

INOVALIS REIT 2015 First Quarter Report

**INOVALIS REIT
CONDENSED INTERIM CONSOLIDATED FINANCIAL
STATEMENTS (unaudited)
Three-month period ended March 31, 2015**


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 Company.

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

Assets	Note	As at March 31, 2015	As at December 31, 2014
Non-current assets			
Investment properties	4	301,949	308,596
Investment accounted for using the equity method	5	17,830	18,307
Acquisition loan		17,029	17,548
Derivative financial instruments	6	1,483	875
Restricted cash and other financial assets		1,494	309
Total non-current assets		339,785	345,635
Current assets			
Trade and other receivables		3,407	2,852
Derivative financial instruments	6	1,257	761
Other current assets		3,114	731
Restricted cash		356	291
Cash and cash equivalents		19,493	24,185
Total current assets		27,627	28,820
Total assets		367,412	374,455
Liabilities and Unitholders' equity			
Liabilities	Note	As at March 31, 2015	As at December 31, 2014
Non-current liabilities			
Mortgage loans		45,856	47,150
Finance lease liabilities		125,313	130,680
Lease equalization loans		3,128	3,101
Tenant deposits		1,582	1,626
Exchangeable securities	7	17,490	16,663
Derivative financial instruments	6	1,298	1,077
Deferred tax liabilities		948	949
Total non-current liabilities		195,615	201,246
Current liabilities			
Finance lease liabilities		6,644	6,991
Lease equalization loans		399	248
Tenant deposits		369	380
Exchangeable securities	7	1,848	1,482
Derivative financial instruments	6	504	605
Trade and other payables		7,766	5,653
Other current liabilities		1,202	233
Total current liabilities		18,732	15,592
Total liabilities		214,347	216,838
Unitholders' equity			
Trust units		133,188	133,010
Retained earnings		17,202	17,291
Accumulated other comprehensive income	11	2,675	7,316
Total Unitholders' equity		153,065	157,617
Total liabilities and Unitholders' equity		367,412	374,455

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 Statement of Earnings

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

	<i>Note</i>	For the three months ended March 31, 2015	For the three months ended 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)
Net rental earnings		3,189	3,112
Administration expenses		(1,000)	(1,029)
Foreign exchange gain		9	38
Net change in fair value of investment properties		1,750	1,136
Business acquisition costs		-	(52)
Operating earnings		3,948	3,205
Gain (loss) on financial instruments at fair value through profit or loss		633	(741)
Share of the profit of an investment accounted for using the equity method		170	-
Finance income	8	560	7
Finance costs	8	(1,229)	(868)
Distributions on Exchangeable securities	7	(429)	(286)
Net change in fair value of Exchangeable securities	7	(552)	(1,398)
Earnings before income tax		3,101	(81)
Income tax expense		(36)	(14)
Earnings for the period		3,065	(95)
Earnings per unit attributable to unit holders:			
Basic and diluted earnings per unit	9	0.20	(0.01)

See accompanying notes to condensed interim consolidated financial statements

Interim Consolidated Statement of Comprehensive Income (loss)

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

	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Earnings for the period	3,065	(95)
Other comprehensive income		
Derivatives designated as a hedge of the net investment in a foreign entity		
Net gains	650	-
Derivatives designated as cash flow hedges		
Net losses	(128)	-
Reclassification of net gains to earnings	24	-
Change in cumulative translation adjustment account	(5,187)	5,262
Total other comprehensive (loss) income	(4,641)	5,262
Total comprehensive (loss) income for the period	(1,576)	5,167

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Interim Consolidated Statement of changes in Unitholders' Equity

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

	Note	Number of Units issued and outstanding	Trust Units	Retained earnings	Accumulated other comprehensive income	Total
As at December 31, 2014		15,278,536	133,010	17,291	7,316	157,617
Distributions earned by Unitholders	10	-	-	(3,154)	-	(3,154)
Distributions Reinvestment Plan	10	20,343	178	-	-	178
Transactions with owners		<u>20,343</u>	<u>178</u>	<u>(3,154)</u>	<u>-</u>	<u>(2,976)</u>
Earnings for the period		-	-	3,065	-	3,065
Other comprehensive loss					(4,641)	(4,641)
As at March 31, 2015		<u>15,298,879</u>	<u>133,188</u>	<u>17,202</u>	<u>2,675</u>	<u>153,065</u>
As at December 31, 2013		11,285,087	98,719	10,610	13,671	123,000
Distributions earned by Unitholders	10	-	-	(2,328)	-	(2,328)
Distributions Reinvestment Plan	10	3,455	30	-	-	30
Transactions with owners		<u>3,455</u>	<u>30</u>	<u>(2,328)</u>	<u>-</u>	<u>(2,298)</u>
Earnings for the period				(95)		(95)
Other comprehensive income					5,262	5,262
As at March 31, 2014		<u>11,288,542</u>	<u>98,749</u>	<u>8,187</u>	<u>18,933</u>	<u>125,869</u>

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Interim Consolidated Statement of Cash Flows

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

	<i>Note</i>	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Operating activities			
Earnings before income taxes for the period		3,101	(81)
Adjustments for non-cash items and other reconciling items	15	(1,740)	1,662
		<u>1,361</u>	<u>1,581</u>
Working capital adjustments	15	559	2,969
		<u>1,920</u>	<u>4,550</u>
Investing activities			
Deposit (participation in a joint venture)		(1,150)	-
Additions to investment properties	4	(123)	-
Net change in other financial assets		(100)	(270)
Settlement of derivative financial instruments		253	(299)
		<u>(1,120)</u>	<u>(569)</u>
Financing activities			
Exchangeable securities issued during the period		(230)	(151)
Distributions on Units paid in cash	10	(2,974)	(2,298)
Distributions on Exchangeable securities paid in the form of repayment of interest bearing notes issued by a subsidiary	7	(156)	(365)
Regular repayment of finance lease liabilities		(1,753)	(1,971)
Lease equalization loan		240	485
		<u>(4,873)</u>	<u>(4,300)</u>
Net decrease in cash and cash equivalents			
		(4,073)	(319)
Effects of foreign exchange adjustments on cash and cash equivalent		(619)	258
Cash and cash equivalents at the beginning of the period			
		24,185	6,120
Cash and cash equivalents at the end of the period			
		<u>19,493</u>	<u>6,059</u>
Cash and cash equivalents at the end of the period			
Cash		19,265	6,059
Cash equivalents		228	-
		<u>19,493</u>	<u>6,059</u>

See accompanying notes to condensed interim consolidated financial statements

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

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 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 period ended March 31, 2015, were authorized for issuance by the Board of Trustees on May 13, 2015.

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 12 – 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 2014 audited consolidated annual financial statements.

Basis of presentation

The unaudited condensed interim consolidated financial statements are prepared on a going concern basis and have been presented in Canadian dollars for reporting to the REIT’s Unitholders. 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, 2014.

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, 2014.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 4 – Investment properties

	For the three months ended March 31, 2015	For the year ended December 31, 2014
Investment properties		
Beginning of period	308,596	244,900
Additions, net of reimbursements	53	-
Capitalized letting fees	70	-
Acquisitions through business combinations	-	65,142
Amount derecognized upon exercise of early purchase option on lease	-	(122,420)
Amount recognized upon entry into new sales-leaseback arrangement	-	122,420
Transaction and transfer fees related to new sales-leaseback arrangement	-	2,633
Rent free period	663	1,997
Net change in fair value of investment properties	1,750	5,248
Foreign currency translation adjustment	(9,183)	(11,324)
End of period	301,949	308,596

Note 5 – Investment accounted for using the equity method

Outlined below is a breakdown of the carrying amounts of the components of the investment in the CanCorp Duisburg (“CCD”) joint venture:

	For the three months ended March 31, 2015	For the year ended December 31, 2014
Carrying amount of investment in a joint venture		
Balance at the beginning of the period	18,307	-
Net change in equity investment in joint venture	(115)	3,668
Net change in interest-bearing loan to joint venture	(362)	14,639
Balance at the end of the period	<u>17,830</u>	<u>18,307</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 5 – Investment accounted for using the equity method (continued)

Summarized financial information regarding CCD	As at March 31, 2015	As at December 31, 2014
Balance Sheet		
Investment property	68,796	70,892
Deferred tax asset	208	164
Cash and cash equivalents	2,012	1,948
Other current assets	-	364
Total assets	<u>71,016</u>	<u>73,368</u>
Non-current financial liabilities	61,489	62,953
Current liabilities	766	1,558
Deferred tax liability	1,631	1,612
Total liabilities	<u>63,886</u>	<u>66,123</u>
Equity	7,130	7,245
Total liabilities and equity	<u>71,016</u>	<u>73,368</u>

Summarized financial information regarding CCD	For the three months ended March 31, 2015
Income statement	
Net rental income	1,084
Operating profit	953
Finance costs	(948)
Earnings from continuing operations	5
Current income tax expense	(4)
Deferred income tax expense	(20)
Earnings for the period	(19)
Other comprehensive loss	(96)
Total comprehensive income loss	<u>(115)</u>
Pro rata share of post-acquisition earnings recognized in the Consolidated financial statements	
50% pro rata share of earnings for the period	(10)
Add interest earned from loan to CCD	180
End of the period	<u>170</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 6 – Financial derivatives and hedging activities

During the period, the REIT entered into a series of 36 option contracts whereby it purchased put options and sold call options, both in Euros. These new option contracts cover monthly periods up to and including January 10, 2018. Put options purchased and call options sold have the same strike price. These contracts are not designated as part of a hedging relationship. Accordingly, they are classified 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			As at March 31, 2015		As at December 31, 2014		
		From	To	Euros or rate	\$ or rate	Rate	Total notional amount	Fair value	Total notional amount	Fair value	
Derivatives classified for hedge accounting											
Foreign exchange	25	1-Apr-15	13-Apr-17	486	750	1.54374	18,750	1,999	-	-	
Foreign exchange	28	1-Jan-15	13-Apr-17	486	750	1.54374	-	-	21,000	1,567	
Interest rate SWAP	1	1-Apr-15	1-Jul-19	Variable	Fixed	0.685%	78,357	(1,802)	82,181	(1,682)	
Interest rate CAP	2	29-Mar-14	5-May-19	Variable	Capped	2.000%	46,318	112	47,729	69	
Other derivatives											
Option contracts on foreign exchange											
Put options purchased	25	10-Apr-15	11-Apr-17	167	250	1.4956	6,250				
Call options sold	25	10-Apr-15	11-Apr-17	334	500	1.4956	12,500				
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								629		-	
								938		(46)	

Note 7 – Exchangeable securities

Exchangeable securities issued and outstanding	Number of Exchangeable securities	Carrying amount of Exchangeable securities
Balance - December 31, 2013	1,388,685	12,234
Transactions in 2014		
Asset management fees paid in Exchangeable securities	200,896	1,907
Share offering 2014	453,766	4,111
Net change in fair value of Exchangeable securities		(107)
Balance - December 31, 2014	2,043,347	18,145
Transactions in 2015		
Asset management fees paid in Exchangeable securities	70,147	641
Net change in fair value of Exchangeable securities	-	552
Balance - March 31, 2015	2,113,494	19,338

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 7 – Exchangeable securities (continued)

Exchangeable securities	As at March 31, 2015	As at December 31, 2014
Exchangeable securities	19,338	18,145
Less current portion	<u>(1,848)</u>	<u>(1,482)</u>
Non-current portion of Exchangeable securities	<u>17,490</u>	<u>16,663</u>

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. 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 March 31, 2015	For the three months ended March 31, 2014
Amount payable at the beginning of the period	35	213
Declared and recognized in earnings during the period	429	286
Accrued or paid in cash in the form of interest on interest bearing notes issued by CanCorpEurope S.A.	(230)	(151)
Paid in cash in the form of repayment of interest bearing notes issued by CanCorpEurope S.A.	<u>(156)</u>	<u>(365)</u>
Amount payable at the end of the period	<u>78</u>	<u>(17)</u>
Weighted average number of Exchangeable securities outstanding	2,044,126	1,389,211
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.1888	0.3714
Distributions paid per unit (based on quarterly basis)	0.2063	0.2063

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 8 – Finance costs and finance income

	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Interest costs on mortgage loans	(216)	-
Interest costs related to finance leases	(615)	(447)
Interest costs related to lease equalization loans	(42)	-
	<u>(873)</u>	<u>(447)</u>
Interest SWAP	(120)	-
Other finance costs	(22)	(25)
	<u>(1,015)</u>	<u>(472)</u>
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(109)	(396)
Amortization of transaction costs on mortgage loans	(105)	-
	<u>(1,229)</u>	<u>(868)</u>
Finance costs		
Finance income	3	7
Finance income from Inovalis	377	-
Finance income from CCD	180	-
	<u>560</u>	<u>7</u>
Finance income		
Net Finance costs	<u>(669)</u>	<u>(861)</u>

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 9 – 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 March 31, 2015	For the three months ended March 31, 2014
Basic earnings per Unit		
Net earnings attributable to unitholders	3,065	(95)
Weighted average number of units outstanding	15,288,573	11,286,496
Basic earnings per unit	0.20	(0.01)

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

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

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 10 – Distributions

	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Amount payable at the beginning of the year	1,050	776
Declared and recognised during the period	3,154	2,328
Distributions paid in units (Distribution Reinvestment Plan)	(178)	(30)
Paid in cash	(2,974)	(2,298)
Amount payable at the end of the year	1,052	776
Total distributions	3,154	2,328
Distributions paid per unit (based on weighted average number of units outstanding)	0.2062	0.2063

Distributions in respect of Exchangeable securities are detailed in Note 7 – Exchangeable securities.

Note 11 – Accumulated other comprehensive income

	As at March 31, 2015	As at December 31, 2014
Net changes in unrealized gains on derivatives designated as a hedge of the net investment in a foreign entity	2,592	1,942
Net changes in unrealized losses on interest rate derivatives designated as a cash flow hedge	(2,219)	(2,115)
Cumulative translation adjustment account	2,302	7,489
Accumulated other comprehensive income	2,675	7,316

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 12 – Transactions with related parties

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 that are settled quarterly through the issue of Exchangeable securities. No guarantees were given.

Related parties (Inovalis and its subsidiaries)	Financial statement line item	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Revenues and expenses			
Rental income	Rental income	282	-
Service charge income	Service charge income	219	-
Asset management fees	Administration expenses	(513)	(455)
Facilities management fees	Service charge expenses	(833)	(411)
Property management Fees	Service charge expenses	(142)	(169)
Interest on lease equalization loan	Finance costs	(42)	(23)
Other finance costs and standby credit facility	Finance costs	-	(12)
Interest income from Inovalis	Finance income	377	-
Reimbursement of travel expenses	Administration expenses	(70)	-
		(722)	(1,070)
Reimbursement of disbursements paid to third parties on behalf of the REIT			
Interest on notes	Distributions recognized on Exchangeable securities	(230)	(151)
Reimbursement of debt		(156)	(365)
Total distributions on Exchangeable securities recognized in earnings		(386)	(516)
Due to (from) Inovalis			
		As at March 31, 2015	As at December 31, 2014
Trade and other receivables		(966)	(637)
Trade and other payables		1,663	1,767
Acquisition loan		(17,029)	(17,548)
Distributions payable		78	35
Lease equalization loans		3,527	3,349
		(12,727)	(13,034)

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 12 – Transactions with related parties (continued)

CCD

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

Related parties (CCD)	Income statement line item	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Asset management fees rebilled to CCD	Administration expenses	(128)	-
Interest revenues	Finance income	(180)	-
		(308)	-
Due from (to) CCD			
		As at March 31, 2015	As at December 31, 2014
Investment in associate	Investment accounted for using the equity method	3,553	3,668
Loan receivable	Investment accounted for using the equity method	14,277	14,639
Accounts receivable	Trade and other receivables	114	62
		17,944	18,369

Note 13 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended March 31, 2015	For the three months ended March 31, 2014
France	4,786	1,708	6,494	5,438
Germany	497	21	518	556
	5,283	1,729	7,012	5,994

Investment properties and investments in joint venture by geographic region	As at March 31, 2015	December 31, 2014
France	269,387	275,045
Germany	50,392	51,858
	319,779	326,903

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 14 – Fair value measurements

The following table provides a comparison of the carrying amounts and fair value of the REIT's finance leases and financial assets and liabilities that are not carried at fair value in the consolidated financial statements and for which the carrying values are not reasonable approximations of their fair value.

As at March 31, 2015	Fair value hierarchy level	Carrying amount	Fair value
Financial assets			
Acquisition loan	2	17,029	17,029
Financial liabilities			
Mortgage loans	2	45,856	45,856
Finance leases	2	131,957	131,313
Lease equalization loans	3	3,527	3,527
Tenant deposits	3	1,951	1,951

As at December 31, 2014	Fair value hierarchy level	Carrying amount	Fair value
Financial assets			
Acquisition loan	2	17,548	17,548
Financial liabilities			
Mortgage loans	2	47,150	47,150
Finance leases	2	137,671	136,341
Lease equalization loans	3	3,349	3,351
Tenant deposits	3	2,006	1,991

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

- The fair value of the Acquisition loan is estimated using the nominal amounts expected to be received at maturity and a discount rate based on prevailing market interest rates adjusted by an internally determined credit spread.
- The fair value of floating rate finance lease liabilities is estimated by discounting future cash flows using rates currently available for debt with similar terms and remaining maturities. The fair value approximates their carrying values gross of unamortized transaction costs only if the credit spread has not changed significantly.
- The fair values of the finance leases, the lease equalization loans and the tenant deposits are estimated using the nominal amounts expected to be repaid at maturity and a discount rate based on prevailing market interest rates adjusted by an internally determined credit spread.

INOVALIS REIT

Notes to the Condensed Interim Consolidated Financial Statements

Three-month period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 14 – Fair value measurements (continued)

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 March 31, 2015			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	301,949	301,949
Derivative financial instruments - assets	-	2,740	-	2,740
Derivative financial instruments - liabilities	-	(1,802)	-	(1,802)
Exchangeable securities	-	(19,338)	-	(19,338)

	As at December 31, 2014			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	308,596	308,596
Derivative financial instruments - assets	-	1,636	-	1,636
Derivative financial instruments - liabilities	-	(1,682)	-	(1,682)
Exchangeable securities	-	(18,145)	-	(18,145)

- 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 March 31, 2015 (none in 2014).

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

The reconciliation of the carrying amounts of non-financial assets classified within Level 3 is in Note 4 – Investment properties. The gains or losses relating to the investment properties are recognized in profit or loss on the income statement line entitled "Net change in fair value of investment properties". The entire amount of the gain or loss reported on this line in the reporting period is unrealized.

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 period ended March 31, 2015

(Unaudited - All dollar amounts are in thousands of Canadian dollars, except unit or per unit amounts)

Note 15 – Cash flow information

	For the three months ended March 31, 2015	For the three months ended March 31, 2014
Adjustments for non-cash items and other reconciling items:		
Rent free period	(663)	(485)
Management fees paid in Exchangeable securities	513	455
Net change in fair value of investment properties	(1,750)	(1,136)
(Gain) loss on financial instruments at fair value through profit or loss	(633)	741
Distributions on Exchangeable securities	429	286
Net change in fair value of Exchangeable securities	552	1,398
Finance income	(560)	-
Interest expense	1,229	843
Income taxes paid	(8)	(5)
Share of the profit of an investment accounted for using the equity method	(170)	-
Unrealized exchange gains	(27)	12
Interest received	363	-
Interest paid	(1,015)	(447)
	<u>(1,740)</u>	<u>1,662</u>
Working capital adjustments		
Increase in trade and other receivables	(2,670)	(1,868)
(Increase) decrease in tenant deposits	(3)	95
Increase in trade and other payables	3,232	4,742
	<u>559</u>	<u>2,969</u>

Note 16 – Subsequent events

Subsequent to the end of the period, on April 8th 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.

Corporate information

Head office

Inovalis REIT
151 Yonge Street, 11th floor
Toronto, Ontario, M5C 2W7
Phone: (647) 775-8431
Fax: (647) 775-8301

Investor relations

Phone: (647) 775-8432
E-mail: info@inovalis.com
Website: 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

REAL ESTATE INVESTMENT TRUST

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151 Yonge Street, 11th floor
Toronto, Ontario, M5C 2W7
www.inovalisreit.com