

INOVALIS REIT 2015 Second Quarter Report

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

Three-month and six-month periods ended June 30, 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	<i>Note</i>	As at June 30, 2015	As at December 31, 2014
Non-current assets			
Investment properties	4	320,713	308,596
Investment accounted for using the equity method	5	36,756	18,307
Acquisition loan		17,389	17,548
Derivative financial instruments	6	881	875
Restricted cash and other financial assets		313	309
Total non-current assets		376,052	345,635
Current assets			
Trade and other receivables		4,354	2,852
Derivative financial instruments	6	1,005	761
Other current assets		1,296	731
Restricted cash		387	291
Cash and cash equivalents		4,500	24,185
Total current assets		11,542	28,820
Total assets		387,594	374,455
Liabilities and Unitholders' equity			
Liabilities	<i>Note</i>	As at June 30, 2015	As at December 31, 2014
Non-current liabilities			
Mortgage loans		46,926	47,150
Finance lease liabilities		126,380	130,680
Lease equalization loans		4,258	3,101
Tenant deposits		1,622	1,626
Exchangeable securities	7	17,597	16,663
Derivative financial instruments	6	883	1,077
Deferred tax liabilities		996	949
Total non-current liabilities		198,662	201,246
Current liabilities			
Finance lease liabilities		7,104	6,991
Lease equalization loans		677	248
Tenant deposits		291	380
Exchangeable securities	7	2,126	1,482
Derivative financial instruments	6	455	605
Trade and other payables		6,421	5,653
Other current liabilities		1,218	233
Total current liabilities		18,292	15,592
Total liabilities		216,954	216,838
Unitholders' equity			
Trust units		133,386	133,010
Retained earnings		30,660	17,291
Accumulated other comprehensive income	11	6,594	7,316
Total Unitholders' equity		170,640	157,617
Total liabilities and Unitholders' equity		387,594	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)

	Note	For the three months ended June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Rental income		5,306	4,658	10,589	9,545
Service charge income		1,930	1,115	3,659	2,222
Service charge expenses		(1,334)	(786)	(5,144)	(3,645)
Other revenues	12	1,240	-	1,240	-
Other property operating (expenses) revenues		(26)	52	(47)	29
Net rental earnings		7,116	5,039	10,297	8,151
Administration expenses		(1,125)	(837)	(2,117)	(1,866)
Foreign exchange (loss) gain		(56)	(19)	84	19
Net change in fair value of investment properties		11,416	(1,693)	13,166	(556)
Business acquisition costs		(54)	(361)	(54)	(413)
Operating earnings		17,297	2,129	21,376	5,335
Gain (loss) on financial instruments at fair value through profit or loss		(123)	30	379	(710)
Share of earnings from investments accounted for using the equity method	5	131	-	121	-
Loss recognized on exercise of early payment option on finance leases		-	(7,972)	-	(7,972)
Finance income	8	824	8	1,564	15
Finance costs	8	(1,214)	(855)	(2,443)	(1,719)
Distributions on Exchangeable securities	7	(438)	(297)	(867)	(584)
Net change in fair value of Exchangeable securities	7	217	73	(335)	(1,325)
Earnings before income taxes		16,694	(6,884)	19,795	(6,960)
Current income tax expense		(5)	(3)	(8)	(7)
Deferred income tax expense		(74)	(10)	(107)	(20)
Earnings for the period		16,615	(6,897)	19,680	(6,987)
Earnings per unit attributable to unit holders:	9				
Basic earnings per unit		1.09	(0.61)	1.29	(0.62)
Diluted earnings per unit		0.97	(0.61)	1.20	(0.62)

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 June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Earnings for the period	16,615	(6,897)	19,680	(6,987)
Other comprehensive income (loss)				
Derivatives designated as a hedge of the net investment in a foreign entity				
Net gains (losses)	(280)	989	370	989
Derivatives designated as cash flow hedges				
Net gains (losses)	528	(1,001)	400	(1,001)
Reclassification of net losses to earnings	21	-	45	-
Change in cumulative translation adjustment account	3,650	(5,368)	(1,537)	(106)
Total other comprehensive income (loss)	3,919	(5,380)	(722)	(118)
Total comprehensive income (loss) for the period	20,534	(12,277)	18,958	(7,105)

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	-	-	(6,311)	-	(6,311)
Distributions reinvestment Plan	10	42,908	376	-	-	376
Transactions with owners		<u>42,908</u>	<u>376</u>	<u>(6,311)</u>	<u>-</u>	<u>(5,935)</u>
Earnings for the period		-	-	19,680	-	19,680
Other comprehensive loss		-	-	-	(722)	(722)
As at June 30, 2015		<u>15,321,444</u>	<u>133,386</u>	<u>30,660</u>	<u>6,594</u>	<u>170,640</u>
As at December 31, 2013		11,285,087	98,719	10,610	13,671	123,000
Distributions earned by Unitholders	10	-	-	(4,657)	-	(4,657)
Distributions reinvestment Plan	10	7,141	65	-	-	65
Issue costs		-	(34)	-	-	(34)
Transactions with owners		<u>7,141</u>	<u>31</u>	<u>(4,657)</u>	<u>-</u>	<u>(4,626)</u>
Earnings for the period		-	-	(6,987)	-	(6,987)
Other comprehensive loss		-	-	-	(118)	(118)
As at June 30, 2014		<u>11,292,228</u>	<u>98,750</u>	<u>(1,034)</u>	<u>13,553</u>	<u>111,269</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)

	Note	For the three months ended June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Operating activities					
Earnings before income taxes		16,694	(6,884)	19,795	(6,960)
Adjustments for non-cash items and other reconciling items	15	(11,077)	9,942	(12,816)	11,603
		5,617	3,058	6,979	4,643
Working capital adjustments	15	(596)	8,952	(37)	11,927
Net cash flows related to operating activities		5,021	12,010	6,942	16,570
Investing activities					
Investment in a joint-Venture - Walpur Four	5	(3,993)	-	(5,143)	-
Investment in a joint-venture - Arcueil	5	(13,915)	-	(13,915)	-
Additions to investment properties	4	(115)	(60)	(238)	(60)
Loan repayments received from joint ventures		845	-	845	-
Net changes in other financial assets		-	2,973	(100)	2,703
Settlement of derivative financial instruments		338	(2,825)	591	(3,123)
Net cash flows related to investing activities		(16,840)	88	(17,960)	(480)
Financing activities					
Unit issue costs		-	(34)	-	(34)
Distributions on Units paid in cash	10	(2,958)	(2,294)	(5,932)	(4,592)
Distributions on exchangeable securities paid in the form of interest on notes issued by a subsidiary	7	(225)	(144)	(455)	(296)
Distributions on Exchangeable securities paid in the form of repayment of interest bearing notes issued by a subsidiary	7	(195)	(111)	(351)	(476)
Proceeds from new mortgage loans, net of transaction costs		-	50,838	-	50,838
Proceeds from new sale-leaseback, net of initial down payment		-	85,708	-	85,708
Transaction fees related to new lease		-	(2,633)	-	(2,633)
Repayment of lease liability upon exercise of early payment option		-	(100,095)	-	(100,095)
Regular repayment of finance lease liabilities		(1,373)	(1,086)	(3,126)	(3,057)
Purchase of derivative financial instrument		-	(529)	-	(529)
- CAP on mortgage loan interest		-	(529)	-	(529)
Lease equalization loan		1,361	483	1,601	967
Net cash flows related to financing activities		(3,390)	30,103	(8,263)	25,801
Net increase (decrease) in cash and cash equivalents		(15,209)	42,201	(19,281)	41,891
Effects of foreign exchange adjustments on cash and cash equivalent		216	(294)	(404)	(237)
Cash and cash equivalents at the beginning of the period		19,493	5,867	24,185	6,120
Cash and cash equivalents at the end of the period		4,500	47,774	4,500	47,774
Cash and cash equivalents at the end of the period					
Cash		4,500	47,530	4,500	47,530
Cash equivalents		-	244	-	244
		4,500	47,774	4,500	47,774

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, 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 and six-month periods ended June 30, 2015, were authorized for issuance by the Board of Trustees on August 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. 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.

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 4 – Investment properties

Investment properties	For the six months ended June 30, 2015	For the year ended December 31, 2014
Beginning of period	308,596	244,900
Additions, net of reimbursements	113	-
Capitalized letting fees	125	-
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	1,413	1,997
Net change in fair value of investment properties	13,116	5,248
Foreign currency translation adjustment	(2,650)	(11,324)
End of period	320,713	308,596

Note 5 – Investment accounted for using the equity method

Walpur

On April 8, 2015, the REIT purchased a 50% interest in Walpur Four SARL (“Walpur”), a joint venture which owns an office property located in Germany, for a total consideration of 3,832 Euros (\$5,143). This consideration is composed of a cash consideration paid of 332 Euros (\$445) for the equity interest and a 8.75% interest-bearing loan of 3,500 Euros (\$4,698), repayable the date the Joint Venture Agreement terminates.

Arcueil

At the end of June 2015, in contemplation of the acquisition described in subsequent events (note 16), the REIT proceeded with the transfer of an amount of 10,000 Euros (\$13,915) to a newly created joint venture in exchange for a 25% equity interest. The partner invested an amount of 30,000 Euros (\$41,733) for a 75% equity interest that will be classified as a debt in the financial statements of the joint venture.

Outlined below is a breakdown of the carrying amounts of the components of the investment in the CanCorp Duisburg (“CCD”), Walpur and Arcueil joint ventures:

Carrying amount of investment in joint ventures	CCD	Walpur	Arcueil	For the six months ended June 30, 2015	For the year ended December 31, 2014
Balance at the beginning of the period	18,307	-	-	18,307	-
Net change in equity investment in joint ventures	(39)	594	13,915	14,470	3,668
Net change in interest-bearing loan to joint ventures	(621)	4,600	-	3,979	14,639
Balance at the end of the period	<u>17,647</u>	<u>5,194</u>	<u>13,915</u>	<u>36,756</u>	<u>18,307</u>

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 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 of the joint ventures	CCD	Walpur	Arcueil	As at June 30, 2015	As at December 31, 2014
Balance Sheet					
Investment properties	70,251	24,275	-	94,526	70,892
Deferred tax asset	262	-	-	262	164
Cash and cash equivalents	894	1,845	55,648	58,387	1,948
Other current assets	268	538	-	806	364
Total assets	<u>71,675</u>	<u>26,658</u>	<u>55,648</u>	<u>153,981</u>	<u>73,368</u>
Non-current financial liabilities	61,811	24,318	41,733	127,862	62,953
Current liabilities	866	839	-	1,705	1,436
Deferred tax liability	1,712	317	-	2,029	1,612
Total liabilities	<u>64,389</u>	<u>25,474</u>	<u>41,733</u>	<u>131,596</u>	<u>66,001</u>
Equity	<u>7,286</u>	<u>1,184</u>	<u>13,915</u>	<u>22,385</u>	<u>7,367</u>
Total liabilities and equity	<u>71,675</u>	<u>26,658</u>	<u>55,648</u>	<u>153,981</u>	<u>73,368</u>

Summarized financial information of the joint ventures	CCD	Walpur	Arcueil	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Income statement					
Net rental income	2,276	669	-	2,945	-
Operating profit	1,861	488	-	2,349	-
Finance costs	(1,856)	(124)	-	(1,980)	-
Earnings from continuing operations	5	364	-	369	-
Current income tax expense	(4)	-	-	(4)	-
Deferred income tax expense	(17)	(106)	-	(123)	-
Earnings for the period	(16)	258	-	242	-
Other comprehensive income	(65)	35	-	(30)	-
Total comprehensive income	<u>(81)</u>	<u>293</u>	<u>-</u>	<u>212</u>	<u>-</u>
Pro rata share of post-acquisition earnings recognized in the Consolidated financial statements					
50% pro rata share of earnings for the period	<u>(8)</u>	<u>129</u>	<u>-</u>	<u>121</u>	<u>-</u>
Interest earned from loans to Joint ventures	<u>710</u>	<u>103</u>	<u>-</u>	<u>813</u>	<u>-</u>

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 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 six month period ended June 30, 2015, 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.

The REIT also entered into 5 new monthly foreign currency hedge contracts whereby the REIT can purchase \$1,000 each month at an exchange rate of 1.4376 Canadian dollars per euro. The new contracts cover 5 monthly periods from February 14, 2018 to June 14, 2018. These contracts have been designated as hedges of the REIT's net investment in a foreign operation.

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

Classification and type	Number of contracts	Period covered		Conversion from/to			As at June 30, 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	5	14-Feb-18	14-Jun-18	696	1,000	1.4376	5,000	(3)	-	-
Foreign exchange	22	1-Jul-15	13-Apr-17	486	750	1.5437	16,500	1,451	21,000	1,567
Interest rate SWAP	1	1-Jul-15	1-Jul-19	Variable	Fixed	0.685%	78,560	(1,338)	82,181	(1,682)
Interest rate CAP	2	30-Jun-15	5-May-19	Variable	Capped	2.000%	47,297	125	47,729	69
Other derivatives										
Option contracts on foreign exchange										
Put options purchased	22	10-Jul-15	11-Apr-17	167	250	1.4956	5,500			
Call options sold	22	10-Jul-15	11-Apr-17	334	500	1.4956	11,000			
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								313		-
								548		(46)

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 7 – Exchangeable securities

Exchangeable securities issued and outstanding	Number of Exchangeable securities	Carrying amount of Exchangeable securities
Balance - December 31, 2014	2,043,347	18,145
Transactions in 2015		
Asset management fees paid in Exchangeable securities	135,988	1,243
Net change in fair value of Exchangeable securities	-	335
Balance - June 30, 2015	2,179,335	19,723

Exchangeable securities	As at June 30, 2015	As at December 31, 2014
Exchangeable securities	19,723	18,145
Less current portion	(2,126)	(1,482)
Non-current portion of Exchangeable securities	17,597	16,663

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, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Amount payable at the beginning of the period	78	(17)	35	213
Declared and recognized in earnings during the period	438	297	867	584
Accrued or paid in cash in the form of interest on interest bearing notes issued by CanCorpEurope S.A.	(225)	(144)	(455)	(296)
Paid in cash in the form of repayment of interest bearing notes issued by CanCorpEurope S.A.	(195)	(111)	(351)	(476)
Amount payable at the end of the period	96	25	96	25
Weighted average number of Exchangeable securities outstanding	2,114,218	1,436,513	2,079,367	1,412,992
Distributions paid per unit (based on weighted average Exchangeable securities outstanding)	0.1987	0.1775	0.3876	0.5464
Distributions paid per unit (based on three-month/six-month basis)	0.2063	0.2063	0.4125	0.4125

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 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 June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Interest costs on mortgage loans	(208)	(162)	(424)	(162)
Interest costs related to finance leases	(582)	(404)	(1,197)	(851)
Interest costs related to lease equalization loans	(45)	(30)	(87)	(53)
	(835)	(596)	(1,708)	(1,066)
Interest SWAP	(127)	-	(247)	-
Other finance costs	(48)	(23)	(70)	(6)
Standby charge on finance lease during approval period	-	(144)	-	(144)
Other finance costs to Inovalis	(3)	(14)	(3)	(29)
Net derivative finance costs	-	21	-	21
	(1,013)	(756)	(2,028)	(1,224)
Amortization of fair value adjustment on finance leases assumed at a discount at the time of a business acquisition	(105)	(28)	(214)	(424)
Amortization of transaction costs on mortgage loans	(96)	(71)	(201)	(71)
Finance costs	(1,214)	(855)	(2,443)	(1,719)
Finance income	1	8	4	15
Finance income from Inovalis relating to the acquisition loan	370	-	747	-
Finance income from joint ventures	453	-	813	-
Finance income	824	8	1,564	15
Net Finance costs	(390)	(847)	(879)	(1,704)

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 9 – Earnings per Unit

(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, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Basic earnings per unit				
Earnings attributable to unitholders	16,615	(6,897)	19,680	(6,987)
Weighted average number of units outstanding	15,310,081	11,290,383	15,299,387	11,288,451
Basic earnings per unit	1.09	(0.61)	1.29	(0.62)

(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.

	For the three months ended June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Diluted earnings per unit				
Earnings attributable to unitholders	16,615	(6,897)	19,680	(6,987)
Distributions recognized on Exchangeable securities	438	297	867	584
Net change in fair value of Exchangeable securities	(217)	(73)	335	1,325
Earnings attributable to diluted unitholders	16,836	(6,673)	20,882	(5,078)
Weighted average number of units outstanding	15,310,081	11,290,383	15,299,387	11,288,451
Weighted average number of Exchangeable securities outstanding	2,114,218	1,436,513	2,079,367	1,412,992
Weighted average number of units used for diluted earnings per unit	17,424,298	12,726,896	17,378,754	12,701,443
Diluted earnings per unit	0.97	(0.61)	1.20	(0.62)

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

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 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 June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Amount payable at the beginning of the period	1,052	776	1,050	776
Declared and recognised during the period	3,158	2,329	6,311	4,657
Distributions paid in units (Distribution Reinvestment Plan)	(199)	(35)	(376)	(65)
Paid in cash	(2,958)	(2,294)	(5,932)	(4,592)
Amount payable at the end of the period	1,053	776	1,053	776
Total distributions	3,158	2,329	6,311	4,657
Distributions paid per unit (based on weighted average number of units outstanding)	0.2062	0.2063	0.4123	0.4125
Distributions paid per unit (based on an annualized basis)	0.2063	0.2063	0.4125	0.4125

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

Note 11 – Accumulated other comprehensive income

	As at June 30, 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	2,312	1,942
Net changes in unrealized losses on interest rate derivatives designated as a cash flow hedge	(1,670)	(2,115)
Cumulative translation adjustment account	5,952	7,489
Accumulated other comprehensive income	6,594	7,316

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(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.

Asset manager

Inovalis and its subsidiaries	Financial statement line item	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Revenues and expenses			
Rental income	Rental income	478	-
Service charge income	Service charge income	354	-
Other revenue ⁽¹⁾	Other revenue	1,240	-
Asset management fees	Administration expenses	(1,038)	(892)
Facilities management fees	Service charge expenses	(1,696)	(844)
Property management Fees	Service charge expenses	(438)	(322)
Interest on lease equalization loan	Finance costs	(87)	(53)
Other finance costs	Finance costs	(3)	(29)
Interest income from acquisition loan	Finance income	747	-
Reimbursement of travel expenses	Administration expenses	(190)	(123)
		(633)	(2,263)
 ⁽¹⁾ Recovery of an amount paid for anticipated repairs that are no longer required			
Reimbursement of disbursements paid to third parties on behalf of the REIT			
Interest on notes	Distributions recognized on Exchangeable securities	(455)	(296)
Reimbursement of debt		(351)	(476)
Total distributions on Exchangeable securities recognized in earnings		(755)	(772)
Due to (from) Inovalis			
		As at June 30, 2015	As at December 31, 2014
Trade and other receivables		(1,393)	(637)
Trade and other payables		1,487	1,767
Acquisition loan		(17,389)	(17,548)
Distributions payable		96	35
Lease equalization loans		4,935	3,349
		(12,264)	(13,034)

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 12 – Transactions with related parties (continued)

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, 2015	For the six months ended June 30, 2014
Asset management fees rebilled to joint ventures	Administration expenses	(205)	-
Earnings from joint ventures	Share of earnings from investments accounted for using the equity method	121	-
Interest revenues on loans	Finance income	813	-
		729	-
Due from (to) joint ventures			
		As at March 31, 2015	As at December 31, 2014
Investment in associates	Investment accounted for using the equity method	18,138	3,668
Loan receivable	Investment accounted for using the equity method	18,618	14,639
Accounts receivable	Trade and other receivables	116	62
		36,872	18,369

Note 13 – Geographical information

Total revenue by geographic region	Rental Income	Service Charge Income	For the three months ended June 30, 2015	For the three months ended June 30, 2014
France	4,808	1,696	6,504	5,218
Germany	498	18	516	555
Total revenue	5,306	1,714	7,020	5,773

Total revenue by geographic region	Rental Income	Service Charge Income	For the six months ended June 30, 2015	For the six months ended June 30, 2014
France	9,609	3,404	13,013	9,545
Germany	980	39	1,019	2,222
	10,589	3,443	14,032	11,767

Investment properties and investments in joint ventures by geographic region	As at June 30, 2015	December 31, 2014
France	301,834	275,045
Germany	55,635	51,858
	357,469	326,903

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Notes to the Condensed Interim Consolidated Financial Statements

Three-month and six-month periods ended June 30, 2015

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

Note 14 – 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, 2015			
	Level 1	Level 2	Level 3	Total
Investment properties	-	-	320,713	320,713
Derivative financial instruments - assets	-	1,886	-	1,886
Derivative financial instruments - liabilities	-	(1,338)	-	(1,338)
Exchangeable securities	-	(19,723)	-	(19,723)

	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 June 30, 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.

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Notes to the Condensed Interim Consolidated Financial Statements

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(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 June 30, 2015	For the three months ended June 30, 2014	For the six months ended June 30, 2015	For the six months ended June 30, 2014
Adjustments for non-cash items and other reconciling items:				
Rent free period	(750)	(483)	(1,413)	(967)
Management fees paid in Exchangeable securities	525	437	1,038	892
Net change in fair value of investment properties	(11,416)	1,693	(13,166)	556
(Gain) loss on financial instruments at fair value through profit or loss	123	(30)	(379)	710
Distributions on Exchangeable securities	438	297	867	584
Net change in fair value of Exchangeable securities	(217)	(73)	335	1,325
Finance income	(824)	(8)	(1,564)	(15)
Finance cost	1,215	855	2,444	1,719
Income taxes paid	-	(15)	(8)	(20)
Loss recognized on exercise of early payment option on finance leases	-	7,972	-	7,972
Earnings from investments in joint ventures	(131)	-	(121)	-
Unrealized exchange (gains) losses	67	(65)	(90)	(54)
Cash items classified as operating activities				
Interest received	563	-	926	-
Interest paid	(670)	(638)	(1,685)	(1,099)
	<u>(11,077)</u>	<u>9,942</u>	<u>(12,816)</u>	<u>11,603</u>
Working capital adjustments				
(Increase) decrease in trade and other receivables	(422)	178	(3,092)	(1,691)
Increase (decrease) in tenant deposits	(62)	3	(65)	98
Increase (decrease) in trade and other payables	(112)	8,771	3,120	13,520
	<u>(596)</u>	<u>8,952</u>	<u>(37)</u>	<u>11,927</u>

Note 16 – Subsequent events

Subsequent to the end of the period, on July 7, 2015, the REIT proceeded with the acquisition, on a joint venture basis, of a 25% interest in the Arcueil office property located in Greater Paris, that has an estimated value of 90,000 Euros (\$125,000) (representing 100% of the property). The REIT will have the option to purchase the other partner's interest in the joint venture on or after July 2nd, 2018. In the event that the asset is sold, the REIT will receive 75% of the profit generated from the transaction. This transaction will be accounted for as a joint venture.

Corporate information

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Stock exchange listing

The Toronto Stock Exchange
Listing symbol: INO.UN

Distribution Reinvestment Plan

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

INOVALIS

REAL ESTATE INVESTMENT TRUST

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