and assumptions, which may prove to be incorrect, include, but are not limited to, the various assumptions set forth in this document as well as the following: (i) we will continue to receive financing on acceptable terms; (ii) our future level of indebtedness and our future growth potential will remain consistent with our current expectations; (iii) there will be no changes to tax laws adversely affecting our financing capability, operations, activities, structure or distributions; (iv) we will retain and continue to attract qualified and knowledgeable personnel as we expand our portfolio and business; (v) the impact of the current economic climate and the current global financial conditions on our operations, including our financing capability and asset value, will remain consistent with our current expectations; (vi) there will be no material changes to government and environmental regulations adversely affecting our operations; (vii) conditions in the international and, in particular, the French and German real estate markets, including competition for acquisitions, will be consistent with the current climate; and (viii) capital markets will provide us with readily available access to equity and/or debt financing.

The forward-looking statements are subject to inherent uncertainties and risks, including, but not limited to, the factors listed under the *Risk and Uncertainties* section of this MD&A, and are described in greater detail in our IPO prospectus dated March 28, 2013 and in our short-form equity offering prospectus dated October 30, 2014, which are available at [www.sedar.com](http://www.sedar.com). Consequently, actual results and events may vary significantly from those included in, contemplated or implied by such statements.

## MARKET AND INDUSTRY DATA

This MD&A includes market and industry data and forecasts that were obtained from third-party sources, industry publications and publicly available information as well as industry data prepared by Inovalis SA on the basis of its knowledge of the commercial real estate industry in which we operate (including Inovalis SA estimates and assumptions relating to the industry based on that knowledge). Inovalis SA's knowledge of the real estate industry has been developed through its 18 years of experience and participation in the industry. Inovalis SA believes that its industry data is accurate and that its estimates and assumptions are reasonable, but there can be no assurance as to the accuracy or completeness of this data. Third-party sources generally state that the information contained therein has been obtained from sources believed to be reliable, but there can be no assurance as to the accuracy or completeness of included information. Although Inovalis SA believes it to be reliable, Inovalis SA has not verified any of the data from third-party sources referred to in this MD&A, or analysed or verified the underlying studies or surveys relied upon or referred to by such sources, or ascertained the underlying assumptions relied upon by such sources.

## NON-IFRS MEASURES

Funds from operations (“**FFO**”) and adjusted funds from operations (“**AFFO**”) are not measures recognized under IFRS and do not have standardized meanings prescribed by IFRS. FFO and AFFO are supplemental measures of performance for real estate businesses. We believe that AFFO is an important measure of economic performance and is indicative of our ability to pay distributions, while FFO is an important measure of operating performance and the performance of real estate properties. The IFRS measurement most directly comparable to FFO and AFFO is net earnings. See the *Non-IFRS Reconciliation (FFO and AFFO)* section for reconciliation of FFO and AFFO to net earnings.

FFO is defined as net earnings in accordance with IFRS, excluding: (i) acquisition costs incurred in connection with the purchase of properties being accounted for as a business combination, (ii) gain on bargain purchase, (iii) net change in fair value of investment properties, (iv) net change in fair value of financial instruments at fair value through profit and loss, (v) changes in fair value of Exchangeable securities, (vi) adjustment for property taxes accounted for under IFRIC 21, (vii) loss on exercise of lease option, (viii) adjustment for foreign exchange gains or losses on monetary items not forming part of an investment in a foreign operation, (ix) gain on disposal of an interest in a subsidiary and the non-cash portion of earnings from an investment accounted for using the equity method and (x) non-recurring finance costs. It has also been adjusted to exclude the distributions declared on Exchangeable securities. These distributions are recognized in profit and loss consistent with the classification of the Exchangeable securities as a liability. However, they are not to be considered when determining distributions for the Unitholders as indeed they are subordinated to the distributions to the Unitholders.

AFFO is defined as FFO subject to certain adjustments, including adjustments for: (i) the non-cash effect of straight line rents, (ii) the cash effect of the lease equalization loans (equalizing the rent payments, providing the REIT with stable and predictable monthly cash flows over the term of the France Telecom leases in the Vanves property, the Smart & Co. lease in the Courbevoie property and the Rue du Commerce leases in the Baldi property), (iii) amortization of fair value adjustment on assumed debt, (iv) the non-cash portion of the asset management fees paid in Exchangeable securities, (v) capital expenditures, (vi) capital expenditures paid by the vendors of the leasehold interest in the properties and/or tenants and (vii) amortization of transaction costs on mortgage loans.

FFO and AFFO should not be construed as alternatives to net earnings or cash flow from operating activities, determined in accordance with IFRS, as indicators of our performance. Our method of calculating FFO and AFFO may differ from other issuers’ methods and accordingly may not be comparable to measures used by them.

## BUSINESS OVERVIEW AND STRATEGY

Inovalis REIT is an unincorporated open-ended real estate investment trust governed by the laws of the Province of Ontario. Inovalis REIT was founded and sponsored by Inovalis SA, who is our asset manager. Our Units have been listed on the Toronto Stock Exchange under the trading symbol INO.UN since April 10, 2013. Our head and registered office is located at 151 Yonge Street, 11<sup>th</sup> floor, Toronto, Ontario, M5C 2W7.

Our long-term objectives are to:

- generate predictable and growing cash distributions on a tax-efficient basis from investments in income-producing office properties
- maximize the long-term value of both our properties and Units through active and efficient management
- grow our asset base, primarily in France and Germany, but also opportunistically in other European countries where assets meet our investment criteria
- increase the cash available for distribution to holders of Units (“Unitholders”), through an accretive acquisition program that successfully leverages Inovalis SA’s extensive relationships and depth of commercial property and financing.

The REIT's Investment Criteria encompasses office properties outside of Canada with an occupancy level above 80% (unless AFFO accretive), secured rental cash flows, a property value between €20 million (\$27 million) to €60 million (\$82 million) and a potential future upside with respect to matters including rent and area development. According to management, this target investment size falls within a very liquid segment of the real estate market in Europe, and debt financing for such acquisitions is readily available from local lenders.

## **BUSINESS ENVIRONMENT**

### **French commercial real estate investment market**

2014 was an outstanding year for investment in commercial real estate in France, with €26 BN (\$35 BN) invested over the whole of 2014 according to BNP Paribas Real Estate, up 41% over one year and much higher than the 10-year average of €19 BN (\$26 BN). Despite its slow economic growth, France is still much sought after, enjoying its second best year ever for investment after 2007. The Greater Paris region accounted for the largest share of acquisitions (72%). Offices are still investors' favourite, attracting 58% of investment.

According to BNP Paribas Real Estate, the prime yield in the Central Business District stabilized 4.0% and the prime yield in the Inner Rim further compressed down to 5.3%. Investors have increasingly bought properties beyond Paris business districts, which are structurally incapable of supplying demand and which offer low yields. Non-prime office yields have slightly declined in the majority of markets in the Greater Paris Region, where the appetite for prime products is still high.

As at December 31, 2014, the vacancy rate in the Greater Paris Region was 7.2% and inside Paris was 5.1%. This figure is mainly comprised of lower quality properties as, according to CBRE, new and redeveloped properties only accounted for 20% of the immediate supply. In 2014, 22.6 million sq.ft was taken up, up 13% year on year.

### **German commercial real estate investment market**

Office properties remained the most dominant asset class in the German commercial property market with a share of 42%. In 2014, office buildings attracted investments totalling €17 BN (\$23 BN). This was more than 25% up on the already active prior-year results. For investors, Germany continues to offer an extremely attractive and stable environment with interest rates still low, active consumers, upward-trending early indicators and a labour market that remains robust.

Office yields have declined throughout Germany on the average by 15 basis points in 2014 according to BNP Paribas Real Estate. Prime office properties in the largest cities (Berlin, Dusseldorf, Frankfurt, Hamburg, Munich) trade at a cap rate ranging between 4.30% and 4.80%.

Banks are competing for the financing of first class office properties with long-term leases in good locations. As competition increases, banks are increasingly financing slightly riskier properties.

## **REAL ESTATE MANAGEMENT AND ADVISORY SERVICES**

Pursuant to the Management Agreement, Inovalis SA is the 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.

Upon the earlier of (i) the REIT achieving a market capitalization of \$750 million (including any Exchangeable securities held by Inovalis SA) based on the volume weighted average price (VWAP) over a 20-day trading period and (ii) April 10, 2018, the Management Agreement will terminate and the management of the REIT will be internalized at no additional cost.

## OUR OPERATIONS

### Performance indicators<sup>(1)</sup>

Asat	March 31, 2015	March 31, 2014
Gross leasable area (sq.ft)	834,527	529,267
Number of properties	7	4
Number of tenants	26	12
Occupancy rate (excluding Vendor Leases)	90.9%	96.0%
Occupancy rate (including Vendor Leases)	93.7%	100.0%
Weighted average lease term <sup>(2)</sup>	6.4 years	7.3 years

(1) Taking into account 50% of the Duisburg property gross leasable area as the REIT has a 50% interest in that property

(2) Excluding early termination rights. Taking into account early termination rights, the weighted average lease term is 4.3 years

### Occupancy

The overall weighted average occupancy rate across our portfolio was 90.9% at March 31, 2015. Taking into account the vendor leases on the Vanves, Baldi and Sablière properties (on 23,336 sq.ft in total, or 2.8% of our portfolio's total GLA), occupancy rate across the portfolio reaches 93.7%. During the first quarter of 2015, two new leases were signed with Regus on the Courbevoie and Vanves properties on a total of 20,818 sq.ft.

External brokers are working with the Inovalis SA team to lease remaining vacant premises on the REIT's portfolio.

### Tenants

The tenant base in the portfolio is well diversified from an industry segment standpoint, with many tenants having large national or multinational footprints. Over 80% of 2015 estimated gross rental income come from French public agencies, are guaranteed by large German or international banks, or are signed with an affiliate of an investment grade corporate (Mitsubishi – Hitachi).

The following table shows our five largest tenants, sorted out by contribution to gross leasable area (GLA). Tenant marked with (\*) is a tenant from property owned on a partnership basis and is taken into account applying the percentage of ownership the REIT has in the underlying property.

Tenant	Tenant Sector	Tenant Since	GLA (sq.ft.)	% of Total GLA
France Telecom	Telecommunications	1999	186,070	22.3%
Facility Services Hannover GmbH	Banking / Real estate	2003	124,076	14.9%
Mitsubishi Hitachi Power Systems Europe GmbH (*)	Manufacturer	2007	108,959	13.1%
National Conservatory of Arts and Crafts	Education and training	2003	50,407	6.0%
French Environment and Energy Agency	Public sector / Government	1982	49,460	5.9%
<b>Top 5 tenants</b>			<b>518,971</b>	<b>62.2%</b>
Other tenants	Diversified		239,884	28.7%
Vendor Lease	-		23,336	2.8%
Vacant			52,335	6.3%
<b>Total</b>			<b>834,527</b>	<b>100.0%</b>

### Leasing profile

#### Rental indexation

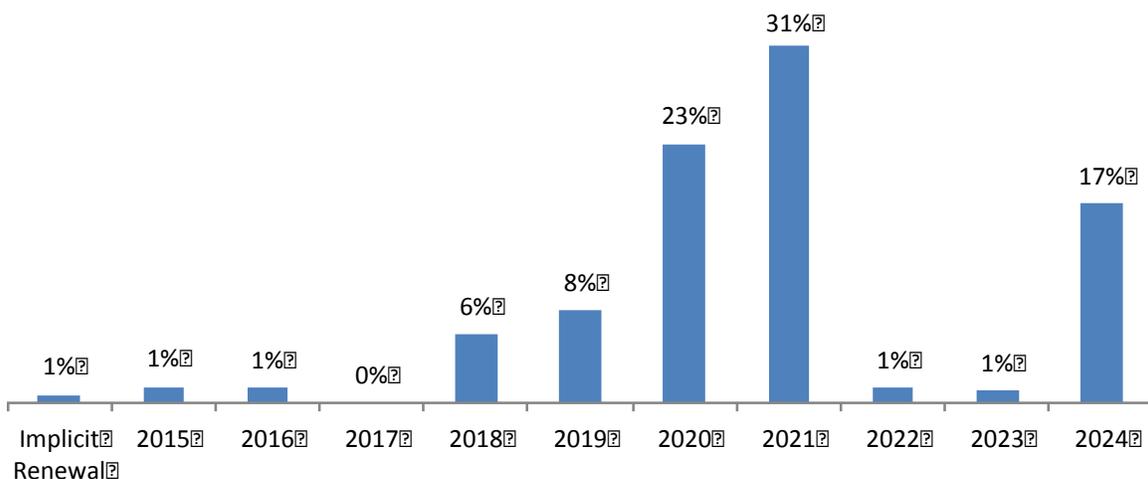
All leases have rental indexation based on either the French ICC (construction cost index) or ILAT (index averaging construction costs and CPI indexes) or the German Consumer Price Index, as applicable.

**Lease rollover profile**

Our stable tenant base is complemented by a balanced lease maturity profile, with an average of 6.7% of GLA maturing each year between 2015 and 2020, as illustrated by the chart below. The REIT has an average remaining lease term of 6.4 years (not including tenant early termination rights). Assuming all tenants leave at next possible early termination rights, which is a highly improbable scenario, average remaining lease term on our portfolio is 4.3 years.

The following graph sets out the amount of GLA and percentage of total GLA of the properties subject to leases expiring during the periods shown (excluding early lease terminations).

**Lease Maturity Profile as at March 31, 2015**  
*(% of total GLA)*



## CONSOLIDATED FINANCIAL INFORMATION

<i>(in thousands of CAD\$)</i>	3-month period ended	
	March 31, 2015	March 31, 2014
Rental income	5,283	4,887
Service charge income	1,729	1,107
Service charge expense	(3,802)	(2,859)
Other property operating expense	(21)	(23)
<b>Net rental earnings</b>	<b>3,189</b>	<b>3,112</b>
Administration expenses	(1,000)	(1,029)
Foreign exchange (loss) gain	9	38
Net change in fair value of investment properties	1,750	1,136
Business acquisition costs	-	(52)
<b>Operating earnings</b>	<b>3,948</b>	<b>3,205</b>
Gain (loss) on financial instruments at fair value through P&L	633	(741)
Share of the profit of an investment (equity method)	170	-
Finance income	560	7
Finance costs	(1,229)	(868)
Distributions on Exchangeable securities	(429)	(286)
Net change in fair value of Exchangeable securities	(552)	(1,398)
<b>Earnings before income taxes</b>	<b>3,101</b>	<b>(81)</b>
Current income tax expense	(36)	(14)
<b>Earnings for the period</b>	<b>3,065</b>	<b>(95)</b>

### Net rental earnings

Rental income does not include the revenue generated by the 50% interest in the Duisburg property, which amounted to \$542 for the quarter (share of the REIT). The latter is recognized partly as Finance income from an associate and partly as Share of the profit of an investment accounted for using the equity method. For the three months ended March 31, 2015, net rental earnings amounted to \$3,189, representing an increase of \$77 year-on-year, which is the combination of \$337 of higher income and the decline of the Euro (\$260).

### Administration expenses

Administration expenses are primarily comprised of asset management fees paid to Inovalis SA and of other general administrative expenses such as trustee fees, directors' and officers' liability insurance, professional fees (including accounting fees), legal fees, filing fees, shareholders related expenses and other expenses. Administration expenses for the quarter ended March 31, 2015 amounted to \$1,000 vs. \$1,029 for the quarter ended March 31, 2014. \$513 is related to the asset management fees paid to Inovalis SA (vs. \$455 for the quarter ended March 31, 2014) and \$487 to other expenses (vs. \$574 for the quarter ended March 31, 2014).

### Net change in fair value of investment properties

During the quarter ended March 31, 2015, the net change in fair value of investment properties recognized in earnings was \$1,750. It amounted to \$1,136 for the three-month period ended March 31, 2014. For the quarter ended March 31, 2015, the net change in fair value was all realized on the French properties. The Duisburg property, which is owned through a joint venture, did not record any net change in fair value for the period.

### **Gain (loss) on financial instruments at fair value through profit and loss**

The gain on financial instruments at fair value through profit and loss for the quarter ended March 31, 2015 amounted to \$633 and represents essentially the gain realized on the new foreign exchange (“FX”) contracts purchased during the quarter. The new contracts have a strike price of 1.4956, which explains the significant gain since the average FX rate for the Euro for the quarter was 1.3955. During the same quarter in 2014, the REIT recorded a loss of \$741 as the FX contracts held at the time had a strike price for the Euro of 1.3211 when the average rate was 1.5117. These unfavourable contracts were liquidated during the second quarter of 2014.

### **Share of the profit of an investment accounted for using the equity method**

During the quarter, the REIT realized a gain of \$170 on its investment in a 50% interest in the Duisburg property (Germany), which is accounted for using the equity method of accounting. It generated a \$180 of Finance income and a small loss of \$10 for the three-month period ended March 31, 2015. As the Duisburg acquisition was realized in the second quarter of 2014, no such items were recognized in the first quarter ended March 31, 2014.

### **Finance income**

During the quarter ended March 31, 2015, the REIT recorded total finance income of \$560, which is composed of interest revenue of \$377 from the Acquisition loan to Inovalis SA, \$180 from its loan to the Duisburg joint-venture and \$3 of other finance income. During the same quarter ended March 31, 2014, the REIT recorded \$7 on interest revenue on its outstanding cash balance at the time.

### **Finance costs**

For the three-month period ended March 31, 2015, the finance costs amounted to \$1,229 including notably \$873 for interest costs related to finance leases, mortgage loans and the lease equalization loans. For the same period in 2014, total finance costs amounted to \$868, of which \$447 related to finance leases, mortgage loans and the lease equalization loans. Please refer to note 8 of the Interim consolidated financial statements for the period ended March 31, 2015 for a more detailed description of the main components of finance costs for both periods. The variation between the periods is the result of the addition of two properties in the fall of 2014 and the impact of the renegotiation of the long-term debt that was done in the second quarter of 2014.

### **Distributions on Exchangeable securities**

Distributions to the holders of Exchangeable securities are calculated in a manner to provide a return that is economically equivalent to the distributions received by the Unitholders. They are, however, subordinated to the distributions to the other Unitholders for a period of three years from the IPO on April 10, 2013. During the three-month period ended March 31, 2015 the distribution recognized on exchangeable securities was \$429 while it was \$286 for the same period in 2014. The increase is the result of the additional Exchangeable securities purchased by Inovalis SA at the time of the Unit offering in November 2014 and from the additional securities received by Inovalis SA in lieu of asset management fees.

### **Net change in fair value of Exchangeable securities**

The net change in value of the Exchangeable securities, as well as the cost of distributions recognized on Exchangeable securities, are recognized in profit and loss because, for financial reporting purposes, the Exchangeable securities have been classified as a liability at fair value through profit or loss. The actual results reflect a loss for the three-month period ended March 31, 2015 because the quoted value of the REIT’s Units, which is used as the basis for the measurement of the Exchangeable securities, increased since December 31, 2014. The closing price on the TSX was \$9.15 on March 31, 2015, whereas it was \$8.88 on December 31, 2014. For the three-month period ended March 31, 2014, the resulting loss of \$1,398 because the closing price on the TSX was \$9.81 on March 31, 2014, whereas it was \$8.81 on December 31, 2014.

## Last 24 Months Key Financial Information

<i>(in thousands of CAD\$)</i>	3-month period ended							
	March 31, 2015	Dec 31, 2014	Sept. 30, 2014	June 30, 2014	March 31, 2014	Dec 31, 2013	Sept. 30, 2013	June 30, 2013
Rental income	5,283	4,846	4,291	4,658	4,887	4,630	4,409	3,484
Net rental earnings	3,189	5,167	4,608	5,039	3,112	4,394	4,825	2,357
Earnings for the period	3,065	21,374	2,158	(6,897)	(95)	3,955	5,699	7,728
Earnings per Unit (CAD\$)	0.20	1.56	0.19	(0.61)	(0.01)	0.35	0.50	0.68

## NON-IFRS RECONCILIATION (FFO AND AFFO)

<i>(in thousands of CAD\$)</i>	3-month period ended	
	March 31, 2015	March 31, 2014
<b>Earnings for the period</b>	3,065	(95)
<b>Add/(Deduct):</b>		
Business acquisition costs	-	52
Net change in fair value of investment properties	(1,750)	(1,136)
(Gain) loss on financial instruments at fair value through profit and loss	(633)	741
Adjustment for property taxes accounted for under IFRIC 21	2,030	1,659
Share of the profit of an investment (equity method)	(170)	-
Distributions on Exchangeable securities	429	286
Change in fair value of Exchangeable securities	552	1,398
Foreign exchange gains or losses on monetary items not forming part of a net investment in a foreign operation	(9)	(38)
Non-recurring other finance costs	22	-
Finance income from investment	(180)	-
Deferred income tax expense	28	-
FFO from investment	342	-
<b>FFO</b>	<b>3,726</b>	<b>2,867</b>
<b>Add/(Deduct):</b>		
Non-cash effect of straight line rents	(663)	(485)
Cash effect of the lease equalization loans	240	485
Amortization of fair value adjustment on assumed debt	109	396
Amortization of transaction costs on mortgage loans	105	-
Non-cash part of asset management fees paid in Exchangeable securities <sup>(1)</sup>	257	228
Capex net of cash subsidy	(100)	(450)
Adjustment from investment <sup>(2)</sup>	28	-
<b>AFFO</b>	<b>3,702</b>	<b>3,041</b>
FFO / Units (diluted) <sup>(3)</sup> <i>(in CAD\$)</i>	<b>0.21</b>	<b>0.23</b>
AFFO / Units (diluted) <sup>(3)</sup> <i>(in CAD\$)</i>	<b>0.21</b>	<b>0.24</b>

- (1) For purposes of this presentation, 50% of non-cash part of the asset management fee is included in the AFFO reconciliation. Notwithstanding, 100% of the asset management fee is paid in Exchangeable securities
- (2) Adjustment for the non-cash part of asset management fees pertaining to the investment
- (3) Based on the weighted average number of Units, i.e. 17,332,699 and 12,675,707 for the 3-month periods ended March 31, 2015 and 2014

Management believes FFO is an important measure of our operating performance. This non-IFRS measurement is a commonly used measure of performance of real estate operations. However, it does not represent cash flow from operating activities as defined by IFRS and is not necessarily indicative of cash available to fund Inovalis REIT's needs.

AFFO is an important measure of our economic performance and is indicative of our ability to pay distributions. This non-IFRS measurement is commonly used for assessing real estate performance. However, it does not represent cash flow from operating activities as defined by IFRS and is not necessarily indicative of cash available to fund Inovalis REIT's needs.

Our AFFO calculation does not take into account an amount of \$423 receivable from Inovalis SA. This amount was used for the benefit of a deposit for a potential future acquisition at the manager's entire responsibility. The manager will pay this amount to the REIT in the course of the second quarter of 2015.

AFFO payout ratio is 96.6% for the 3-month period ended March 31, 2015. Taking into account the above receivable from the manager, the AFFO payout ratio would be 86.7%. The payout ratio will further decrease when the REIT deploys all or part of the \$19.5 million of cash available on future acquisition and when additional cash is generated by these acquisitions.

Our AFFO calculation is based on the average foreign exchange rate for the period (1.3955 Canadian dollars per Euro for the 3-month period ended March 31, 2015) and does not take into account our foreign currency hedging arrangements (100% of our monthly cash distributions are covered until January 2018 at an average rate of 1.5227).

## PROPERTY CAPITAL INVESTMENTS

### **Fair value**

The fair value of our investment property portfolio as at March 31, 2015, including our 50% interest in Duisburg, was \$334.4 million (vs. \$344.0 million as at December 31, 2014). The fair value of the French properties was \$267.4 million (80.0% of total value) and the fair value of the German properties, including our 50% interest in Duisburg, was \$67.0 million (20.0% of total value).

Management principally uses discounted cash flows to determine the fair value of the investment properties. These values are supported by third party appraisals. Our assessment of the fair values of the French properties was in line with the values determined by Jones Lang LaSalle France in conformity with the requirements of the *Royal Institution of Chartered Surveyors Standards*, the *Charte de l'expertise immobilière* and the *European Valuation Standards of TEGoVA* (the European Group of Valuers' Association) and IFRS 13. Our assessment of the fair value of the German property was in line with the value determined by Jones Lang LaSalle Germany in conformity with the requirements of the *Royal Institution of Chartered Surveyors Standards*.

### **Building improvements**

The REIT is committed to improving its operating performance by incurring appropriate capital expenditures in order to replace and maintain the productive capacity of its property portfolio so as to sustain its rental income generating potential over the portfolio's useful life. In accordance with IFRS, the REIT will capitalize all capital improvement expenditures on its properties that enhance the service potential of a property and extend the useful life of an asset with the term of the capital lease.

An escrow account totalling \$4.2 million of cash was set aside by the vendors of the four initial properties for payment of capital expenditures to be invested before April 2016 in the event a need for capex arises. As at March 31, 2015, about \$1 million was spent.

### **Initial direct leasing costs and lease incentives**

Initial direct leasing costs include leasing fees and related costs, and broker commissions incurred in negotiating and arranging tenant leases. Lease incentives include costs incurred to make leasehold improvements to tenant spaces and cash allowances. Initial direct leasing costs and lease incentives are dependent on asset type, lease terminations and expiries, the mix of new leasing activity compared to renewals, portfolio growth and general market conditions. Short-term leases generally have lower costs than long-term leases.

## Guarantees, commitments and contingencies

The REIT and its subsidiaries have provided guarantees in connection with the finance lease liabilities and the mortgage loans, including pledge of affiliates of the REIT, first mortgages and assignment of receivables and future receivables.

## OTHER SIGNIFICANT ASSETS

### Restricted cash and other financial assets

Restricted cash and other financial assets amounted to \$1,850 as at March 31, 2015. It is comprised of \$700 of collateral for the foreign exchange currency contracts and \$1,150 of deposit for the Bad Homburg acquisition (closed on April 8, 2015).

### Investment accounted for using the equity method

This section encompasses the 50% interest the REIT has in the Duisburg property via its 50% ownership of CanCorp Duisburg I S.à.r.l. Simplified balance sheet and statement of earnings of CanCorp Duisburg I S.à.r.l. can be found in the note 5 of the Consolidated Financial Statements attached to this report. The fair value of the investment accounted for using the equity method was \$17.8 million as at March 31, 2015 compared to \$18.3 million on December 31, 2014. The fair value of the Duisburg property, which we own through a joint-venture arrangement, was \$68.8 million (vs. \$70.9 million as at December 31, 2014).

The REIT's share of the investment property amounts to \$34.4 million as at March 31, 2015. The REIT's share of the mortgage debt associated with this property amounts to \$16.5 million. The table below outlines the share of the REIT's FFO and AFFO coming from this investment.

<i>(in thousands of CAD\$)</i>	3-month period ended March 31, 2015	
	Total	Share of the REIT (50%)
Profit (loss) for the period	(19)	(10)
Adjustment for		
Acquisition costs (reversal of accrual)	(54)	(27)
Finance costs to Partners	720	360
Interests on mortgage loans - amortization of transaction costs	18	9
Deferred income tax	20	10
<b>FFO from investment</b>	<b>685</b>	<b>342</b>
<b>Add/(Deduct):</b>		
Adjustment for asset management fees and other finance costs	56	28
<b>AFFO from investment</b>	<b>741</b>	<b>370</b>

### Acquisition loan

On November 6, 2014, Metropolitan LLC, a 100% subsidiary of the REIT, made a loan to Inovalis in the amount of 12,500 Euros so that Inovalis SA could acquire a property in the greater metropolitan area of Paris France. As of March 31, 2015, the book value of this loan was \$17,029. The loan is secured by a share pledge from a holding company owned by Inovalis SA (which also owns another property in the Greater Paris Region), bears interest at a rate of 8.75% for three years (with an option to extend for one year) and includes a right of first opportunity in favor of the REIT to purchase the property at a discount to the then market price. Whether the REIT exercises its option to buy the property or the property is sold to a third party, the REIT will receive 50% of the profit generated by the sale of the property less all interests received on the Acquisition Loan, in the first case in the form of a discount to the price and in the second case in the form of a cash gain. The minimum income for the REIT on this transaction will be 8.75% per annum.

### Trade and other receivables

Trade and other receivables as at March 31, 2015 amounted to \$3,407 compared to \$2,852 as at December 31, 2014. The increase is principally the result of an increase in rent and service charges receivable from tenants as well as interest receivable for the Acquisition loan from Inovalis SA.

### Other current Assets

Other current assets as at March 31, 2015 amounted to \$3,114 compared to \$731 as at December 31, 2014. This amount is composed of sales tax receivable of \$1,205 and prepaid expenses of \$1,909. The main item in the prepaid expenses is a lease payment for the BBA property for the second quarter that was paid at the end of March. Lease payments are usually made at the beginning of the period.

## PRESENTATION OF OUR CAPITAL

### Liquidity and capital resources

Inovalis REIT's primary sources of capital are cash generated from operating activities, credit facilities, sharing the ownership of actual assets owned entirely and equity issues. Our primary uses of capital include property acquisitions, payment of distributions, costs of attracting and retaining tenants, recurring property maintenance, major property improvements and debt interest payments. We expect to meet all of our ongoing obligations through current cash, cash flows from operations, debt refinancing and, as growth requires and when appropriate, new equity or debt issues. We can also sell some portion of assets owned in order to get access to capital but also in the perspective of diversification of our portfolio.

As at March 31, 2015, we have \$19.5 million of cash available, which after current payables and operating requirements is available for acquisitions. Subsequent to the quarter, approximately \$5.0 million was employed for the acquisition of the 50% interest in the Bad Homburg property.

### Financing activities

Our debt strategy is to have secured mortgage financing with a term to maturity that is appropriate in relation to the lease maturity profile of our portfolio and then to put in place, when appropriate, interest-only financings. We intend to search for fixed rate financings or floating rate financings with a cap. Our preference is to have staggered debt maturities to mitigate interest rate risk and limit refinancing exposure in any particular period. Our debt to book value stands at 51.4%, in line with our long-term targeted range of 50 to 55% and net of the \$19.5 million of cash available as at March 31, 2015, this debt to book value stands at 48.6%.

Key performance indicators in the management of our debt are summarized in the following table.

	For the three months ended March 31, 2015	For the year ended December 31, 2014
Weighted average interest rate <sup>(1)</sup>	1.95%	1.98%
Debt-to-book value <sup>(2)</sup>	51.4%	52.2%
Debt-to-book value, net of cash <sup>(3)</sup>	48.6%	49.0%
Interest coverage ratio <sup>(4)</sup>	4.6 x	4.7 x
Debt due in next 12 months in thousand of CAD\$ (including interests)	6,654	6,991
Weighted average term to maturity of debt <sup>(5)</sup>	7.0 years	7.2 years

(1) Calculated as the weighted average interest rate paid on the finance leases and the mortgage financing

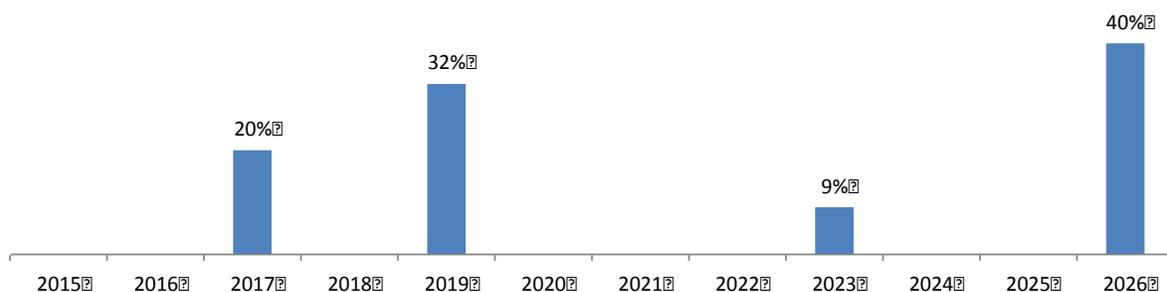
(2) Defined as total debt divided by total assets. Takes into account 50% of the Duisburg property

(3) Defined as total debt divided by total assets, each of which excludes \$19.5 million of cash at March 31, 2015. Takes into account 50% of the Duisburg property

(4) Calculated as net rental earnings plus interest, less general and administrative expenses, divided by interest expense on the financial leases and mortgage financings

(5) Calculated as the weighted average term on all the financial leases and mortgage financings

**Leasehold and Mortgage Financing Maturity Profile**  
*(% of amount outstanding as at March 31, 2015)*



**Equity**

Our discussion about equity is inclusive of Exchangeable securities, which are economically equivalent to the REIT's Units. In our consolidated financial statements, the Exchangeable securities are classified as a combination of current and non-current liabilities under IFRS because of the conversion feature that can be exercised by the holder of those securities.

	<b>3-month period ended March 31, 2015</b>
--	--

**Units**

Number at beginning of period	15,278,536
Increase/(Decrease) in number during the period	-
Units issued pursuant to the DRIP	20,343
Number at end of period	15,298,879
Weighted average number during the period	15,288,573

**Exchangeable securities**

Number at beginning of period	2,043,347
Increase/(Decrease) in number during the period	70,147
Number at end of period	2,113,494
Weighted average number during the period	2,044,126

**Units and Exchangeable securities**

Number at beginning of period	17,321,883
Increase/(Decrease) in number during the period	90,490
Number at end of period	17,412,373
Weighted average number during the period	17,332,699

Our Declaration of Trust authorizes the issuance of an unlimited number of Units and an unlimited number of Special Voting Units. Issued and outstanding Units and Special Voting Units may be subdivided or consolidated from time to time by the Trustees without notice to or approval of the Unitholders of the REIT.

A total of 70,147 Exchangeable securities were issued during the period from January 1, 2015 to March 31, 2015 in favour of Inovalis SA as payment of the asset management fee for the fourth quarter of 2014. 50% of these Exchangeable securities (or 35,074 Exchangeable securities) are subject to an escrow agreement pursuant to which such Exchangeable securities will be released from escrow upon termination of the Management Agreement, except in the case of internalization of the management of the REIT, in which case (i) one third of the Exchangeable

securities will be automatically released upon internalization of the management of the REIT, and (ii) one third of the Exchangeable securities will be released on the first and second anniversaries of the internalization of the REIT.

Further to the Distribution Reinvestment Plan (“**DRIP**”) in place, a total of 20,343 Units were issued to Unitholders during the 3-month period ended March 31, 2015. An additional 7,444 Units were issued on April 15, 2015 for the March 2015 distribution. As of December 31, 2014, 6.3% of the Units were enrolled in the DRIP.

***Distribution and management of foreign exchange risk***

Our Declaration of Trust provides our trustees with the discretion to determine the percentage payout of income that would be in the best interests of the REIT. Given that the level of working capital tends to fluctuate over time and should not affect our distribution policy, we do not consider it when determining our distributions.

In order to ensure the predictability of distributions to our Unitholders, we have established an active foreign exchange hedging program. As at March 31, 2015, according to the hedging program in place, until April 2017, every month, the REIT is committed to sell €486 at a rate of 1.5437 and to receive \$750 thousand. In January 2015, in order to cover 100% of the cash distributions monthly paid by the REIT (including the Units issued in November 2014), the REIT entered into additional contracts. These additional contracts are a combination of put and call options that were chosen so as to make the REIT benefit from an exchange rate higher than the forward contracts rates at the time we entered into these contracts, for a minimum period of three years. Taking into account all of our foreign exchange hedging contracts, the REIT will, every month until January 2018, be selling on the average €657 at an average rate of 1.5227 and receiving \$1,000.

<i>(in thousands of CAD\$ except for per Unit amounts)</i>	<b>3-month period ended March 31, 2015</b>	<b>3-month period ended March 31, 2014</b>
Declared distributions on Units	3,154	2,328
Declared distributions on Exchangeable securities	421	286
<b>Total declared distributions</b>	<b>3,575</b>	<b>2,614</b>
Distribution per Unit (diluted) <sup>(1)</sup>	\$0.21	\$0.21

(1) Calculation based on the declared distributions and weighted average number of Units during the period (including Exchangeable securities)

We currently pay monthly distributions to Unitholders of \$0.06875 per Unit, or \$0.825 per Unit on an annual basis.

**Trade and other payables**

Trade and other payables as at March 31, 2015 amounted to \$7,756 compared to \$5,653 as at December 31, 2014. The increase is principally due to the accrual of all property taxes and levies in the first quarter (\$1,849), which will resorb itself over the course of the year. Also, the addition of new subsidiaries of Sablière and Baldi in the fall of 2014 increases the level of operating expenses and the resulting increases in payables.

## ANALYSIS OF DISTRIBUTED CASH

	3 months ended March 31, 2015	3 months ended March 31, 2014	12 months ended December 31, 2014
Cash flows from operating activities (A)	1,920	4,550	12,199
Earnings before income tax (B)	3,101	(81)	17,546
Declared distribution on Units (C)	3,154	2,328	9,864
Excess (shortfall) of cash flows from operating activities over cash distributions paid (A - C)	(1,234)	2,222	2,335
Excess (shortfall) of profit or loss over cash distributions paid (B - C)	(53)	(2,409)	7,682

As shown in the table above, the cash distributions declared for the three-month period ended March 31, 2015 was greater than the cash flows related to operating activities as reported in the REIT's interim consolidated statement of cash flows for the same period. The cash flows related to operating activities for the period ended March 31, 2015 was impacted by an increase in receivables and prepaid expenses relating to the timing of invoicing of certain annual charges for rent, taxes and other expenses which should resorb themselves over the course of the year. Also, the REIT had \$663 in rent free periods during the quarter which is normally partially compensated by an increase in the lease equalization loans which is presented in the cash flow statements under financing activities.

Also, as shown in the table above, the amount of distributions declared for the quarter was greater than the amount of earnings reported during the period. Notwithstanding this situation, the REIT does not believe that any portion of these distributions should be regarded as an economic return of capital. The REIT's profit or loss reflects a number of gains or losses that do not affect cash as well as a number of expenses that are related to investing or financing activities rather than to operating activities.

Every quarter, the REIT ensures that sufficient funds were being generated from rental operations to continue making distributions at the planned rate. To perform this assessment, management uses the FFO and AFFO measures presented in the section entitled Non-IFRS reconciliation (FFO and AFFO). These measures are used to determine the amount of funds generated by ongoing rental operations that are available for distribution. These measures remove from consideration those gains and losses that are recognized for accounting purposes but that do not impact cash flow. They also remove from consideration various revenues and expenses that are recognized in profit or loss for accounting purposes but which do not arise from ongoing rental operations, for example because they were incurred to acquire revenue generating assets.

As quantified in the FFO and AFFO calculations, the funds used to make the distributions during the current quarter were generated through the REIT's ongoing rental operations.

The REIT expects to continue paying distributions based on the current plan.

## RISK AND UNCERTAINTIES

We are exposed to various risks and uncertainties, many of which are beyond our control. Material risks and uncertainties that could materially affect our operations and future performance are described in our prospectus dated March 28, 2013, in our short-form equity offering prospectus dated October 30, 2014, and in our 2014 annual report which are available at [www.sedar.com](http://www.sedar.com).

## OUTLOOK

We believe that the current market environment is a favourable one for the REIT to prosper. In addition to actively managing our properties, we are continuously assessing potential acquisitions in our target markets and will focus on the ones offering value and stability. Our long-term credit worthy tenants, low cost of debt with proper maturity and the foreign exchange rate contracts for our distributions until January 2018, not only provide investors with steady cash flows, but also serve as a basis for future growth. In addition of the cash available, we can also sell some portion of assets that we own to get access to additional cash and at the same time diversify our portfolio risk.

## CRITICAL ACCOUNTING POLICIES

The preparation of the REIT's interim consolidated financial statements in conformity with IFRS requires management to make judgments and estimates that affect the reported amounts of revenues and investment properties owned directly and indirectly at the reporting date. However, uncertainty about these estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

We consider the following policies and estimates to be the most critical in understanding the assumptions and judgments that are involved in preparing our financial statements and the uncertainties that could affect our financial results, financial condition and cash flows: (i) recognition and valuation of investment properties; and (ii) distinction between business combinations or asset acquisitions.

A more detailed description of significant accounting policies and critical accounting judgement and estimates that we apply under IFRS is provided in notes 3 and 4 of the audited annual consolidated financial statements for the period ended December 31, 2014.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The REIT's Chief Executive Officer (the "CEO"), and the Chief Financial Officer (the "CFO") of the REIT are responsible for establishing and maintaining the REIT's disclosure controls and procedures ("DCP") including adherence to the Disclosure Policy adopted by the Board of Trustees. The Disclosure Policy requires all staff and certain other personnel providing services to the REIT to keep senior management fully apprised of all material information affecting the REIT so that they may evaluate and discuss this information and determine the appropriateness and timing for public release.

The REIT's CEO and the CFO are also responsible for the design of internal controls over financial reporting ("ICFR"). Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the REIT, (2) provide reasonable assurance that all transactions are recorded as necessary to permit the preparation of financial statements in accordance with International Financial Reporting Standards, and that receipts and expenditures of the REIT are being made only in accordance with authorizations of the management and Trustees of the REIT, and 3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the REIT's assets that could have a material effect on the REIT's financial statements.

On November 13, 2014 the REIT acquired two office rental properties located in the greater region of Paris, France, that were previously held indirectly by AREF Real Estate France SAS. Since the REIT's management has not yet had the opportunity to design or evaluate the controls, policies and procedures related to these properties, it has limited the scope of its design of disclosure controls and procedures and internal controls over financial reporting to exclude all of its acquired businesses.

**Summary of the acquired businesses**

000\$

Revenues for the quarter ended March 31, 2015	1,841
Assets (Investment Properties)	63,129
Liabilities (principally Finance lease liabilities)	57,426

Management has considered the fact that the acquired businesses include risks that could reasonably result in a material misstatement in the REIT's interim consolidated financial statements.

A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instances of fraud, if any, have been detected. These inherent limitations include, amongst other items: (i) that Management's assumptions and judgments could ultimately prove to be incorrect under varying conditions and circumstances; or (ii) the impact of isolated errors. Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by Management override. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals.

Over the last months, given the continued growth and diversification of the REIT's investments, methods of financing and hedging activities, several new financial statement lines were added to the financial statements. Consequently, several new internal controls were implemented to mitigate the related risk of misstatement, notably with respect to the Investment accounted for using the equity method, the Acquisition loan, the deferred income taxes and the financial disclosure associated with hedge accounting.

## **SUBSEQUENT EVENTS**

### **New acquisition**

Subsequent to the end of the period, on April 8<sup>th</sup> 2015, the REIT purchased, on a 50-50 joint-ownership basis, an office property located in Germany, for an all-in-cost of approximately €18,300 (\$24,900). The acquisition was financed with a first mortgage of \$15,100 and equity investments of approximately \$9,800 (including acquisition costs). The REIT's share of the investment (approximately \$4,900) was paid from existing cash on hand. This transaction will be accounted for as a joint venture.