

**INOVALIS REIT 2016 Second Quarter Report**

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

**Three-month and six-month periods ended June 30, 2016**

**The attached unaudited condensed interim consolidated financial statements have been prepared by management of Inovalis Real Estate Investment Trust and have not been reviewed by the auditors of the Trust.**

## INOVALIS REIT Interim Consolidated Balance Sheets

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

(in thousands of Canadian dollars)

Assets	Note	As at June 30, 2016	As at December 31, 2015
<b>Non-current assets</b>			
Investment properties	5	417 925	355 704
Investments accounted for using the equity method	6	43 376	40 337
Acquisition loan		-	18 786
Derivative financial instruments	8	344	92
Restricted cash		-	1 375
<b>Total non-current assets</b>		461 645	416 294
<b>Current assets</b>			
Trade and other receivables		4 131	4 803
Derivative financial instruments	8	254	197
Other current assets		1 555	1 333
Restricted cash		-	305
Cash		7 679	6 895
<b>Total current assets</b>		13 619	13 533
<b>Total assets</b>		475 264	429 827
<b>Liabilities and Unitholders' equity</b>			
Liabilities	Note	As at June 30, 2016	As at December 31, 2015
<b>Non-current liabilities</b>			
Mortgage loans	7	85 195	70 779
Finance lease liabilities	7	146 600	120 285
Lease equalization loans		4 361	5 090
Tenant deposits		2 506	1 746
Exchangeable securities	9	18 696	18 034
Provision relating to an investment accounted for using the equity method	6	-	925
Derivative financial instruments	8	3 013	2 698
Deferred tax liabilities		1 467	1 651
<b>Total non-current liabilities</b>		261 838	221 208
<b>Current liabilities</b>			
Mortgage loans	7	507	415
Finance lease liabilities	7	6 461	6 217
Lease equalization loans		1 613	1 335
Tenant deposits		110	116
Exchangeable securities	9	2 293	1 366
Derivative financial instruments	8	1 242	878
Trade and other payables		10 504	6 174
Other current liabilities		1 028	469
<b>Total current liabilities</b>		23 758	16 970
<b>Total liabilities</b>		285 596	238 178
<b>Equity</b>			
Trust units		140 878	136 365
Retained earnings		37 332	35 359
Accumulated other comprehensive income	13	11 500	19 925
		189 710	191 649
Non-controlling interest		(42)	-
<b>Total equity</b>		189 668	191 649
<b>Total liabilities and equity</b>		475 264	429 827

See accompanying notes to condensed interim consolidated financial statements

On behalf of the Board of Trustees of Inovalis Real Estate Investment Trust:

**Stéphane Amine**  
Chairman and Trustee

**Daniel Argiros**  
Lead Trustee

## INOVALIS REIT

### Interim Consolidated Statements of Earnings

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

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

	<i>Note</i>	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Rental income		5 853	5 306	11 526	10 589
Service charge income		1 185	1 930	2 775	3 659
Service charge expenses		(989)	(1 334)	(5 474)	(5 144)
Other revenues	14	42	1 240	42	1 240
Other property operating expenses		(26)	(26)	(67)	(47)
<b>Net rental earnings</b>		<b>6 065</b>	<b>7 116</b>	<b>8 802</b>	<b>10 297</b>
Administration expenses		(1 505)	(1 125)	(2 724)	(2 117)
Foreign exchange (loss) gain		11	(56)	107	84
Net change in fair value of investment properties		3 552	11 416	644	13 166
Option cost related to the acquisition of the Metropolitan property (adjustment of fair value)	4	(664)	-	9 213	-
Acquisition costs		(30)	(54)	(689)	(54)
Share of net earnings from investments accounted for using the equity method		(153)	131	(358)	121
<b>Operating earnings</b>		<b>7 276</b>	<b>17 428</b>	<b>14 995</b>	<b>21 497</b>
Gain (loss) on financial instruments at fair value through profit or loss		(2 093)	(123)	(2 237)	379
Gain (loss) recognized on exercise of early payment option on finance leases		678	-	(1 242)	-
Loss on refinancing of a debt		-	-	(605)	-
Finance income	10	2 784	824	2 836	1 564
Finance costs	10	(1 623)	(1 214)	(3 139)	(2 443)
Distributions on Exchangeable securities	9	(482)	(438)	(934)	(867)
Net change in fair value of Exchangeable securities	9	(403)	217	(1 019)	(335)
<b>Earnings before income taxes</b>		<b>6 137</b>	<b>16 694</b>	<b>8 655</b>	<b>19 795</b>
Current income tax expense		(23)	(5)	(108)	(8)
Deferred income tax recovery (expense)		(276)	(74)	(123)	(107)
<b>Earnings for the period</b>		<b>5 838</b>	<b>16 615</b>	<b>8 424</b>	<b>19 680</b>
<b>Earnings for the period attributable to :</b>					
Non-controlling interest		(1)	-	(42)	-
Unitholders' of the Trust		5 839	16 615	8 466	19 680
		<b>5 838</b>	<b>16 615</b>	<b>8 424</b>	<b>19 680</b>
<b>Earnings per unit attributable to unit holders:</b>	11				
Basic earnings per unit		0,37	1,09	0,54	1,29
Diluted earnings per unit		0,37	0,97	0,54	1,20

See accompanying notes to condensed interim consolidated financial statements

## INOVALIS REIT

### Interim Consolidated Statements of Comprehensive Income (loss)

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

(in thousands of Canadian dollars)

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Earnings for the period</b>	<b>5 838</b>	<b>16 615</b>	<b>8 424</b>	<b>19 680</b>
<b>Other comprehensive income (loss)</b>				
Derivatives designated as a hedge of the net investment in a foreign entity				
Net gains (losses)	1 276	(280)	1 678	370
Derivatives designated as cash flow hedges				
Net gains (losses)	(72)	528	(494)	400
Reclassification of net losses to earnings	47	21	67	45
Change in cumulative translation adjustment account	(6 525)	3 650	(9 676)	(1 537)
Total other comprehensive income (loss)	(5 274)	3 919	(8 425)	(722)
<b>Total comprehensive income (loss) for the period</b>	<b>564</b>	<b>20 534</b>	<b>(1)</b>	<b>18 958</b>

See accompanying notes to condensed interim consolidated financial statements

### Interim Consolidated Statements of changes in Unitholders' Equity

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

(in thousands of Canadian dollars, except number of Units)

	Note	Number of Units issued and outstanding	Trust Units	Retained earnings	Accumulated other comprehensive income	Total attributable to the Unitholders' of the Trust	Non-controlling interest	Total equity
As at December 31, 2015		15 637 019	136 365	35 359	19 925	191 649	-	191 649
Issuance of units	<sup>9</sup>	420 000	3 981	-	-	3 981	-	3 981
Distributions earned by Unitholders	<sup>12</sup>	-	-	(6 493)	-	(6 493)	-	(6 493)
Distributions reinvestment Plan	<sup>12</sup>	57 357	532	-	-	532	-	532
Transactions with owners		477 357	4 513	(6 493)	-	(1 980)	-	(1 980)
Earnings for the period		-	-	8 466	-	8 466	(42)	8 424
Other comprehensive loss		-	-	-	(8 425)	(8 425)	-	(8 425)
<b>As at June 30, 2016</b>		<b>16 114 376</b>	<b>140 878</b>	<b>37 332</b>	<b>11 500</b>	<b>189 710</b>	<b>(42)</b>	<b>189 668</b>
As at December 31, 2014		15 278 536	133 010	17 291	7 316	157 617	-	157 617
Distributions earned by Unitholders	<sup>12</sup>	-	-	(6 311)	-	(6 311)	-	(6 311)
Distributions reinvestment Plan	<sup>12</sup>	42 908	376	-	-	376	-	376
Transactions with owners		42 908	376	(6 311)	-	(5 935)	-	(5 935)
Earnings for the period		-	-	19 680	-	19 680	-	19 680
Other comprehensive loss		-	-	-	(722)	(722)	-	(722)
As at June 30, 2015		<b>15 321 444</b>	<b>133 386</b>	<b>30 660</b>	<b>6 594</b>	<b>170 640</b>	<b>-</b>	<b>170 640</b>

See accompanying notes to condensed interim consolidated financial statements

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

(in thousands of Canadian dollars)

	Note	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Operating activities</b>					
Earnings before income taxes for the period		6 137	16 694	8 655	19 795
Adjustments for non-cash items and other reconciling items	17	(1 263)	(11 077)	(1 761)	(12 816)
		4 873	5 617	6 894	6 979
Working capital adjustments	17	831	(596)	4 300	(37)
<b>Net cash flows related to operating activities</b>		<b>5 704</b>	<b>5 021</b>	<b>11 194</b>	<b>6 942</b>
<b>Investing activities</b>					
Business acquisition	4	(860)	-	(21 638)	-
Acquisition costs		(30)	-	(689)	-
Investment in a joint-Venture - Walpur Four		-	(3 993)	-	(5 143)
Investment in a joint venture - Cologne		(6 189)	-	(6 189)	-
Distribution from (investment in) a joint-venture - Arcueil		-	(13 915)	525	(13 915)
Additions to investment properties	5	(129)	(115)	(994)	(238)
Loan repayments received from joint ventures		-	845	-	845
Other long term assets		1 514	-	-	-
Net changes in restricted cash		1 000	-	1 680	(100)
Settlement of derivative financial instruments		(826)	338	(1 042)	591
<b>Net cash flows related to investing activities</b>		<b>(5 520)</b>	<b>(16 840)</b>	<b>(28 347)</b>	<b>(17 960)</b>
<b>Financing activities</b>					
Distributions on Units paid in cash	12	(2 959)	(2 958)	(5 929)	(5 932)
Distributions on Exchangeable securities paid in the form of interest on notes issued by a subsidiary	9	(211)	(225)	(369)	(455)
Distributions on Exchangeable securities paid in the form of repayment of interest bearing notes issued by a subsidiary	9	-	(195)	(165)	(351)
Proceeds from new mortgage loans, net of transaction costs	7	(0)	-	18 795	-
Proceeds from new finance liabilities, net of transaction costs	7	-	-	52 654	-
Transaction fees related to the exercise of early payment option on finance leases	4	678	-	(1 242)	-
Repayment of mortgage loans and finance lease liabilities		(654)	(1 373)	(45 541)	(3 126)
Lease equalization loan		5	1 361	(310)	1 601
<b>Net cash flows related to financing activities</b>		<b>(3 142)</b>	<b>(3 390)</b>	<b>17 892</b>	<b>(8 263)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>(2 958)</b>	<b>(15 209)</b>	<b>739</b>	<b>(19 281)</b>
Effects of foreign exchange adjustments on cash and cash equivalent		(1 214)	216	45	(404)
<b>Cash at the beginning of the period</b>		<b>11 851</b>	<b>19 493</b>	<b>6 895</b>	<b>24 185</b>
<b>Cash at the end of the period</b>		<b>7 679</b>	<b>4 500</b>	<b>7 679</b>	<b>4 500</b>

See accompanying notes to condensed interim consolidated financial statements

## **INOVALIS REIT**

### **Notes to the Condensed Interim Consolidated Financial Statements**

Three-month and six-month periods ended June 30, 2016

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

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#### **Note 1 – Organization**

Inovalis Real Estate Investment Trust (the “Trust”) is an open-ended real estate investment trust created pursuant to a Declaration of Trust dated February 8, 2013, under the laws of the Province of Ontario, Canada. These condensed interim consolidated financial statements include the accounts of the Trust and its subsidiaries (together the “REIT”). The REIT’s investment property portfolio, owned directly or through joint arrangements, is comprised of office rental properties located in France and Germany.

The REIT’s head and registered office is located at 151 Yonge Street, 11th floor, Toronto, Ontario, M5C 2W7. The REIT’s units are listed on the Toronto Stock Exchange (“TSX”) under the symbol INO.UN.

The REIT’s condensed interim consolidated financial statements for the three-month and six-month periods ended June 30, 2016, were authorized for issuance by the Board of Trustees on August 12, 2016.

The REIT has hired Inovalis S.A. (“Inovalis”), a real estate asset manager having operations in France and Germany, to manage certain functions (see Note 14 – Transactions with related parties).

#### **Note 2 – Basis of preparation of condensed interim consolidated financial statements**

##### **Statement of compliance**

These unaudited condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, *Interim Financial Reporting*. They are condensed and do not include all disclosures that would otherwise be required in a complete set of financial statements and should be read in conjunction with the 2015 audited consolidated annual financial statements.

##### **Basis of presentation**

The unaudited condensed interim consolidated financial statements are prepared on a going concern basis. All financial information has been rounded to the nearest thousand (CAD\$ 000) except when otherwise indicated.

These unaudited condensed interim consolidated financial statements have been prepared on the historical cost basis except for Investment properties, Exchangeable securities and Derivative financial instruments, which are measured at their fair values.

#### **Note 3 – Significant accounting policies**

The condensed interim consolidated financial statements have been prepared in accordance with the accounting policies adopted in the REIT’s most recent annual financial statements for the year ended December 31, 2015.

##### **Estimates**

When preparing the condensed interim consolidated financial statements, management uses a number of judgements, estimates and assumptions about the recognition and measurement of assets, liabilities, income and expenses. The actual results may differ from the judgements, estimates and assumptions used by management.

The judgements, estimates and assumptions used in the condensed interim consolidated financial statements including the key sources of estimation uncertainty are the same as those used in the preparation of the REIT’s last audited annual consolidated financial statements for the year ended December 31, 2015.

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 4 – Business combination

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

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

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

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

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

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

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 5 – Investment properties

<b>Investment properties</b>	<b>For the six months ended June 30, 2016</b>	<b>For the year ended December 31, 2015</b>
<b>Beginning of period</b>	<b>355 672</b>	<b>308 596</b>
Additions, capitalized letting fees and change in initial direct costs	994	98
		-
Acquisitions through business combinations	78 731	-
Amount derecognized upon exercise of early purchase option on lease		(14 377)
Amount recognized upon acquisition of the property		14 377
Rent free periods	(223)	2 281
Net change in fair value of investment properties <sup>(1)</sup>	644	21 523
Foreign currency translation adjustment	(17 893)	23 206
<b>End of period</b>	<b>417 925</b>	<b>355 704</b>

<sup>(1)</sup> : Including the increase of 1.6M\$ related to the impact of IFRIC 21 for recoverable French property taxes, which has a similar impact on service charge expenses.

#### Note 6 – Investments accounted for using the equity method

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

<b>Carrying amount of investment in joint ventures</b>	<b>CCD</b>	<b>Walpur</b>	<b>Arcueil</b>	<b>Cologne</b>	<b>For the six months ended June 30, 2016</b>	<b>For the year ended December 31, 2015</b>
Balance at the beginning of the period	19,188	6,918	14,231	(926)	39,411	18,307
Net change in equity investment in joint ventures	(117)	(374)	(29)	(287)	(807)	2,244
Net change in loans to joint ventures	(671)	(224)	(522)	6,189	4,772	18,861
Reclassified to liabilities	-	-	-	-	-	925
<b>Balance at the end of the period</b>	<b>18,400</b>	<b>6,320</b>	<b>13,680</b>	<b>4,976</b>	<b>43,376</b>	<b>40,337</b>
<b>Provision relating to an investment accounted for using the equity method</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(925)</b>

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 7 – Mortgage loans and finance lease liabilities

Entity	Nominal value (in 000's of €)	Nominal value (in 000's of \$)	Interest rate	Maturity	As at June 30, 2016		
					Total	Non-current	Current
Mortgage loan - Jeûneurs SCI	19,500	27,990	Euribor 3M + 1.75% <sup>1</sup>	2019-05-05	27,953	27,953	-
Mortgage loan - Véronèse SCI	14,500	20,813	Euribor 3M + 1.75% <sup>1</sup>	2019-05-05	20,810	20,810	-
Mortgage loan - Sablière SCI	13,245	19,012	Euribor 3M + 1.59% <sup>2</sup>	2025-12-23	19,012	18,606	406
Mortgage loan - CanCorpHanover	12,489	17,927	Euribor 3M + 1.45%	2022-12-31	17,927	17,826	101
<b>Mortgage loans</b>	<b>59,734</b>	<b>85,742</b>			<b>85,702</b>	<b>85,195</b>	<b>507</b>
Finance lease liabilities - BBA SCI	54,318	77,968	Euribor 3M + 2.00% <sup>2</sup>	2026-06-20	77,968	74,477	3,491
Finance lease liabilities - Métropolitain	35,859	51,472	Euribor 3M + 1.85% and Euribor 3M + 1.6% <sup>2</sup>	2028-03-20	51,472	50,718	754
Finance lease liabilities - Baldi SCI	16,456	23,621	Euribor 3M + 1.00%	2017-09-30	23,621	21,405	2,216
<b>Finance lease liabilities</b>	<b>106,633</b>	<b>153,061</b>			<b>153,061</b>	<b>146,600</b>	<b>6,461</b>
<b>Total mortgage loans and finance lease liabilities</b>	<b>166,367</b>	<b>238,803</b>			<b>238,763</b>	<b>231,795</b>	<b>6,968</b>

  

Entity	Nominal value (in 000's of €)	Nominal value (in 000's of \$)	Interest rate	Maturity	As at December 31, 2015		
					Total	Non-current	Current
Mortgage loan - Jeûneurs SCI	19,500	29,307	Euribor 3M + 1.75% <sup>1</sup>	2019-05-05	29,175	29,175	-
Mortgage loan - Véronèse SCI	14,500	21,792	Euribor 3M + 1.75% <sup>1</sup>	2019-05-05	21,721	21,721	-
Mortgage loan - Sablière SCI	13,500	20,289	Euribor 3M + 1.72% <sup>2</sup>	2025-12-23	20,298	19,883	415
<b>Mortgage loans</b>	<b>47,500</b>	<b>71,388</b>			<b>71,194</b>	<b>70,779</b>	<b>415</b>
Finance lease liabilities - BBA SCI	55,406	83,270	Euribor 3M + 2.00% <sup>2</sup>	2026-06-20	83,270	79,965	3,305
Finance lease liabilities - CanCorpHanover	12,337	18,541	Euribor 3M + 0.82%	2023-06-30	17,635	16,965	670
Finance lease liabilities - Baldi SCI	17,235	25,902	Euribor 3M + 1.00%	2017-09-30	25,597	23,355	2,242
<b>Finance lease liabilities</b>	<b>84,978</b>	<b>127,713</b>			<b>126,502</b>	<b>120,285</b>	<b>6,217</b>
<b>Total mortgage loans and finance lease liabilities</b>	<b>132,478</b>	<b>199,101</b>			<b>197,696</b>	<b>191,064</b>	<b>6,632</b>

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

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

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

The impact of the derecognition of the finance lease amounting to \$605 (400€) was recognized in the condensed interim consolidated statement of earnings for the six-month period ended June 30, 2016.

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 8 – Financial derivatives and hedging activities

##### 2016

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

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

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

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

A summary of the derivative financial instruments held by the REIT is outlined below:

Classification and type	Number of contracts	Period covered		Conversion from/to		Rate	As at June 30, 2016		As at December 31, 2015	
		From	To	Euros or rate	\$ or rate		Total notional amount	Fair value	Total notional amount	Fair value
<b>Derivatives classified for hedge accounting</b>										
Foreign exchange	11	14-Feb-18	14-Dec-18	677	1,000	1.4762	-	-	11,000	(525)
Foreign exchange	16	1-Jan-16	13-Apr-17	486	750	1.5437	-	-	12,000	241
Foreign exchange	34	1-Jul-16	12-Apr-19	669	1,000	1.4941	34,000	589	-	-
Interest rate SWAP	1	1-Jul-16	1-Jul-19	Variable	Fixed	0.685%	77,968	(2,279)	83,270	(1,924)
Interest rate CAP	2	30-Jun-16	5-May-19	Variable	Capped	2.000%	48,804	9	51,099	48
<b>Other derivatives</b>										
Option contracts on foreign exchange										
Put options purchased	16	12-Jan-16	11-Apr-17	167	250	1.4956	-	-	4,000	-
Call options sold	16	12-Jan-16	11-Apr-17	334	500	1.4956	-	-	8,000	-
Put options purchased	9	10-May-17	10-Jan-18	669	1,000	1.4956	-	-	9,000	-
Call options sold	9	10-May-17	10-Jan-18	1,337	2,000	1.4956	-	-	18,000	-
Option contracts on foreign exchange - fair value										
Interest rate SWAP	1	1-Jul-16	23-Dec-21	Variable	Fixed	0.394%	19,184	(614)	(613)	(85)
Interest rate SWAP	1	1-Jul-16	10-Jan-23	Variable	Fixed	0.282%	51,472	(1,362)	-	-
							<b>(3,657)</b>		<b>(3,287)</b>	

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 9 – Exchangeable securities

	Exchangeable securities	
	Number of Exchangeable securities	Carrying amount of Exchangeable securities
<b>Exchangeable securities issued and outstanding</b>		
Balance - December 31, 2014	2,043,347	18,145
Transactions in 2015		
Asset management fees paid in Exchangeable securities	291,551	2,666
Distribution of Exchangeable securities paid in the form of reimbursement of notes		
Conversion of Exchangeable securities into units of the REIT	(264,500)	(2,529)
Net change in fair value of Exchangeable securities	-	1,118
<b>Balance - December 31, 2015</b>	<b>2,070,398</b>	<b>19,400</b>
Transactions in 2016		
Asset management fees paid in Exchangeable securities	165,173	1,608
Distribution of Exchangeable securities paid in the form of reimbursement of notes	296,036	2,943
Conversion of Exchangeable securities into units of the REIT	(420,000)	(3,981)
Net change in fair value of Exchangeable securities	-	1,019
<b>Balance - June 30, 2016</b>	<b>2,111,607</b>	<b>20,989</b>
<b>Exchangeable securities</b>		
	<b>As at June 30, 2016</b>	<b>As at December 31, 2015</b>
Exchangeable securities	20,989	19,400
Less current portion	(2,293)	(1,366)
Non-current portion of Exchangeable securities	<b>18,696</b>	<b>18,034</b>

The Exchangeable securities represent a financial liability and were designated at fair value through profit or loss.

#### Distributions in respect of Exchangeable securities:

The Exchangeable securities entitle the holders to cash distributions from CanCorpEurope S.A., a subsidiary of the Trust, equal, on a per unit basis, to the distributions paid to holders of units by the REIT.

The following table breaks down distribution payments:

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Amount payable at the beginning of the period	495	78	366	35
Declared and recognized in earnings during the period	482	438	934	867
Accrued or paid in cash in the form of interest on interest bearing notes issued by CanCorpEurope S.A.	(211)	(225)	(369)	(455)
Paid in cash in the form of repayment of interest bearing notes issued by CanCorpEurope S.A.	-	(195)	(165)	(351)
<b>Amount payable at the end of the period</b>	<b>766</b>	<b>96</b>	<b>766</b>	<b>96</b>
Weighted average number of Exchangeable securities outstanding	2,405,014	2,114,218	2,254,144	2,079,367
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.0877	0.1987	0.2369	0.3876
Distributions paid per unit (based on three-month/six-month basis)	0.2063	0.2063	0.4125	0.4125

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 10 – Finance costs and finance income

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Interest costs related to mortgage loans	(412)	(208)	(874)	(424)
Interest costs related to finance leases	(719)	(582)	(1,270)	(1,197)
Interest costs related to lease equalization loans	(69)	(45)	(142)	(87)
	(1,200)	(835)	(2,286)	(1,708)
Interest SWAP	(270)	(127)	(468)	(247)
Other finance costs	(24)	(51)	(111)	(73)
	(1,494)	(1,013)	(2,865)	(2,028)
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(48)	(105)	(99)	(214)
Amortization of transaction costs on mortgage loans	(81)	(96)	(175)	(201)
<b>Finance costs</b>	<b>(1,623)</b>	<b>(1,214)</b>	<b>(3,139)</b>	<b>(2,443)</b>
Finance income	2	1	5	4
Finance income from Inovalis relating to the acquisition loan	-	370	1,163	747
Finance income from joint ventures	2,782	453	1,668	813
<b>Finance income</b>	<b>2,784</b>	<b>824</b>	<b>2,836</b>	<b>1,564</b>

#### Note 11 – Earnings per Unit

The REIT has classified the Units that it issued as equity pursuant to the provisions of IAS 32, Financial Instruments: Presentation, on the basis that the Units meet all of the criteria in IAS 32 for such classification, also referred to as the “puttable exemption”.

##### (a) Basic earnings per Unit

Basic earnings per unit is calculated by dividing the profit attributable to the Unitholders of the REIT by the weighted average number of Units outstanding during the period.

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Basic earnings per unit</b>				
Earnings attributable to unitholders	5 839	16 615	8 466	19 680
Weighted average number of units outstanding	15 716 519	15 310 081	15 683 938	15 299 387
<b>Basic earnings per unit</b>	<b>0,37</b>	<b>1,09</b>	<b>0,54</b>	<b>1,29</b>

##### (b) Diluted earnings per Unit

Diluted earnings per unit is calculated by adjusting the weighted average number of Units outstanding to assume conversion of all dilutive potential Units. The REIT has one category of dilutive potential Units: the Exchangeable securities. Refer to Note 9 - Exchangeable securities for the number of Exchangeable securities outstanding.

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 11 – Earnings per Unit (Cont'd)

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Diluted earnings per unit</b>				
Earnings attributable to unitholders	5 839	16 615	8 466	19 680
Distributions recognized on Exchangeable securities	482	438	934	867
Net change in fair value of Exchangeable securities	403	(217)	1 019	335
<b>Earnings attributable to diluted unitholders</b>	<b>6 724</b>	<b>16 836</b>	<b>10 419</b>	<b>20 882</b>
Weighted average number of units outstanding	15 716 519	15 310 081	15 683 938	15 299 387
Weighted average number of Exchangeable securities outstanding	2 405 014	2 114 218	2 254 144	2 079 367
Weighted average number of units used for diluted earnings per unit	18 121 533	17 424 299	17 938 082	17 378 754
<b>Diluted earnings per unit</b>	<b>0,37</b>	<b>0,97</b>	<b>0,54</b>	<b>1,20</b>

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

#### Note 12 – Distributions

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Amount payable at the beginning of the period	1,077	1,052	1,075	1,050
Declared and recognised during the period	3,264	3,158	6,493	6,311
Distributions paid in units (Distribution Reinvestment Plan)	(275)	(199)	(532)	(376)
Distributions paid in cash	(2,959)	(2,958)	(5,929)	(5,932)
<b>Amount payable at the end of the period</b>	<b>1,107</b>	<b>1,053</b>	<b>1,107</b>	<b>1,053</b>
<b>Total distributions</b>	<b>3,264</b>	<b>3,158</b>	<b>6,493</b>	<b>6,311</b>
Distributions paid per unit (based on weighted average number of units outstanding)	0.2058	0.2062	0.4120	0.4123
Distributions paid per unit (based on an annual basis)	0.2063	0.2063	0.4125	0.4125

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

#### Note 13 – Accumulated other comprehensive income

	As at June 30, 2016	As at December 31, 2015
Net unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	2 360	682
Net unrealized losses on interest rate derivatives designated as a cash flow hedge	(2 585)	(2 158)
Cumulative translation adjustment account	11 725	21 401
<b>Accumulated other comprehensive income</b>	<b>11 500</b>	<b>19 925</b>

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 14 – Transactions with related parties

##### Inovalis Asset manager

Pursuant to the Management agreement, Inovalis is the Asset manager of the REIT and provides the strategic, advisory, asset management, project management, construction management, property management and administrative services necessary to manage the operations of the REIT and its subsidiaries.

Unless otherwise stated, none of these transactions incorporated special terms and conditions. Outstanding balances are usually settled in cash, with the exception of management fees to Inovalis that are settled quarterly through the issuance of Exchangeable securities. No guarantees were given.

Inovalis and its subsidiaries	Financial statement line item	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Revenues</b>			
Rental income	Rental income	242	478
Service charge income	Service charge income	(282) <sup>(2)</sup>	354
Other revenue <sup>(1)</sup>	Other revenue	42	1 240
Interest income from acquisition loan	Finance income	1 158	747
		1 160	2 819
<b>Expenses</b>			
Asset management fees	Administration expenses	(1 608)	(1 243)
less portion invoiced to joint-ventures	Administration expenses	216	205
Facilities management fees	Service charge expenses	(1 484)	(1 696)
Property management Fees	Service charge expenses	(554)	(426)
Letting fees invoiced	Service charge expenses	(180)	(138)
less portion accounted for over the lease term	Service charge expenses	148	125
Reimbursement of travel expenses	Acquisition costs	(88)	-
Interest expense on lease equalization loans	Finance costs	(142)	(87)
Other finance costs	Finance costs	-	(3)
Reimbursement of travel expenses	Administration expenses	(190)	(190)
Trustee fees	Administration expenses	(139)	(113)
		(4 021)	(3 565)
<b>Exchangeable securities</b>			
Interest on notes	Distributions recognized on Exchangeable securities	(369)	(455)
Reimbursement of debt		(165)	(351)
Acquisition costs	Acquisition costs	-	51
Total distributions on Exchangeable securities		(534)	(755)

<sup>(1)</sup> : For the six-month period ended June 30, 2015, recovery of an amount paid for anticipated repairs that are no longer required.

<sup>(2)</sup> : Correspond to a 2013 charge adjustment on the BBA (Vanves) and Véronèse investment properties.

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

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

	Due to (from) Inovalis	
	As at June 30, 2016	As at December 31, 2015
Trade and other receivables	(434)	(1,200)
Trade and other payables	2,739	2,732
Acquisition loan	-	(18,786)
Distributions payable	766	366
Lease equalization loans	5,974	6,425
	<u>9,045</u>	<u>(10,463)</u>

#### Joint ventures

The transactions and balances with entities accounted for using the equity method are summarized below:

Joint ventures	Financial statement line item	For the six months ended June 30, 2016	For the six months ended June 30, 2015
Management fees invoiced to joint ventures	Administration expenses	(216)	(205)
Earnings from joint ventures	Share of net earnings from investments accounted for using the equity method	(358)	121
Finance income	Finance income	1,668	813
		<u>1,094</u>	<u>729</u>

		Due from joint ventures	
		As at June 30, 2016	As at December 31, 2015
Loan receivable	Investments accounted for using the equity method	38,272	33,500
Accounts receivable	Trade and other receivables	294	428
		<u>38,566</u>	<u>33,928</u>

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 15 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended June 30, 2016	For the three months ended June 30, 2015
France	5,438	1,240	6,678	6,504
Germany	528	18	546	516
<b>Total revenue</b>	<b>5,966</b>	<b>1,258</b>	<b>7,224</b>	<b>7,020</b>

Total revenue by geographic region	Rental Income	Service Charge Income	For the six months ended June 30, 2016	For the six months ended June 30, 2015
France	10,471	2,784	13,255	13,229
Germany	1,055	34	1,089	1,019
	<b>11,526</b>	<b>2,818</b>	<b>14,344</b>	<b>14,248</b>

Investment properties, investments in joint ventures and provision relating to investments in joint ventures by geographic region	As at June 30, 2016	As at December 31, 2015
France	397,299	334,385
Germany	64,002	60,731
	<b>461,301</b>	<b>395,116</b>

#### Note 16 – Fair value measurements

##### Fair value hierarchy

The following table shows an analysis of the fair values of financial instruments (including Exchangeable securities) and non-financial assets measured at fair value on a recurring basis recognized on the consolidated balance sheet by level of the fair value hierarchy:

	As at June 30, 2016			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	417,925	417,925
Derivative financial instruments - assets	-	598	-	598
Derivative financial instruments - liabilities	-	(4,255)	-	(4,255)
Exchangeable securities	-	(20,989)	-	(20,989)
	As at December 31, 2015			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	355,704	355,704
Derivative financial instruments - assets	-	289	-	289
Derivative financial instruments - liabilities	-	(3,576)	-	(3,576)
Exchangeable securities	-	(19,400)	-	(19,400)

## **INOVALIS REIT**

### **Notes to the Condensed Interim Consolidated Financial Statements**

Three-month and six-month periods ended June 30, 2016

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

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#### **Note 16 – Fair value measurements (Cont'd)**

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2 - use of a model with inputs (other than quoted prices included in level 1) that are directly or indirectly observable market data.
- Level 3 - use of a model with inputs that are not based on observable market data.

There were no transfers between Level 1 and Level 2 during the period ended June 30, 2016 (none in 2015).

The REIT's management is responsible for determining fair value measurements included in the condensed interim consolidated financial statements, including Level 3 fair values. The inputs, processes and results for recurring measurements, including those valuations calculated by an independent appraiser every semester, are reviewed each quarter by senior management to ensure conformity with IFRS.

The reconciliation of the carrying amounts of non-financial assets classified within Level 3 is in Note 5 – Investment properties. The gains or losses relating to the investment properties are recognized in profit or loss on the income statement line entitled "Net change in fair value of investment properties". The entire amount of the gain or loss reported on this line in the reporting period is unrealized.

The following methods and assumptions were used to estimate the above-mentioned fair values:

- The fair value of derivative financial instruments is determined based on discounted cash flows using interest rate yield curves and volatilities that are observable on an active market, as at the balance sheet date.
- The fair value of the Exchangeable securities is based on the quoted price of the REIT's own units, on the basis that they are exchangeable on a one for one basis throughout their life at the request of the unit holders, and upon maturity of the underlying notes, at the request of the REIT. Other features of the Exchangeable securities have no significant impact on their fair value.

## INOVALIS REIT

### Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2016

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

#### Note 17 – Cash flow information

	For the three months ended June 30, 2016	For the three months ended June 30, 2015	For the six months ended June 30, 2016	For the six months ended June 30, 2015
<b>Adjustments for non-cash items and other reconciling items:</b>				
Rent free period	(100)	(750)	223	(1 413)
Management fees paid in Exchangeable securities	890	602	1 608	1 243
less portion reinvoiced to joint-ventures	(16)	(77)	(159)	(205)
Net change in fair value of investment properties	(3 551)	(11 416)	(644)	(13 166)
(Gain) loss on financial instruments at fair value through profit or loss	2 093	123	2 237	(379)
Loss on refinancing of a debt	-	-	605	-
Distributions on Exchangeable securities	482	438	934	867
Net change in fair value of Exchangeable securities	403	(217)	1 019	335
Loss on refinancing of a debt	-	-	-	-
Finance income	(1 684)	(824)	(2 850)	(1 564)
Finance costs	509	1 215	3 139	2 444
Income taxes paid	(22)	-	(108)	(8)
Loss recognized on exercise of early payment option on finance leases	(678)	-	1 242	-
Option cost related to the acquisition of the Metropolitan property (adjustment of fair value)	664	-	(9 213)	-
Other items	19	-	34	-
Share of net earnings from investment accounted for using the equity method	153	(131)	358	(121)
Unrealized exchange (gains) losses	2	67	(37)	(90)
Cash items classified as operating activities				
Interest received	467	563	953	926
Interest paid	(924)	(670)	(1 791)	(1 685)
Acquisition costs classified in investing activities	30	-	689	-
	<u>(1 263)</u>	<u>(11 077)</u>	<u>(1 761)</u>	<u>(12 816)</u>
<b>Working capital adjustments</b>				
(Increase) decrease in trade and other receivables	529	(422)	(687)	(3 092)
Increase (decrease) in tenant deposits	134	(62)	251	(65)
Increase (decrease) in trade and other payables	186	(112)	4 736	3 120
Other	(18)	-	-	-
	<u>831</u>	<u>(596)</u>	<u>4 300</u>	<u>(37)</u>

#### Note 18 – Subsequent events

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

The REIT intends to use the net proceeds from the sale of the Units as an available source of funding for potential future acquisitions of office properties located in France and Germany and for potential capital expenditures relating to the re-positioning and/or re-development of currently owned properties. Until utilized for these purposes, the REIT intends to repay existing outstanding indebtedness in the amount of approximately \$24.7 million, as well as for working capital and general trust purposes, including potential acquisitions, none of which have been identified at this time.

## **Corporate information**

### **Head office**

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### **Investor relations**

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E-mail: [info@inovalis.com](mailto:info@inovalis.com)  
Website: [www.inovalisreit.com](http://www.inovalisreit.com)

### **Stock exchange listing**

The Toronto Stock Exchange  
Listing symbol: INO.UN

### **Distribution Reinvestment Plan**

Inovalis has implemented a Distribution Reinvestment Plan (“**DRIP**”). By participating in the Plan, Unitholders have cash distributions from Inovalis REIT reinvested in additional Units as and when cash distributions are made with a “bonus” distribution of Units equal to 3% of the amount of the cash distribution reinvested pursuant to the Plan.

# INOVALIS

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REAL ESTATE **INVESTMENT TRUST**

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