

Unaudited Combined Financial Statements of

H&R REAL ESTATE INVESTMENT TRUST
and
H&R FINANCE TRUST

For the three and six months ended June 30, 2010 and 2009

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Combined Balance Sheets
(In thousands of dollars)

	June 30 2010	December 31 2009
	(unaudited)	
Assets		
Income properties (note 3)	\$ 4,124,767	\$ 4,124,856
Properties under development (note 4)	1,013,947	794,534
Accrued rent receivable	130,326	125,212
Other assets (note 5)	104,690	114,473
Mortgages and amount receivable	3,000	63,789
Cash and cash equivalents (note 6)	18,168	109,224
Assets held for sale and discontinued operations (note 23)	-	19,035
	\$ 5,394,898	\$ 5,351,123
Liabilities and Unitholders' Equity		
Liabilities:		
Mortgages payable (note 7)	\$ 2,804,621	\$ 2,818,476
Debentures payable (note 8)	609,366	565,758
Accounts payable and accrued liabilities	195,149	166,971
Future income tax liability	-	138,122
Intangible liabilities	55,887	57,237
Bank indebtedness (note 9)	51,890	13,556
Derivative instruments (notes 7, 9(b) and 19(c))	3,627	-
Liabilities related to discontinued operations (note 23)	-	2,215
	3,720,540	3,762,335
Non-controlling interest (note 10)	77,611	75,122
Unitholders' equity (notes 11 and 12)	1,596,747	1,513,666
Commitments and contingencies (note 24)		
Subsequent events (note 26)		
	\$ 5,394,898	\$ 5,351,123

See accompanying notes to combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Unaudited Combined Statements of Earnings
(In thousands of dollars, except per unit amounts)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2010	2009	2010	2009
Operating revenue:				
Rentals from income properties (note 13)	\$ 151,344	\$ 148,999	\$ 302,567	\$ 305,291
Interest income	802	1,504	2,076	2,999
	152,146	150,503	304,643	308,290
Operating expenses:				
Property operating costs	48,082	45,798	97,750	97,294
Interest (note 14)	44,424	45,199	91,090	88,956
Depreciation and amortization (note 15)	31,518	31,091	62,716	63,085
	124,024	122,088	251,556	249,335
Net property operating income (note 21)	28,122	28,415	53,087	58,955
Net gain (loss) on foreign exchange	4,730	(12,092)	1,202	(7,197)
Impairment loss on income properties (note 3)	-	(6,763)	-	(14,992)
Unrealized gain (loss) on derivative instruments (notes 7, 9(b) and 19(c))	(7,124)	5,767	(7,055)	5,767
Loss on repayment of debentures (note 8(c))	-	-	(38,834)	-
Gain on extinguishment of debt (note 3)	1,655	-	1,655	-
Trust expenses	(2,258)	(1,957)	(4,817)	(3,820)
Net earnings before income taxes, non-controlling interest and discontinued operations	25,125	13,370	5,238	38,713
Income tax recovery (expense) (note 22)	124,705	(1,637)	123,075	(6,225)
Net earnings before non-controlling interest and discontinued operations	149,830	11,733	128,313	32,488
Non-controlling interest (note 10)	(5,175)	(979)	(4,318)	(1,321)
Net earnings from continuing operations	144,655	10,754	123,995	31,167
Net earnings from discontinued operations (note 23)	10	8,147	3,410	9,832
Net earnings	\$ 144,665	\$ 18,901	\$ 127,405	\$ 40,999
Basic net earnings per unit (note 16):				
Continuing operations	\$ 1.00	\$ 0.07	\$ 0.86	\$ 0.22
Discontinued operations	-	0.06	0.02	0.07
	\$ 1.00	\$ 0.13	\$ 0.88	\$ 0.29
Diluted net earnings per unit (note 16):				
Continuing operations	\$ 0.91	\$ 0.07	\$ 0.84	\$ 0.21
Discontinued operations	-	0.06	0.02	0.06
	\$ 0.91	\$ 0.13	\$ 0.86	\$ 0.27

See accompanying notes to combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

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Unaudited Combined Statements of Unitholders' Equity and Comprehensive Income

(In thousands of dollars)

UNITHOLDERS' EQUITY	Value of units	Accumulated net earnings	Accumulated distributions	Contributed surplus	Equity component of warrants and debentures	Accumulated other comprehensive loss (note 12)	Total
Unitholders' equity, December 31, 2008	\$ 2,188,052	\$ 744,777	\$ (1,268,723)	\$ -	\$ 6,767	\$ (19,205)	\$ 1,651,668
Proceeds from issuance of units	6,522	-	-	-	-	-	6,522
Issue costs	(454)	-	-	-	-	-	(454)
Issuance of warrants, net of costs	-	-	-	-	8,533	-	8,533
Net earnings	-	40,999	-	-	-	-	40,999
Distributions to unitholders (note 11(b))	-	-	(51,193)	-	-	-	(51,193)
Unit-based compensation (note 11(a))	181	-	-	-	-	-	181
Other comprehensive income	-	-	-	-	-	(4,568)	(4,568)
Unitholders' equity, June 30, 2009	2,194,301	785,776	(1,319,916)	-	15,300	(23,773)	1,651,688
Proceeds from issuance of units	16,919	-	-	-	-	-	16,919
Issue costs	(412)	-	-	-	-	-	(412)
Equity component from issuance of convertible debentures, net of costs	-	-	-	-	43,326	-	43,326
Net earnings	-	45,526	-	-	-	-	45,526
Distributions to unitholders	-	-	(51,412)	-	-	-	(51,412)
Redemption of units	(28,873)	-	-	28,873	-	-	-
Redemption of warrants	-	(148,308)	-	(28,873)	(8,533)	-	(185,714)
Unit-based compensation	354	-	-	-	-	-	354
Other comprehensive loss	-	-	-	-	-	(6,609)	(6,609)
Unitholders' equity, December 31, 2009	2,182,289	682,994	(1,371,328)	-	50,093	(30,382)	1,513,666
Proceeds from issuance of units	5,668	-	-	-	-	-	5,668
Net earnings	-	127,405	-	-	-	-	127,405
Distributions to unitholders (note 11(b))	-	-	(51,822)	-	-	-	(51,822)
Redemption of convertible debentures (note 8(a))	10	-	-	-	(1)	-	9
Unit-based compensation (note 11(a))	-	-	-	604	-	-	604
Other comprehensive income	-	-	-	-	-	1,217	1,217
Unitholders' equity, June 30, 2010	\$ 2,187,967	\$ 810,399	\$ (1,423,150)	\$ 604	\$ 50,092	\$ (29,165)	\$ 1,596,747

COMPREHENSIVE INCOME	Three Months Ended		Six Months Ended	
	2010	2009	2010	2009
Net earnings	\$ 144,665	\$ 18,901	\$ 127,405	\$ 40,999
Unrealized gain (loss) on translation of self-sustaining foreign operations	3,462	(10,267)	530	(5,839)
Transfer of realized loss on cash flow hedges to net earnings	92	185	184	361
Future income taxes (note 22)	502	970	503	910
Other comprehensive income (loss)	4,056	(9,112)	1,217	(4,568)
Comprehensive income	\$ 148,721	\$ 9,789	\$ 128,622	\$ 36,431

See accompanying notes to combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

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Unaudited Combined Statements of Cash Flows
(In thousands of dollars)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2010	2009	2010	2009
Cash provided by (used in):				
Operations:				
Net earnings	\$ 144,665	\$ 18,901	\$ 127,405	\$ 40,999
Items not affecting cash:				
Rent amortization (notes 13 and 23)	922	1,109	2,092	2,038
Depreciation and amortization (notes 15 and 23)	31,518	31,323	62,757	64,536
(Gain) loss on sale of income properties (note 23)	24	(6,441)	(3,609)	(6,865)
Gain on extinguishment of debt (note 3)	(1,655)	-	(1,655)	-
Impairment loss on income properties (note 3)	-	6,763	-	14,992
Future income tax expense (recovery) (note 22)	(124,821)	1,544	(123,303)	6,059
Unrealized (gain) loss on derivative instruments (notes 7, 9(b) and 19(c))	7,124	(5,767)	7,055	(5,767)
Loss on repayment of debentures (note 8(c))	-	-	38,834	-
Effective interest rate accretion (notes 14 and 23)	2,643	905	5,206	1,485
Unrealized gain (loss) on foreign exchange	(4,730)	12,092	(1,204)	7,177
Unit-based compensation (note 11(a))	307	118	604	181
Net earnings attributable to non-controlling interest (note 10)	5,175	1,290	4,447	1,697
Change in other non-cash operating items (note 17)	(11,515)	(10,783)	(6,716)	(6,009)
	49,657	51,054	111,913	120,523
Financing:				
Bank indebtedness	42,574	(111,724)	38,330	(93,371)
Mortgages payable:				
New mortgages payable	11,465	-	11,465	-
Principal repayments	(27,990)	(23,474)	(51,183)	(52,183)
Proceeds from issuance of debentures payable (notes 8(a) and 8(b))	-	198,629	227,933	198,629
Repayment of debentures payable (note 8(c))	-	-	(227,752)	-
Proceeds from issuance of units, net	26	(546)	37	2,081
Distributions to unitholders (note 11(b))	(22,380)	(23,541)	(46,191)	(47,206)
Distributions to non-controlling interest (note 10)	(979)	(979)	(1,958)	(1,958)
	2,716	38,365	(49,319)	5,992
Investments:				
Properties under development	(107,889)	(94,984)	(209,811)	(147,707)
Income properties:				
Net proceeds on disposition of income properties	(25)	5,507	22,216	25,714
Acquisitions (note 3)	-	-	(24,491)	-
Capital expenditures	(4,007)	(2,531)	(9,491)	(2,653)
Mortgages and amounts receivable	60,898	(161)	60,789	(372)
Restricted cash (note 5)	1,611	2,932	6,857	(2,704)
	(49,412)	(89,237)	(153,931)	(127,722)
Increase (decrease) in cash and cash equivalents	2,961	182	(91,337)	(1,207)
Cash and cash equivalents, beginning of period (notes 6 and 23)	15,207	16,294	109,505	17,683
Cash and cash equivalents, end of period (notes 6 and 23)	\$ 18,168	\$ 16,476	\$ 18,168	\$ 16,476

Supplemental cash flow information (note 17)

See accompanying notes to combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

These combined financial statements include the accounts of H&R Real Estate Investment Trust (the "REIT") and H&R Finance Trust ("Finance Trust"). These combined financial statements are presented as supplementary information to the financial statements of the REIT and Finance Trust (collectively, the "Trusts"), all of which are filed on SEDAR.

The REIT is an unincorporated open-ended trust and Finance Trust is an unincorporated investment trust (note 11). Unitholders of the Trusts participate pro rata in distributions of income and, in the event of termination of the Trusts, participate pro rata in the net assets remaining after satisfaction of all liabilities.

The combined financial statements are a result of the REIT's completion of an internal reorganization on October 1, 2008 pursuant to a Plan of Arrangement (the "Plan of Arrangement") as described in the REIT's information circular dated August 20, 2008 resulting in the stapling of the Trusts' units. The Plan of Arrangement resulted in, among other things, the creation on October 1, 2008 of Finance Trust. Each unitholder received, for each REIT unit held, a unit of Finance Trust. Each issued and outstanding Finance Trust unit is stapled to a unit of the REIT on a one-for-one basis so as to form stapled units ("Stapled Units"), and such Stapled Units are listed and posted for trading on the Toronto Stock Exchange ("TSX"). The Stapled Units of each of the Trusts may only be transferred together as Stapled Units unless an event of "uncoupling" has occurred.

The presentation of combined financial statements of the Trusts is useful to the unitholders on the following basis:

- The units of the Trusts are stapled (as noted above), resulting in the two Trusts being under common ownership;
- A support agreement between the Trusts ensures that, until such time as an event of uncoupling occurs, when units are issued by the REIT, units must also be issued by Finance Trust simultaneously so as to maintain the stapled unit structure;
- The sole activity of Finance Trust is to provide capital funding to H&R REIT (U.S.) Holdings Inc. ("U.S. Holdco"), a wholly owned U.S. subsidiary of the REIT; and
- The investment activities of Finance Trust are restricted in its Declaration of Trust to providing such funding to U.S. Holdco and to make temporary investments of excess funds.

On November 30, 2009, the Trusts completed a reorganization (the "2009 Reorganization") as part of the steps required to enable the REIT to qualify for the REIT Exemption under certain provisions in the Income Tax Act (Canada) applicable to publicly traded trusts and partnerships. The 2009 Reorganization involved, among other things, a redemption of 5,437,565 Stapled Units of the Trusts held by H&R Portfolio Limited Partnership ("HRLP"), a subsidiary partnership of the REIT. In accordance with the respective Declarations of Trust for the Trusts and upon the exercise of discretion by the trustees of the REIT, as provided for in the Declaration of Trust of the REIT, the redemption price for the REIT units was paid in cash, while Finance Trust delivered notes receivable from U.S. Holdco, in payment of the redemption price for the Finance Trust Units redeemed.

1. Significant accounting policies:

In the opinion of the Trusts, the accompanying interim combined financial statements contain all the adjustments necessary to present fairly the financial position as at June 30, 2010 and December 31, 2009 and the results of operations and cash flows for the three and six months ended June 30, 2010 and 2009. Canadian generally accepted accounting principles ("GAAP") requires additional disclosures for annual financial statements and accordingly, these combined financial statements should be read in conjunction with the audited combined financial statements and notes for the year ended December 31, 2009.

The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results for the full year.

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Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

1. Significant accounting policies (continued):

The interim combined financial statements follow the same accounting policies and methods of their application as the December 31, 2009 annual audited combined financial statements.

2. Future changes in accounting policies:

International Financial Reporting Standards ("IFRS")

The Canadian Accounting Standards Board ("AcSB") confirmed that the adoption of IFRS would be effective for the interim and annual periods beginning on or after January 1, 2011 for Canadian publicly accountable profit-oriented enterprises. IFRS will replace current Canadian GAAP for these enterprises. Comparative IFRS information for the previous fiscal year will also have to be reported. These new standards will be effective for the Trusts in the first quarter of 2011.

The Trusts are currently in the process of evaluating the potential impact of IFRS on their combined financial statements. This will be an ongoing process as the International Accounting Standards Board and the AcSB issue new standards and recommendations. The Trusts' combined financial performance and financial position as disclosed in the Trusts' current Canadian GAAP financial statements may be significantly different when presented in accordance with IFRS.

3. Income properties:

June 30, 2010	Cost	Accumulated depreciation and amortization	Net book value
Land	\$ 888,325	\$ -	\$ 888,325
Buildings	3,311,219	(482,076)	2,829,143
Building improvements	32,762	(7,173)	25,589
Paving and equipment	125,746	(57,136)	68,610
	4,358,052	(546,385)	3,811,667
Intangible assets	451,622	(138,522)	313,100
	\$ 4,809,674	\$ (684,907)	\$ 4,124,767

H&R REAL ESTATE INVESTMENT TRUST

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Notes to Unaudited Combined Financial Statements
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3. Income properties (continued):

December 31, 2009	Cost	Accumulated depreciation and amortization	Net book value
Land	\$ 877,530	\$ -	\$ 877,530
Buildings	3,282,641	(444,212)	2,838,429
Building improvements	23,260	(5,997)	17,263
Paving and equipment	128,820	(56,156)	72,664
	4,312,251	(506,365)	3,805,886
Intangible assets	442,708	(123,738)	318,970
	\$ 4,754,959	\$ (630,103)	\$ 4,124,856

During the three months ended June 30, 2009, the REIT recorded an impairment charge of \$6,763 on three of its U.S. income properties occupied by Bruno's Supermarkets, LLC and during the six months ended June 30, 2009, the REIT recorded an impairment charge of \$14,992 on four of its U.S. income properties, comprised of one property occupied by Circuit City and three properties occupied by Bruno's Supermarkets, LLC. Each impairment was triggered by the tenant vacating the premises following their bankruptcy announcement. No such impairment was recorded during the three and six months ended June 30, 2010.

During the six months ended June 30, 2010, the lender accepted title to the income property previously occupied by Circuit City, thereby releasing the REIT from any further obligation with respect to the mortgage on such property. The REIT recorded a gain on the extinguishment of this debt of \$1,655 in both the three and six months ended June 30, 2010.

Legal title to each of the United States properties is held by a separate legal entity which is 100% owned, directly or indirectly, by U.S. Holdco. The assets of each such separate entity are not available to satisfy the debts or obligations of any other person or entity. Each such separate entity maintains separate books and records. The identity of the owner of a particular United States property is available from U.S. Holdco. This structure does not prevent distributions to the entity owners provided there are no conditions of default.

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Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

3. Income properties (continued):

Acquisitions:

During the six months ended June 30, 2010, the REIT acquired four income properties. These acquisitions have been recorded by the purchase method with the results of operations included in these combined financial statements from the date of acquisition. There were no acquisitions during the year ended December 31, 2009. The following table summarizes the acquired net assets at fair value on their respective dates of acquisition:

Assets	
Land	\$ 14,302
Building	37,678
Paving and equipment	2,200
Intangible acquired in-place lease costs	6,382
Customer relationship value	769
	61,331
Liabilities	
Mortgages payable, net of mark to market adjustments	36,276
Intangible below-market rent leases	564
Net assets acquired and settled by cash	\$ 24,491

4. Properties under development:

Project	Address	June 30	December 31
		2010	2009
The Bow (note 24(a))	5th Ave. at Centre Street, Calgary, AB	\$ 937,935	\$ 719,173
Heart Lake	Mayfield West Business Park, Caledon, ON	39,880	39,809
Airport Road	7900 Airport Road, Brampton, ON	36,132	35,552
		\$ 1,013,947	\$ 794,534

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Notes to Unaudited Combined Financial Statements
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5. Other assets:

	June 30 2010	December 31 2009
Tenant inducements (net of accumulated amortization of \$11,507 (2009 - \$9,807))	\$ 34,809	\$ 29,797
Leasing expenses (net of accumulated amortization of \$21,266 (2009 - \$19,145))	26,528	27,542
Prepaid expenses and sundry assets	21,314	12,811
Restricted cash	13,144	20,001
Future income tax asset	-	14,316
Accounts receivable	8,895	6,543
Swap derivatives (note 9(b))	-	3,463
	\$ 104,690	\$ 114,473

6. Cash and cash equivalents:

Cash and cash equivalents at June 30, 2010 includes cash on hand of \$14,219 (December 31, 2009 - \$9,281) and bank term deposits of \$3,949 (December 31, 2009 - \$99,943) at rates of interest varying between 0.14% to 0.50% (December 31, 2009 - 0.11% to 0.26%).

7. Mortgages payable:

The mortgages payable are secured by income properties and letters of credit in certain cases, bearing fixed interest with a contractual weighted average rate of 6.2% (December 31, 2009 - 6.2%) per annum and maturing between 2010 and 2035. Included in mortgages payable at June 30, 2010 are U.S. dollar denominated mortgages of U.S. \$841,775 (December 31, 2009 - U.S. \$826,906). The Canadian equivalents of these amounts are \$892,282 (December 31, 2009 - \$868,252).

The REIT entered into an interest rate swap on one mortgage. The fair value of this interest rate swap as at June 30, 2010 is \$400 and has been recorded as a liability resulting in an unrealized loss of \$400 for the three and six months ended June 30, 2010.

Debt related to certain Canadian properties is held by separate legal entities, where the rent received from each property is first used to satisfy the related debt obligations with any balance then available to satisfy the cash flow requirements of the REIT.

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7. Mortgages payable (continued):

Future principal mortgage payments are as follows:

Years ending December 31:	
2010 *	\$ 59,752
2011	170,994
2012	369,468
2013	197,092
2014	278,915
Thereafter	1,600,102
	2,676,323
Mortgages payable due on demand **	134,687
Financing cost and mark-to-market adjustment arising on acquisitions	(6,389)
	\$ 2,804,621

* For the balance of the year

** Relates to nine non-recourse mortgages to the REIT for income properties in which the tenants, Boscov's Department Stores and Bruno's Supermarkets, LLC, have filed for protection under Chapter 11 of the United States Bankruptcy Code. The REIT has handed over control of seven of these income properties to the lenders and therefore expects to be released from any further obligations under these non-recourse mortgages upon the transfer of title to the lenders.

8. Debentures payable:

					June 30	December 31	
					2010	2009	
		Contractual	Effective		Face value	Carrying value	Carrying value
Maturity		interest rate	interest rate	Conversion price			
2013 Convertible Debentures	June 30, 2013	6.65%	9.10%	\$ 23.11	\$115,000	\$107,723	\$106,734
2014 Convertible Debentures (a)	December 31, 2014	6.75%	12.30%	14.00	149,990	121,653	119,427
2017 Convertible Debentures	June 30, 2017	6.00%	8.60%	19.00	175,000	151,970	150,830
Series A Senior Debentures (b)	February 3, 2015	5.20%	5.40%	-	115,000	114,037	-
Series B Senior Debentures (b)	February 3, 2017	5.90%	6.06%	-	115,000	113,983	-
Non-Convertible Debentures (c)	-	11.50%	12.90%	-	-	-	188,767
					\$ 609,366	\$565,758	

(a) 2014 Convertible Debentures:

During the six months ended June 30, 2010, holders of \$10 of 2014 Convertible Debentures at face value exercised their option to convert to units. Of the \$10, \$1 was recorded as a reduction of the original equity component and \$9 was recorded as a reduction of the debt component. This ratio is consistent with the original equity and debt ratio. A total of 714 Stapled Units were issued on conversion.

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8. Debentures payable (continued):

(b) *Series A Senior Debentures and Series B Senior Debentures:*

In February 2010, the REIT issued \$115,000 Series A unsecured senior debentures (the "Series A Senior Debentures"), bearing interest at the annual contractual rate of 5.20% and an effective interest rate of 5.40%. The Series A Senior Debentures mature on February 3, 2015, and interest is paid semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$113,981, net of issue costs of \$1,019.

In February 2010, the REIT issued \$115,000 Series B unsecured senior debentures (the "Series B Senior Debentures"), bearing interest at the annual contractual rate of 5.90% and an effective interest rate of 6.06%. The Series B Senior Debentures mature on February 3, 2017, and interest is paid semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$113,953, net of issue costs of \$1,047.

Interest expense is recorded as a charge to income and is calculated at an effective interest rate with the difference between the coupon rate and the effective rate being credited to the carrying value such that, at maturity, the carrying value is equal to the face value of the then outstanding Series A Senior Debentures and Series B Senior Debentures, (collectively "Senior Debentures").

At its option, the REIT may redeem any of the Senior Debentures, in whole at any time, or in part from time to time, prior to maturity on payment of a redemption price equal to the greater of (i) the Canada Yield Price as defined in the Supplemental Trust Indenture and (ii) par, together in each case with accrued and unpaid interest to the date fixed for redemption. The REIT will give notice of any redemption at least 30 days but not more than 60 days before the date fixed for redemption. Where less than all of any Senior Debentures are to be redeemed pursuant to their terms, the Senior Debentures to be so redeemed will be redeemed on a pro rata basis according to the principal amount of Senior Debentures registered in the respective name of each holder of Senior Debentures or in such other manner as the Indenture Trustee may consider equitable.

The Senior Debentures are rated BBB (with a Stable trend) by Dominion Bond Rating Services Limited.

(c) *Non-Convertible Debentures:*

In February 2010, the REIT repaid the outstanding Non-Convertible Debentures having an aggregate face value of \$200,000 for a total repurchase price of \$229,989. The repurchase price included accrued interest of \$2,237. The REIT recognized a one-time non-recurring charge to the combined statement of earnings of \$38,834, representing the difference between the repurchase price, excluding accrued interest expense, and the carrying value of the Non-Convertible Debentures of \$188,918.

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9. Bank indebtedness:

The REIT has the following facilities:

- (a) A general operating facility which is secured by fixed charges over certain income properties due on December 31, 2011. Subject to lenders' approval, the maturity date can be extended for 364 days from the original maturity date of December 31, 2011. The total facility as at June 30, 2010 is \$285,443 (December 31, 2009 - \$284,650) and can be drawn in either Canadian or U.S. dollars (to a maximum of \$100,000 Canadian for U.S. borrowings). The amount available at June 30, 2010, after taking into account the bank indebtedness drawn of \$51,890 (including amounts in note 23) (December 31, 2009 - \$13,560) and the outstanding letters of credit and other items, is \$203,711 (December 31, 2009 - \$236,716). The Canadian dollar bank indebtedness bears interest at rates approximating the prime rate of a Canadian chartered bank. At June 30, 2010, the Canadian prime interest rate was 2.50% (December 31, 2009 - 2.25%) per annum.

The REIT may increase the general operating facility to a maximum amount of \$300,000 upon providing further properties as security.

Included in bank indebtedness at June 30, 2010 is U.S. \$70 (December 31, 2009 - U.S. \$33). The Canadian equivalents of these amounts are \$74 (December 31, 2009 - \$35). The U.S. dollar bank indebtedness bears interest at LIBOR rates.

- (b) A secured construction financing facility for the REIT's development project, the Bow (the "Bow Facility"). The Bow Facility consists of a non-revolving term construction credit facility in the amount of \$425,000 available by way of prime loans, bankers' acceptances and/or letters of credit. The initial maturity date of the facility is October 22, 2012. Borrowing under this facility is subject to the satisfaction of certain conditions including:
- (i) not less than \$906,000 of cash equity having been invested in the project by the REIT or any affiliate thereof;
 - (ii) execution of an acceptable management agreement with the REIT for the project; and
 - (iii) the REIT having in place a committed revolving credit facility of not less than \$300,000 (subject to reduction to \$200,000 in certain circumstances) with a maturity date of not less than 11 months from the date of the initial borrowing under the Bow Facility.

These conditions have not been satisfied as at June 30, 2010 nor has any amount been drawn upon the credit facility.

The REIT entered into an interest rate swap that is intended to limit its interest rate exposure during the term of the Bow construction financing facility. The expected annual effective interest rate for this facility, including the cost of the swap, is 6.90%. The fair value of this interest rate swap as at June 30, 2010 is \$1,979 and has been recorded as a liability resulting in an unrealized gain (loss) of (\$5,511) for the three months ended June 30, 2010 (June 30, 2009 - \$5,767) and an unrealized gain (loss) of (\$5,442) for the six months ended June 30, 2010 (June 30, 2009 - \$5,767).

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10. Non-controlling interest:

Non-controlling interest represents the amount of equity related to the Class B units of HRLP, issued to participating vendors in exchange for properties acquired by HRLP. The accounts of HRLP are consolidated into the REIT, and thus included in the combined financial statements. Class B units of HRLP are only exchangeable on a one-for-one basis, at the option of the holder, into Stapled Units.

Holders of the Class B units of HRLP are entitled to receive distributions on a per unit amount equal to a per Stapled Unit amount provided to holders of Stapled Units. HRLP, the REIT, Finance Trust and H&R Portfolio LP Trust entered into an exchange and support agreement that provides, among other things, for (i) certain capital contributions to be made by the REIT in case HRLP has insufficient (a) funds to pay the required distributions on the Class B LP units of HRLP, or (b) U.S. Holdco Notes to pay the fair market value of the Finance Trust Units required to be delivered upon exchange of any Class B LP unit; and (ii) the mechanics whereby Class B LP units may be exchanged for Stapled Units.

	Amount	Number of Class B units
As at December 31, 2008	\$ 75,367	5,437,565
Non-controlling interest from continuing operations	1,321	-
Non-controlling interest from discontinued operations (note 23)	376	-
Distributions on Class B units of HRLP	(1,958)	-
As at June 30, 2009	75,106	5,437,565
Non-controlling interest from continuing operations	1,728	-
Non-controlling interest from discontinued operations	245	-
Distributions on Class B units of HRLP	(1,957)	-
As at December 31, 2009	75,122	5,437,565
Non-controlling interest from continuing operations	4,318	-
Non-controlling interest from discontinued operations (note 23)	129	-
Distributions on Class B units of HRLP	(1,958)	-
As at June 30, 2010	\$ 77,611	5,437,565

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11. Unitholders' equity:

The following number of Stapled Units are issued and outstanding:

As at December 31, 2008	147,032,851
Issued under the Distribution Reinvestment Plan and Unit Purchase Plan (the "DRIP")	886,879
	<u>147,919,730</u>
Stapled Units held by a subsidiary	(5,437,565)
As at June 30, 2009	<u>142,482,165</u>
As at June 30, 2009	147,919,730
Issued under the DRIP	374,865
Stapled Units redeemed from a subsidiary	(5,437,565)
Options exercised	968,232
As at December 31, 2009	<u>143,825,262</u>
As at December 31, 2009	143,825,262
Issued under the DRIP	352,298
2014 Convertible Debentures converted into Stapled Units (note 8(a))	714
As at June 30, 2010	<u>144,178,274</u>

(a) Unit option plan:

As at June 30, 2010, a maximum of 8,800,000 Stapled Units were authorized to be issued to the REIT's officers, employees and certain trustees, of which 7,600,000 options (December 31, 2009 - 7,000,000 options) have been granted. The exercise price of each option approximated the market price of the Stapled Units on the date of grant and shall be increased by the amount, if any, by which, (i) the fair market value of one Finance Trust unit at the time of exercise of such option, exceeds (ii) the fair market value of one Finance Trust unit at the time of grant of such option. The options vested at 33.3% per year from the grant date, being fully vested after three years, and expire ten years after the date of the grant.

During the six months ended June 30, 2010, 600,000 options were granted (June 30, 2009 - 600,000). The fair value of the unit options used to compute compensation cost is the estimated fair value of each option grant on the grant date. This was calculated using an option pricing model with the following weighted average assumptions: expected distribution yield is 5.13%; expected volatility is 25.00%; risk free interest rate is 2.71%; and expected option life is 4.50 years from the date of grant. The weighted average grant-date fair value of the options in total is \$1,589. Unit-based compensation expense of \$307 for the three months ended June 30, 2010 (June 30, 2009 - \$118) and \$604 for the six months ended June 30, 2010 (June 30, 2009 - \$181) was included in the trust expenses amount recorded in net earnings and charged to unitholders' equity.

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11. Unitholders' equity (continued):

A summary of the status of the unit option plan as at June 30, 2010 and 2009 and the changes during the six months ended on those dates are as follows:

	2010		2009	
	Units	Weighted average exercise price	Units	Weighted average exercise price
Outstanding, beginning of year	2,086,434	\$ 13.05	2,454,666	\$ 13.73
Granted	600,000	15.42	600,000	9.30
Outstanding, as at June 30	2,686,434	\$ 13.58	3,054,666	\$ 12.86
Options exercisable, as at June 30	1,286,434	\$ 13.12	1,854,666	\$ 12.81

The options outstanding at June 30, 2010 are exercisable at varying prices ranging from \$9.30 to \$16.56 (June 30, 2009 - \$9.30 to \$16.56) with a weighted average remaining life of 6.6 years (June 30, 2009 - 5.3 years). The vested options are exercisable at varying prices ranging from \$9.30 to \$16.56 (June 30, 2009 - \$12.01 to \$13.36) with a weighted average remaining life of 4.1 years (June 30, 2009 - 2.6 years).

(b) Distributions:

Under the REIT's Declaration of Trust, the total amount of income of the REIT to be distributed to unitholders, for each calendar year, shall be subject to the absolute discretion of the trustees.

Pursuant to Finance Trust's Declaration of Trust, unitholders of Finance Trust are entitled to receive all of the Distributable Cash of Finance Trust, as defined in the Declaration of Trust. Distributable Cash means, subject to certain exceptions, all amounts received by Finance Trust less certain costs, expenses or other amounts payable by Finance Trust, and less any amounts which, in the opinion of the trustees, may reasonably be considered to be necessary to provide for the payment of any costs or expenditures that have been or will be incurred in the activities and operations of Finance Trust and to provide for payment of any tax liability of Finance Trust.

The REIT and Finance Trust declared distributions, on a combined per unit basis, for the three months ended June 30, 2010 of \$0.18 (June 30, 2009 - \$0.18) and for the six months ended June 30, 2010 of \$0.36 (June 30, 2009 - \$0.36).

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11. Unitholders' equity (continued):

The details of the distribution are as follows:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2010	2009	2010	2009
Cash distributions to unitholders	\$ 22,380	\$ 23,541	\$ 46,191	\$ 47,206
Unit distributions (issued under the DRIP)	3,545	2,082	5,631	3,987
	\$ 25,925	\$ 25,623	\$ 51,822	\$ 51,193

(c) Short form base shelf prospectus:

On January 18, 2010, the REIT and Finance Trust filed Amendment No. 2 to the short form base shelf prospectus dated May 11, 2009 and amended July 17, 2009, to increase the aggregate offer price of securities that may be offered under the short form base shelf prospectus from \$500,000 to \$1,000,000 (or the equivalent thereof, at the date of issue, in any other currency or currencies, as the case may be).

12. Accumulated other comprehensive loss:

	Cash flow hedges	Foreign operations	Total
Balance as at December 31, 2008	\$ (8,270)	\$ (10,935)	\$ (19,205)
Transfer of realized loss on cash flow hedges to net earnings	361	-	361
Future income taxes (note 22)	910	-	910
Unrealized loss on translation of self-sustaining foreign operation	-	(5,839)	(5,839)
Balance as at June 30, 2009	(6,999)	(16,774)	(23,773)
Transfer of realized loss on cash flow hedges to net earnings	4,083	-	4,083
Future income taxes	74	-	74
Unrealized loss on translation of self-sustaining foreign operation	-	(10,766)	(10,766)
Balance as at December 31, 2009	(2,842)	(27,540)	(30,382)
Transfer of realized loss on cash flow hedges to net earnings	184	-	184
Future income taxes (note 22)	503	-	503
Unrealized gain on translation of self-sustaining foreign operation	-	530	530
Balance as at June 30, 2010	\$ (2,155)	\$ (27,010)	\$ (29,165)

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13. Rentals from income properties:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Rentals from income properties	\$ 150,014	\$ 147,715	\$ 300,348	\$ 301,159
Straight-lining of contractual rent	2,252	2,396	4,311	6,085
Rent amortization of tenant inducements	(757)	(846)	(1,700)	(1,383)
Rent amortization of above- and below-market rents	(165)	(266)	(392)	(570)
	\$ 151,344	\$ 148,999	\$ 302,567	\$ 305,291

14. Interest:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Contractual interest on mortgages payable	\$ 43,191	\$ 45,557	\$ 86,567	\$ 92,334
Contractual interest on debentures payable	10,231	6,191	21,274	8,077
Effective interest rate accretion	2,643	806	5,206	1,332
Bank interest and charges	556	551	943	1,718
	56,621	53,105	113,990	103,461
Capitalized interest	(12,197)	(7,906)	(22,900)	(14,505)
	\$ 44,424	\$ 45,199	\$ 91,090	\$ 88,956

15. Depreciation and amortization:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Depreciation of income properties	\$ 24,129	\$ 23,564	\$ 47,998	\$ 47,840
Amortization of intangible assets on acquisitions	5,899	6,199	11,697	12,576
Amortization of leasing expenses	1,490	1,328	3,021	2,669
	\$ 31,518	\$ 31,091	\$ 62,716	\$ 63,085

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16. Net earnings per unit:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Net earnings	\$ 144,665	\$ 18,901	\$ 127,405	\$ 40,999
Add net earnings attributable to				
non-controlling interest (note 10)	5,175	1,290	4,447	1,697
Add convertible debenture interest	9,309	-	13,602	-
Diluted net earnings	\$ 159,149	\$ 20,191	\$ 145,454	\$ 42,696

The weighted average number of Stapled Units outstanding was as follows:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Basic Stapled Units	144,031,614	142,346,374	143,951,872	142,203,244
Effect of dilutive securities:				
Unit option plan	510,255	-	483,679	-
Convertible debentures	24,900,513	-	19,924,204	-
Warrants	-	8,611,349	-	8,611,349
Non-controlling interest conversion to Stapled Units (note 10)	5,437,565	5,437,565	5,437,565	5,437,565
Diluted units	174,879,947	156,395,288	169,797,320	156,252,158

Net earnings per Stapled Unit:

Basic	\$ 1.00	\$ 0.13	\$ 0.88	\$ 0.29
Diluted	\$ 0.91	\$ 0.13	\$ 0.86	\$ 0.27

The 2013 convertible debentures are anti-dilutive for the six months ended June 30, 2010; therefore, the potential conversion into Stapled Units has not been included in the calculation of diluted units.

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17. Supplemental cash flow information:

The change in non-cash operating items for the three and six months ended June 30, 2010 and 2009 are as follows:

	Three months ended		Six months ended	
	June 30		June 30	
	2010	2009	2010	2009
Leasing expenses and tenant inducements	\$ (1,352)	\$ (666)	\$ (2,747)	\$ (2,282)
Accrued rent receivable	(3,019)	(1,893)	(4,985)	(6,410)
Prepaid expenses and sundry assets	(5,358)	(6,861)	(8,398)	(8,868)
Accounts receivable	(1,146)	2,567	(2,316)	3,067
Accounts payable and accrued liabilities	(640)	(3,930)	11,730	8,484
	\$ (11,515)	\$ (10,783)	\$ (6,716)	\$ (6,009)

The following amounts recognized during the three and six months ended June 30, 2010 and 2009 have been excluded from operating, financing and investing activities in the combined statements of cash flows:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2010	2009	2010	2009
Acquisition of income properties through assumption of mortgages payable, net of mark to market adjustments	\$ -	\$ -	\$ 36,276	\$ -
Release of mortgage obligation upon lender consent	(20,805)	-	(20,805)	(4,633)
Non-cash transfer of income property to lender	20,609	-	20,609	-
Non-cash transfer of property from properties under development to income properties	-	-	-	117,007
Non-cash distributions to unitholders (note 11(b))	3,545	2,082	5,631	3,987
Non-cash conversion of convertible debentures (note 8(a))	-	-	10	-
Non-cash assumption of mortgage payable on disposition	-	11,901	-	11,901
Non-cash issuance of warrants	-	8,533	-	8,533
Additions to properties under development included in accounts payable	4,028	9,521	9,602	29,017
Additions to tenant inducements included in accounts payable	5,590	-	6,142	-

During the three months ended June 30, 2010, interest paid amounted to \$56,690 (June 30, 2009 - \$54,743) and during the six months ended June 30, 2010, interest paid amounted to \$100,133 (June 30, 2009 - \$100,901).

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18. Capital risk management:

The REIT's primary objectives when managing capital are:

- (a) to provide unitholders with stable and growing cash distributions, generated by revenue it derives from investments in income-producing real estate properties; and
- (b) to maximize unit value through the ongoing active management of the REIT's assets, the acquisition of additional properties and the development and construction of projects which are pre-leased to creditworthy tenants.

The REIT considers its capital to be its unitholders' equity, non-controlling interest, mortgages payable, debentures payable and bank indebtedness. As long as the REIT complies with its investment and debt restrictions set out in its Declaration of Trust, it is free to determine the appropriate level of capital in context with its cash flow requirements, overall business risks and potential business opportunities. As a result of this, the REIT will make adjustments to its capital based on its investment strategies and changes in economic conditions.

Finance Trust's primary objective when managing capital is to provide unitholders with a cash distribution from the interest income it earns on its notes receivable and cash. Finance Trust manages its capital by adhering to the investment restrictions outlined in its Declaration of Trust.

The REIT's level of indebtedness is subject to the limitations set out in its Declaration of Trust. The REIT is limited to a total indebtedness to gross book value ratio of 65% (provided that for this purpose "indebtedness" excludes the 2013 Convertible Debentures, 2014 Convertible Debentures, 2017 Convertible Debentures and U.S. Holdco notes payable to Finance Trust). In June 2010, the Declaration of Trust was amended to exclude from "indebtedness" certain guarantees provided by the REIT of debt assumed by purchasers on a primary obligor basis, in connection with past dispositions of properties, and for which the purchaser has provided the REIT an indemnity or similar arrangement. As at June 30, 2010, this ratio was 50.6% (December 31, 2009 - 52.5%). Management uses this ratio as a key indicator in managing the REIT's capital.

In addition to the above key ratio, the REIT's general operating facility (note 9(a)) has the following covenants which are required to be calculated based on the REIT's and Finance Trust's combined financial statements:

		June 30	December 31
Covenant		2010	2009
(a) Maximum indebtedness to gross book value	65%	50.7%	50.5%
(b) Minimum debt service coverage ratio	1.20 : 1	1.49 : 1	1.55 : 1
(c) Minimum equity	\$1,300,000 plus 75% of net cash proceeds from future equity offerings	\$1,596,747	\$1,513,666

The REIT has other various covenants with respect to its debt. The REIT is in compliance with the covenants as at June 30, 2010.

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18. Capital risk management (continued):

The REIT's mortgage providers also have minimum limits on debt-to-service coverage ratios ranging from 1.10 to 1.50 as at June 30, 2010 and December 31, 2009. The REIT monitors these ratios and is in compliance with such external requirements, except for the mortgages due on demand (note 7).

19. Risk management:

(a) *Credit risk:*

The REIT is exposed to credit risk as an owner of income properties in that tenants may experience financial difficulty and be unable to fulfill their lease commitment or the failure of tenants to occupy and pay rent in accordance with existing lease agreements. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties and acquires income properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, account for a significant portion of the REIT's cash flow. The only tenants which account for more than 5% of the rental income from income properties are Bell Canada, TransCanada PipeLines Limited, Telus Communications and Bell Mobility. Each of these companies that have a public debt rating is rated with at least an A (low) rating by a recognized rating agency.

(b) *Liquidity risk:*

The REIT is subject to liquidity risk on its mortgages payable, debentures payable and bank indebtedness whereby it may not be able to refinance or pay its debt obligations when they become due.

Management's strategy for managing liquidity risk is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when they come due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the REIT's reputation. In order to meet this strategy, the REIT strives to enter into long-term leases with creditworthy tenants which assists in the REIT's primary strategy of maintaining predictable cash flows. The REIT attempts to appropriately structure the term of mortgages to closely match the term of leases. This strategy enables the REIT to meet its contractual monthly mortgage obligations. Due to the long-term length of most of the REIT's mortgages, a significant amount of principal is usually paid by the time the mortgages mature.

The contractual obligations for mortgages payable are disclosed in note 7. The REIT also has contractual obligations for debentures payable, as described in note 8.

The agreements and indentures governing indebtedness of the REIT contain certain covenants that, among other things, require the REIT to maintain certain financial ratios and thresholds and impose on the REIT certain restrictions (subject in each case to exceptions) regarding: the disposition of the Bow project, lands related to the Bow, or any other properties or assets in excess of certain thresholds; the creation of liens or granting of negative pledges; creation or incurrence of debt; the making of distributions; the purchase or redemption of securities; the entering into any merger or similar transaction with any person; changes of a fundamental nature (including senior management, business objectives, purposes or operations, capital structure, constating documents, and subordinated debt); the cancellation or waiver of material contracts; the making of any investment in excess of certain thresholds; the repayment or repurchase of any subordinated indebtedness; the involvement of other real estate development or construction projects in excess of certain thresholds; and changes to the Bow project budget. As a result, the REIT is limited by such covenants and restrictions.

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19. Risk management (continued):

Management measures its liquidity risk through review of financial covenants contained in debt agreements and in accordance with the Declaration of Trust. In order to maintain liquidity, the REIT has a general operating facility, as described in note 9 (a), available to draw on to fund its obligations.

(c) *Market risk:*

The REIT is subject to currency risk and interest rate risk. The REIT's objective is to manage and control market risk exposure within acceptable parameters, while optimizing the return on risk.

(i) *Currency risk:*

A portion of the REIT's properties are located in the United States, and therefore, the REIT is subject to foreign currency fluctuations that may impact its financial position and results. In order to mitigate the risk, the REIT's debt on these properties is also held in U.S. dollars to act as a natural hedge. In addition, the REIT entered into a foreign exchange forward contract with a Canadian chartered bank effectively locking the REIT's rate to exchange \$2,000 USD per month at 1.0402 for a two-year period expiring in April 2012. The fair value of this foreign exchange forward contract as at June 30, 2010 is \$1,248 and has been recorded as a liability resulting in an unrealized loss of \$1,213 for the three and six months ended June 30, 2010.

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.03 for the six months ended June 30, 2010 (June 30, 2009 - \$1.21) would have decreased other comprehensive income by approximately \$10,000 (June 30, 2009 - \$25,800) and increased net earnings by approximately \$100 (June 30, 2009 - \$1,700). This analysis assumes that all the variables, in particular interest rates, remain constant (a \$0.10 weakening of the Canadian dollar against the U.S. dollar at June 30, 2010 would have had the equal but opposite effect).

(ii) *Interest rate risk:*

The REIT is exposed to interest rate risk on its borrowings. It minimizes this risk by obtaining long-term fixed interest rate debt. At June 30, 2010, the percentage of fixed rate debt to total debt was 98.5% (December 31, 2009 - 99.6%). As at June 30, 2010, the REIT does not account for any of its fixed rate financial liabilities as held-for-trading. Therefore, a change in interest rates at the reporting date would not affect net income with respect to these fixed rate instruments.

The bank indebtedness is subject to variable interest rates. An increase in interest rates of 100 basis points for the three months ended June 30, 2010 would have decreased net earnings by approximately \$100 (June 30, 2009 - \$195) and for the six months ended June 30, 2010 would have decreased net earnings by approximately \$100 (June 30, 2009 - \$500). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

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20. Related party transactions:

H&R Property Management Ltd. (the "Property Manager"), a company partially owned by family members of the Chief Executive Officer, provides property management services for substantially all properties owned by the REIT, including leasing services, for a fee of 2% of gross revenue. The Property Manager also provides support services in connection with the acquisition, disposition and development activities of the REIT and is also entitled to an incentive fee. Acquisitions and development support services are provided for a fee of 2/3 of 1% of total acquisition and development costs, as defined in the agreement which is effective January 1, 2007. Effective January 1, 2008, the support services relating to dispositions of income properties are provided for a fee of 10% of the gain on sale of income properties adjusted for the add back of accumulated depreciation and amortization. The current agreement expires on January 1, 2015 with one automatic five-year extension.

During the three months ended June 30, 2010, the REIT recorded fees pursuant to this agreement of \$3,437 (June 30, 2009 - \$3,431), of which nil (June 30, 2009 - nil) was capitalized to the cost of the income properties acquired, \$616 (June 30, 2009 - \$514) was capitalized to properties under development and \$317 (June 30, 2009 - \$371) was capitalized to leasing expenses. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the three months ended June 30, 2010, a further amount of \$625 (June 30, 2009 - \$1,050) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager. Of this amount, nil (June 30, 2009 - \$1,050) has been waived by the Property Manager and \$625 (June 30, 2009 - nil) has been expensed in the combined statements of earnings.

During the six months ended June 30, 2010, the REIT recorded fees pursuant to this agreement of \$7,096 (June 30, 2009 - \$6,970), of which \$410 (June 30, 2009 - nil) was capitalized to the cost of the income properties acquired, \$1,058 (June 30, 2009 - \$1,002) was capitalized to properties under development and \$847 (June 30, 2009 - \$1,228) was capitalized to leasing expenses. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the six months ended June 30, 2010, a further amount of \$1,250 (June 30, 2009 - \$2,240) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager. Of this amount, nil (June 30, 2009 - \$2,240) has been waived by the Property Manager and \$1,250 (June 30, 2009 - nil) has been expensed in the combined statements of earnings.

Pursuant to the above agreements, as at June 30, 2010, \$1,482 (December 31, 2009 - \$857) was payable to the Property Manager.

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the three months ended June 30, 2010 is \$334 (June 30, 2009 - \$313) and for the six months ended June 30, 2010 is \$666 (June 30, 2009 - \$614).

These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements
(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

21. Segmented disclosures:

Segmented information on identifiable assets by geographic region and property operating income is as follows:

Capital assets are attributed to countries based on the location of the properties.

	June 30	December 31
	2010	2009
Income properties and properties under development		
Canada	\$4,008,173	\$3,823,522
United States	1,130,541	1,095,868
	\$5,138,714	\$4,919,390

Net property operating income for the three months ended June 30, 2010	United		Total
	Canada	States	
Operating revenue	\$ 127,337	\$ 24,809	\$ 152,146
Property operating costs	(43,684)	(4,398)	(48,082)
Interest	(31,365)	(13,059)	(44,424)
Depreciation and amortization	(23,114)	(8,404)	(31,518)
Net property operating income	\$ 29,174	\$ (1,052)	\$ 28,122

Net property operating income for the three months ended June 30, 2009	United		Total
	Canada	States	
Operating revenue	\$ 124,411	\$ 26,092	\$ 150,503
Property operating costs	(41,202)	(4,596)	(45,798)
Interest	(30,410)	(14,789)	(45,199)
Depreciation and amortization	(22,734)	(8,357)	(31,091)
Net property operating income	\$ 30,065	\$ (1,650)	\$ 28,415

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements
(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

21. Segmented disclosures (continued):

Net property operating income for the six months ended June 30, 2010	Canada	United States	Total
Operating revenue	\$ 255,546	\$ 49,097	\$ 304,643
Property operating costs	(88,965)	(8,785)	(97,750)
Interest	(65,048)	(26,042)	(91,090)
Depreciation and amortization	(45,981)	(16,735)	(62,716)
Net property operating income	\$ 55,552	\$ (2,465)	\$ 53,087

Net property operating income for the six months ended June 30, 2009	Canada	United States	Total
Operating revenue	\$ 252,127	\$ 56,163	\$ 308,290
Property operating costs	(87,557)	(9,737)	(97,294)
Interest	(58,320)	(30,636)	(88,956)
Depreciation and amortization	(45,569)	(17,516)	(63,085)
Net property operating income	\$ 60,681	\$ (1,726)	\$ 58,955

22. Income tax recovery (expense):

	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Income tax recovery (expense) included in the determination of net earnings from continuing operations:				
Current	\$ (116)	\$ (93)	\$ (228)	\$ (166)
Future	124,821	(1,544)	123,303	(6,059)
	124,705	(1,637)	123,075	(6,225)
Future income tax included in the determination of other comprehensive income	502	970	503	910
	\$ 125,207	\$ (667)	\$ 123,578	\$ (5,315)

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

22. Income tax recovery (expense) (continued):

On June 22, 2007, legislation relating to the federal income taxation of a specified investment flow-through trust or partnership (a "SIFT"), received royal assent (the "SIFT Rules"). A SIFT includes certain publicly listed or traded partnerships and trusts and generally includes an income trust. The REIT is a SIFT until December 31, 2010, as discussed below.

Under the SIFT Rules, following a transition period for qualifying SIFTs, certain distributions from a SIFT will no longer be deductible in computing the SIFT's taxable income, and the SIFT will be subject to tax on an amount equal to the amount of such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital will not be subject to such tax.

A SIFT which was publicly listed before November 1, 2006 (an "Existing Trust") will become subject to the tax on distributions commencing with the 2011 taxation year end. However, an Existing Trust may become subject to this tax prior to the 2011 taxation year end if its equity capital increases beyond certain limits measured against the market capitalization of the Existing Trust at the close of trading on October 31, 2006. The REIT has not exceeded such limits.

Under the SIFT Rules, the new taxation regime will not apply to a real estate investment trust that meets prescribed conditions relating to the nature of its income and investments throughout the taxation year (the "REIT Exemption").

During the second quarter of 2010, the REIT completed the necessary restructuring to qualify for the REIT Exemption commencing January 1, 2011. Accordingly, management believes the REIT will not be subject to the SIFT Rules provided that the REIT does not exceed the normal growth guidelines at any time prior to 2011 and qualifies for the REIT Exemption at all times after 2010. Accordingly, the net future income tax liability of \$124,821 for the three months ended June 30, 2010 was reversed into earnings.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

23. Assets held for sale and discontinued operations:

There are currently no properties held for sale as at June 30, 2010 (December 31, 2009 - one industrial and one retail property).

The following table sets forth the balance sheets associated with income properties classified as discontinued operations.

	December 31
	2009
<hr/>	
Assets	
Income properties (net of accumulated depreciation of 2009 - \$3,418)	\$ 17,465
Accrued rent receivable	188
Prepaid expenses and sundry assets	105
Accounts receivable	36
Leasing expenses (net of accumulated amortization of 2009 - \$1,206)	960
Cash and cash equivalents	281
	<hr/>
	\$ 19,035
<hr/>	
Liabilities	
Accounts payable and accrued liabilities	\$ 2,211
Bank indebtedness	4
	<hr/>
	\$ 2,215
<hr/>	

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

23. Assets held for sale and discontinued operations (continued):

The REIT sold two properties during the first six months of 2010 and seven properties in the year ended December 31, 2009. The results of operations from these properties have been separately disclosed below.

	Three Months Ended		Six Months Ended	
	June 30		June 30	
Net earnings from discontinued operations	2010	2009	2010	2009
Operating revenue:				
Rentals from income properties	\$ 38	\$ 4,885	\$ 400	\$ 10,375
Straight-lining of contractual rent	-	354	(129)	686
Rent amortization of tenant inducements	-	-	-	(92)
Rent amortization of above- and below-market rents	-	3	-	7
	38	5,242	271	10,976
Interest income	-	-	-	1
	38	5,242	271	10,977
Operating expenses:				
Property operating costs	4	1,249	300	2,656
Contractual interest on mortgages payable	-	1,645	-	3,373
Effective interest rate accretion	-	99	-	153
Bank interest and charges	-	-	-	1
Depreciation and amortization	-	232	41	1,451
	4	3,225	341	7,634
Net property operating income (loss)	34	2,017	(70)	3,343
Gain (loss) on sale of income properties	(24)	6,441	3,609	6,865
Non-controlling interest (note 10)	-	(311)	(129)	(376)
Net earnings from discontinued operations	\$ 10	\$ 8,147	\$ 3,410	\$ 9,832

24. Commitments and contingencies:

- (a) The REIT is currently undertaking significant development activities for the two million square foot office building in Calgary, Alberta (the "Bow"), which is fully pre-leased to EnCana Corporation for a 25-year term. The REIT has committed to incurring additional construction and development costs for this project of approximately \$609,000, including capitalized interest, over the remaining construction period, of which approximately \$500,000 is expected to be incurred during the next twelve months. As at June 30, 2010, the total cost incurred on the project amounted to \$937,935 (note 4). This budget includes the construction of 1,360 parking stalls. Construction commenced in the spring of 2007 and is planned to be completed in 2012 to meet the completion timetable. The first four tranche completion dates upon which floors are scheduled to be delivered to EnCana Corporation are as follows: floors 1-14 by July 3, 2011, floors 15-23 by August 29, 2011, floors 24-29 by September 10, 2011 and floors 30-41 by October 12, 2011. The delivery schedule of floors 42-59 is expected to be set by the end of November 2011. In certain circumstances, should the delivery of tranches of space within the project be delayed, the REIT will be liable to the tenant for certain delay costs which may be significant.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Unaudited Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

For the six months ended June 30, 2010 and 2009

24. Commitments and contingencies (continued):

- (b) In the normal course of operations, the REIT has issued letters of credit in connection with developments, financings, operations and acquisitions. As at June 30, 2010, the REIT has outstanding letters of credit totalling \$29,817 (December 31, 2009 - \$34,349), including \$18,232 (December 31, 2009 - \$18,164) which has been pledged as security for certain mortgages payable. These letters of credit are secured in the same manner as the bank indebtedness (note 9 (a)).
- (c) The REIT provides guarantees on behalf of third parties, including co-owners. As at June 30, 2010, the REIT issued guarantees amounting to \$42,308 (December 31, 2009 - \$43,278), expiring between 2011 and 2016, relating to the co-owner's share of mortgage liability. In addition, the REIT continues to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable until such debts are extinguished or the lenders agree to release the REIT's covenants. At June 30, 2010 the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$117,773 (December 31, 2009 - \$119,150) which expires between 2013 and 2018. There have been no defaults by the primary obligor for debts on which the REIT has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in these financial statements.

Credit risks arise in the event that these parties default on repayment of their debt since they are guaranteed by the REIT. These credit risks are mitigated as the REIT has recourse under these guarantees in the event of a default by the borrowers, in which case the REIT's claim would be against the underlying real estate investments.

- (d) The REIT is involved in litigation and claims in relation to the income properties that arise from time to time in the normal course of business. In the opinion of management, any liability that may arise from such contingencies would not have a significant adverse effect on the combined financial statements.

25. Comparative figures:

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

26. Subsequent events:

- (a) In July 2010, the REIT completed a public offering of \$100,000 of 5.90% Series D convertible unsecured subordinated debentures due June 30, 2020 (the "2020 Convertible Debentures"). Each 2020 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at a conversion price of \$23.50 per Stapled Unit at: (i) any time prior to the maturity date and (ii) the business day immediately preceding the date specified by the REIT for redemption of the 2020 Convertible Debentures.
- (b) In August 2010, the REIT completed the acquisition of a retail property comprising approximately 14,800 square feet located in Tyler, Texas for a purchase price of approximately \$6,600.
- (c) In August 2010, the REIT completed the acquisition of two retail properties located in Taylor and Wilkes-Barre, Pennsylvania comprising approximately 133,100 square feet for a total purchase price of approximately \$18,400.

**COMBINED MANAGEMENT'S DISCUSSION
AND ANALYSIS OF H&R REAL ESTATE
INVESTMENT TRUST AND H&R FINANCE TRUST**

For the Three and Six months ended June 30, 2010

Dated: August 12, 2010

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SECTION I

FORWARD-LOOKING DISCLAIMER

Management's discussion and analysis ("MD&A") of the combined financial position and the combined results of operations of H&R Real Estate Investment Trust (the "REIT") and H&R Finance Trust ("Finance Trust" and collectively with the REIT, "Trusts") for the three and six months ended June 30, 2010 should be read in conjunction with the Trusts' combined financial statements and the notes thereto for the years ended December 31, 2009 and 2008. Historical results, including trends which might appear, should not be taken as indicative of future operations or results. Certain prior period items have been reclassified to conform with the presentation adopted in the current period.

Certain information in this MD&A contains forward-looking information within the meaning of applicable securities laws (also known as forward-looking statements) including, among others, statements made or implied under the headings "Results of Operations", "Liquidity and Capital Resources", "Outlook" and "Risks and Uncertainties" relating to the Trusts' objectives, strategies to achieve those objectives, the Trusts' beliefs, plans, estimates, projections and intentions, and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts including, in particular, the Trusts' expectation regarding future development in connection with the Bow. Forward-looking statements generally can be identified by words such as "outlook", "objective", "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "should", "plans", "project", "budget" or "continue" or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect the Trusts' current beliefs and are based on information currently available to management.

Forward-looking statements are provided for the purpose of presenting information about management's current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. These statements are not guarantees of future performance and are based on the Trusts' estimates and assumptions that are subject to risks and uncertainties, including those described below under "Risks and Uncertainties" and those discussed in the Trusts' materials filed with the Canadian securities regulatory authorities from time to time, which could cause the actual results and performance of the Trusts to differ materially from the forward-looking statements contained in this MD&A. Those risks and uncertainties include, among other things, risks related to: Unit prices; availability of cash for distributions; development and financing relating to the Bow development; restrictions pursuant to the terms of indebtedness; liquidity; credit risk and tenant concentration; interest rate and other debt related risk; tax risk; ability to access capital markets; dilution; lease rollover risk; construction risks; currency risk; unitholder liability; co-ownership interest in properties; competition for real property investments; environmental matters; reliance on one corporation for management of substantially all the REIT's properties; changes in legislation and indebtedness of the Trusts. Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements include that the general economy is stable; local real estate conditions are stable; interest rates are relatively stable; and equity and debt markets continue to provide access to capital. The Trusts caution that this list of factors is not exhaustive. Although the forward-looking statements contained in this MD&A are based upon what the Trusts believe are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements.

Readers are also urged to examine the REIT and Finance Trust's materials filed with the Canadian securities regulatory authorities from time to time as they may contain discussions on risks and uncertainties which could cause the actual results and performance of the REIT and Finance Trust to differ materially from the forward-looking statements contained in this MD&A. Neither Finance Trust nor any of its trustees or officers, assumes any responsibility for the completeness of the information contained in the REIT's materials filed with the Canadian securities regulatory authorities or for any failure of the REIT or its trustees or officers to disclose events or facts which may have occurred or which may affect the significance or accuracy of any such information. Neither the REIT nor any of its trustees or officers, assumes any responsibility for the completeness of the information contained in Finance Trust's materials filed with the Canadian securities regulatory authorities or for any failure of Finance Trust or its trustees or officers to disclose events or facts which may have occurred or which may affect the significance or accuracy of any such information.

All forward-looking statements in this MD&A are qualified by these cautionary statements. These forward-looking statements are made as of August 12, 2010 and the Trusts, except as required by applicable law, assume no obligation to update or revise them to reflect new information or the occurrence of future events or circumstances. All information for the three and six months ended June 30, 2010 and 2009 is unaudited.

OVERVIEW

The REIT is an unincorporated open-ended trust created by a Declaration of Trust and governed by the laws of the Province of Ontario.

Unitholders are entitled to have their REIT units comprising part of the Stapled Units (as defined below), redeemed at any time on demand payable in cash (subject to monthly limits) and/or *in specie*, provided that the corresponding Finance Trust units are being contemporaneously redeemed.

Finance Trust is an unincorporated investment trust. Finance Trust was established pursuant to a Plan of Arrangement (the "Plan of Arrangement") on October 1, 2008 as an open-ended limited purpose unit trust pursuant to its Declaration of Trust. Each issued and outstanding Finance Trust unit is "stapled" to a unit of the REIT on a one-for-one basis such that Finance Trust units and the REIT units trade together as stapled units ("Stapled Units"), and such Stapled Units are listed and posted for trading on the Toronto Stock Exchange ("TSX"). Apart from provisions necessary to achieve such stapling, each REIT unit and Finance Trust unit retains its own separate identity and is separately listed (but not posted for trading) on the TSX (unless there is an event of uncoupling, in which case Finance Trust units will cease to be listed on the TSX).

The REIT has two primary objectives:

- to provide unitholders with stable and growing cash distributions, generated by the revenue it derives from investments in income producing real estate properties; and
- to maximize unit value through ongoing active management of the REIT's assets, acquisition of additional properties and the development and construction of projects which are pre-leased to creditworthy tenants.

The REIT's strategy to accomplish these two objectives is to accumulate a diversified portfolio of high quality income producing properties in Canada and the United States occupied by creditworthy tenants on a long-term basis. The REIT does not have any specific allocation targets as to property type, but rather focuses on creditworthy tenants with long-term leases.

Currently, the REIT's main focus is on the construction of the Bow in Calgary, AB. The total budget for the project is \$1.5 billion net of rent received during the construction period. The Bow is a 2-million square foot head office complex pre-leased, on a triple net basis, to EnCana Corporation for a term of 25 years. EnCana Corporation is scheduled to begin occupancy in 2011. The project is currently on schedule and on budget. The total annualized year one projected income from the Bow is expected to be approximately \$94 million. Rent step ups will be 0.75% per annum on the office space and 1.5% per annum on the parking income for the full 25-year term.

The primary purpose of Finance Trust is to be a flow-through vehicle to allow the REIT to indirectly access the capital markets in a tax-efficient manner by indirectly borrowing money from the REIT's unitholders. Finance Trust's primary activity is to hold debt issued by H&R REIT (U.S.) Holdings Inc. ("U.S. Holdco"), a wholly owned U.S. subsidiary of the REIT. As at June 30, 2010, Finance Trust holds U.S. \$122.7 million of aggregate principal amount of notes payable by U.S. Holdco ("U.S. Holdco Notes"). Subject to cash flow requirements, Finance Trust intends to distribute to its unitholders, who are also unitholders of the REIT, all of its cash flow, consisting primarily of interest paid by U.S. Holdco, less administrative and other expenses and amounts to satisfy liabilities.

Investment Restrictions

Under Finance Trust's Declaration of Trust, the assets of Finance Trust may be invested only in:

- (a) U.S. Holdco Notes; and
- (b) temporary investments in cash, term deposits with a Canadian chartered bank or trust company registered under the laws of a province of Canada, short-term government debt securities, or money market instruments (including banker's acceptances) of, or guaranteed by, a Schedule 1 Canadian bank ("Cash Equivalents"), but only if each of the following conditions are satisfied: (a) if the Cash Equivalents have a maturity date, the trustees hold them until maturity; (b) the Cash Equivalents are required to fund expenses of Finance Trust, a redemption of units, or distributions to unitholders, in each case before the next distribution date; and (c) the purpose of holding the Cash Equivalents is to prevent funds from being non-productive, and not to take advantage of market fluctuations.

The Finance Trust Declaration of Trust provides that Finance Trust shall not make any investment, take any action or omit to take any action which would result in the units of Finance Trust not being considered units of a "mutual fund trust" for purposes of the Income Tax Act (Canada) (the "Tax Act") or that would disqualify Finance Trust as a "fixed investment trust" under the Internal Revenue Code of 1986 as amended (the "Code") and the applicable regulations. In order to qualify as a "fixed investment trust" under the Code, Finance Trust generally may not acquire assets other than the U.S. Holdco Notes or certain investments in cash or cash equivalents.

FINANCIAL HIGHLIGHTS

(in '000's except per unit amounts)	June 30, 2010	December 31, 2009
Total assets	\$5,394,898	\$5,351,123
Debt to gross book value of assets (per the REIT's Declaration of Trust)	50.6%	52.5%
Debt to gross book value of assets	57.0%	56.8%
Units outstanding	144,178	143,825
Class B units of H&R Limited Partnership outstanding	5,438	5,438
	Three months ended June 30, 2010	Three months ended June 30, 2009
Property rental revenue	\$151,344	\$148,999
Property operating income	28,122	28,415
Normalized funds from operations ("NFFO")	55,064	59,634
Weighted average number of basic units for NFFO	149,469	147,784
Normalized funds from operations per basic unit	\$0.37	\$0.40
Distributions paid per unit	\$0.18	\$0.18
Payout ratio per unit as a % of basic NFFO	48.6%	45.0%

Net earnings is reconciled to FFO which is reconciled both to NFFO and AFFO. AFFO is reconciled to cash provided by operations, being the most comparable GAAP measures to these non-GAAP financial measures. See pages 22-26.

NON-GAAP FINANCIAL MEASURES

Property operating income, same-asset property operating income, funds from operations ("FFO"), normalized funds from operations ("NFFO"), adjusted funds from operations ("AFFO") and Gross Book Value ("GBV") are all supplemental financial measures used by management to track the Trusts' financial performance. Such measures are not recognized under Canadian generally accepted accounting principles ("GAAP") and therefore do not have standardized meanings prescribed by GAAP. Management believes that these non-GAAP financial measures are a meaningful measure of operating performance as they reject the assumption that the value of real estate investments diminishes predictably over time. These non-GAAP financial measures should not be construed as alternatives to comparable financial measures calculated in accordance with GAAP. Further, the Trusts' method of calculating such supplemental financial measures may differ from the methods of other real estate investment trusts or other issuers and accordingly, such supplemental financial measures used by management may not be comparable to similar measures presented by other real estate investment trusts or other issuers.

KEY PERFORMANCE DRIVERS

OPERATIONS		Office	Industrial	Retail	Total*
<i>Occupancy as at June 30⁽¹⁾</i>	2010	98.6%	98.3%	99.9%	98.7%
	2009	99.0%	98.6%	99.9%	98.9%
<i>Occupancy – same asset as at June 30⁽²⁾</i>	2010	98.6%	98.3%	99.9%	98.7%
	2009	99.3%	98.4%	99.9%	98.9%
<i>Average contractual rent per square foot for the three months ended June 30⁽³⁾</i>	2010	\$19.79	\$5.74	\$12.48	\$10.15
	2009	\$19.53	\$5.82	\$13.04	\$10.18

* weighted average total

⁽¹⁾ Excluding those tenants who have filed for protection under Chapter 11 of the United States Bankruptcy Code.

⁽²⁾ Same asset refers to those properties owned by the REIT for the entire eighteen month period ended June 30, 2010 and excludes any assets classified as discontinued operations and those assets whose tenants terminated their leases due to U.S. bankruptcies.

⁽³⁾ For continuing operations only and excluding those tenants who have filed for protection under Chapter 11 of the United States Bankruptcy Code.

	June 30, 2010	December 31, 2009
Average remaining term to maturity of leases (years)	10.3	10.5
Average remaining term to maturity of mortgages payable (years)	8.0	8.3

PORTFOLIO OVERVIEW

The geographic diversification of the REIT's portfolio (excluding those properties whose tenants have filed for Chapter 11 protection with a United States bankruptcy court) as at June 30, 2010 is outlined in the charts below:

NUMBER OF PROPERTIES	Ontario	United States	Alberta	Quebec	Other	Total
Office	22	2	4	1	4	33
Industrial	53	16	19	11	19	118
Retail	32	76	5	5	3	121
Total	107	94	28	17	26	272

Square Feet (in thousands)	Ontario	United States	Alberta	Quebec	Other	Total
Office	5,208	258	1,406	452	884	8,208
Industrial	9,450	6,314	2,810	2,850	1,176	22,600
Retail	1,759	4,666	515	498	524	7,962
Total	16,417	11,238	4,731	3,800	2,584	38,770

Properties under development (in thousands of dollars)

Project	Address	June 30, 2010	December 31, 2009
The Bow	5 th Ave. At Centre Street, Calgary, AB	\$937,935	\$719,173
Heart Lake	Mayfield West Business Park, Caledon, ON	39,880	39,809
Airport Road	7900 Airport Rd., Brampton, ON	36,132	35,552
		\$1,013,947	\$794,534

Top Twenty Sources of Revenue by Tenant

	Tenant	% of rentals from income properties ⁽¹⁾	Number of locations	REIT owned sq.ft. (in 000's)	Average lease term to maturity (in years)
1.	Bell Canada	11.6	4	1,734	15.3
2.	TransCanada Pipelines Limited	7.2	2	950	10.7
3.	Telus Communications	6.0	2	943	12.9
4.	Bell Mobility	5.6	2	775	15.4
5.	Rona Inc.	3.9	14	2,151	9.4
6.	Versacold Logistics Canada Inc.	3.4	12	1,733	16.5
7.	Canadian Tire Corp.	3.4	4	2,189	16.2
8.	Royal Bank of Canada	3.1	4	466	6.2
9.	Lowes Companies Inc.	2.3	11	1,435	8.7
10.	Nestle USA	1.9	3	2,168	7.3
11.	Nestle Canada Inc.	1.9	1	170	9.2
12.	Shell Oil Products	1.8	18	249	12.1
13.	Purolator Courier	1.8	12	1,071	10.9
14.	Public Works of Canada	1.6	3	277	6.8
15.	Finning International	1.6	16	893	11.9
16.	Marsh Supermarkets	1.4	9	548	16.4
17.	Hudson's Bay Company	1.1	3	937	8.7
18.	Sobey's Inc.	1.1	10	347	11.6
19.	Loblaw Properties Limited	1.0	1	716	12.6
20.	BJ's Wholesale Club Inc.	1.0	4	452	11.8
	Total	62.7%	135	20,204	

⁽¹⁾ The percentage of rentals from income properties is based on estimated annualized gross revenue excluding the straight lining of contractual rent and discontinued operations.

LEASE EXPIRIES	Office		Industrial		Retail		Total	
	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry
2010 *	0.1	23.59	0.3	6.49	0.1	23.05	0.5	13.22
2011	0.4	23.04	0.4	12.71	0.1	10.52	0.9	17.06
2012	0.7	17.27	1.8	5.04	0.1	20.42	2.6	8.92
2013	0.5	18.42	5.3	5.33	0.4	9.59	6.2	6.66
2014	1.4	16.52	3.5	4.49	0.4	7.00	5.3	7.86
	3.1	18.07	11.3	5.32	1.1	10.94	15.5	8.26

* for the balance of the year

H&R REIT & FINANCE TRUST- MD&A - June 30, 2010

MORTGAGES PAYABLE	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2010 *	\$49,033	\$10,719	\$59,752	2.2%	6.0%
2011	100,748	70,246	170,994	6.4%	6.5%
2012	99,967	269,501	369,468	13.8%	6.7%
2013	95,642	101,450	197,092	7.4%	7.5%
2014	96,283	182,632	278,915	10.4%	6.2%
Thereafter			1,600,102	59.8%	
			2,676,323	100%	
Mortgages payable due on demand ⁽¹⁾			134,687		
Financing cost and mark-to-market adjustment arising on acquisitions ⁽²⁾			(6,389)		
Total			\$2,804,621		

* For the balance of the year

⁽¹⁾ Relates to nine non-recourse mortgages to the REIT for income properties in which the tenants (Boscov's Department Stores and Bruno's Supermarkets LLC), filed for protection under Chapter 11 of the United States Bankruptcy Code. The REIT has handed over control of seven of these income properties to the lenders and therefore expects to be released from any further obligations under these non-recourse mortgages upon the transfer of title to the lenders.

⁽²⁾ Mark-to-market adjustment represents the difference between the actual mortgages assumed on property acquisitions and the fair value of the mortgages at the date of purchase and is recognized in interest over the life of the applicable mortgage using the effective interest rate method. Deferred financing costs are deducted from the REIT's mortgages payable balances and are recognized in interest over the life of the applicable mortgage.

OUTLOOK

Construction of the Bow, our \$1.5-billion office development in downtown Calgary, is progressing on time and on budget. EnCana is scheduled to take full occupancy of the 58-storey landmark tower during 2012, at which time the Bow should emerge as one of the highest quality office towers in Canada and the keystone of the REIT's portfolio of properties.

Equity and credit markets have eased dramatically over the past year and continue to steadily improve which has allowed us to reduce our real estate financing costs and shore up our balance sheet. This was evidenced by the REIT entering the senior unsecured debenture market in February 2010. The REIT issued \$230 million of unsecured senior debentures at an average contractual interest rate of 5.55% for an average term of six years. In July 2010, the REIT issued \$100 million of convertible unsecured debentures at an interest rate of 5.90% for a 10-year term further demonstrating the improving markets. More abundant and cheaper capital has also increased demand for commercial properties, placing downward pressure on cap rates and thereby increasing the market value of our portfolio.

The REIT acquired 4 newly constructed retail properties in the United States for \$61 million during the first quarter of 2010. The REIT assumed \$36 million of mortgages payable at a contractual interest rate of 6% for a term of twenty years. The REIT's initial levered return from these acquisitions is expected to be approximately 10%. We expect to continue our acquisition strategy this year on a very select and disciplined basis. There are currently few opportunities in Canada to acquire high-quality properties at attractive pricing. However, in the United States, the recovery in the commercial real estate markets and capital markets has been much slower, resulting in higher cap rates than equivalent Canadian properties with financing for good quality properties becoming increasingly available and at attractive pricing.

Last quarter the Trusts announced their intent to increase distributions on a quarterly basis by 25 basis points beginning in October 2010 to the end of Q2 2012 at which time the Bow will be complete and fully occupied and generating net annual rent of approximately \$94 million. The trustees will then review the distribution policy taking into account the additional cash being generated by the Bow. The REIT's portfolio is performing well as it was specifically designed to do, and management sees continued growth from our contracted rental escalations and accretive acquisitions. There seems to be no pressure of rising interest rates in the near term, and management expects continued demand for our units as investors thirst for secure yield continues to grow. In short, the Trusts remain very optimistic and excited about their ability to continue to grow and prosper in the coming year.

The Trust's current distribution policy (as mentioned above) is outlined below.

Distribution Period	Monthly Distribution Per Stapled Unit	Annualized Distribution Per Stapled Unit
Q3 2010 (July, August and September)	\$0.0700	\$0.84
Q4 2010 (October, November and December)	\$0.0725	\$0.87
Q1 2011 (January, February and March)	\$0.0750	\$0.90
Q2 2011 (April, May and June)	\$0.0775	\$0.93
Q3 2011 (July, August and September)	\$0.0800	\$0.96
Q4 2011 (October, November and December)	\$0.0825	\$0.99
Q1 2012 (January, February and March)	\$0.0850	\$1.02
Q2 2012 (April, May and June)	\$0.0875	\$1.05

The trustees retain the right to re-evaluate its distribution policy from time to time as they consider appropriate. As all distributions remain subject to declaration by the REIT's trustees, there is no assurance that the actual distributions declared will be as provided in the distribution policy.

SECTION II

RESULTS OF OPERATIONS

(in thousands of dollars except per unit amounts)	Three months ended June 30			Six months ended June 30		
	2010	2009	% Change	2010	2009	% Change
Operating revenue:						
Rentals from income properties	\$151,344	\$148,999	2	\$302,567	\$305,291	(1)
Interest income	802	1,504	(47)	2,076	2,999	(31)
	152,146	150,503	1	304,643	308,290	(1)
Operating expenses:						
Property operating costs	48,082	45,798	5	97,750	97,294	-
Interest	44,424	45,199	(2)	91,090	88,956	2
Depreciation and amortization	31,518	31,091	1	62,716	63,085	(1)
	124,024	122,088	2	251,556	249,335	1
Net property operating income	28,122	28,415	(1)	53,087	58,955	(10)
Net gain (loss) on foreign exchange	4,730	(12,092)		1,202	(7,197)	
Impairment loss on income properties	-	(6,763)		-	(14,992)	
Unrealized gain (loss) on derivative instruments	(7,124)	5,767		(7,055)	5,767	
Loss on repayment of debentures	-	-		(38,834)	-	
Gain on extinguishment of debt	1,655	-		1,655	-	
Trust expenses	(2,258)	(1,957)		(4,817)	(3,820)	
Net earnings before income taxes, non-controlling interest and discontinued operations	25,125	13,370		5,238	38,713	
Income tax recovery (expense)	124,705	(1,637)		123,075	(6,225)	
Net earnings before non-controlling interest and discontinued operations	149,830	11,733		128,313	32,488	
Non-controlling interest	(5,175)	(979)		(4,318)	(1,321)	
Net earnings from continuing operations	144,655	10,754		123,995	31,167	
Net earnings from discontinued operations	10	8,147		3,410	9,832	
Net earnings	\$144,665	\$18,901		\$127,405	\$40,999	
Basic net earnings per unit						
Continuing operations	\$1.00	\$0.07		\$0.86	\$0.22	
Discontinued operations	-	0.06		0.02	0.07	
	\$1.00	\$0.13		\$0.88	\$0.29	
Diluted net earnings per unit						
Continuing operations	\$0.91	\$0.07		\$0.84	\$0.21	
Discontinued operations	-	0.06		0.02	0.06	
	\$0.91	\$0.13		\$0.86	\$0.27	

The net change in net earnings for both the three months and six months ended June 30, 2010 as compared to the respective 2009 periods is mainly due to the income tax recovery, loss on repayment of debentures, the change in impairment loss on income properties, gain on extinguishment of debt and the strengthening of the Canadian dollar as compared to the U.S. dollar.

Rentals from Income Properties

Rentals from income properties ("rentals") include all amounts earned from tenants related to lease agreements, including basic rent, parking income, operating cost recoveries and realty tax recoveries. Rentals from properties sold or where an asset meets the held-for-sale criteria have been recorded under net earnings from discontinued operations during the six months ended June 30, 2010 and 2009.

Rentals from Income Properties (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Same-asset – current rentals	\$148,621	\$147,253	\$1,368	\$298,543	\$299,120	(\$577)
Same-asset – straight-lining of contractual rent	2,242	3,345	(1,103)	4,301	7,034	(2,733)
Same-asset rent amortization	(938)	(1,010)	72	(2,108)	(1,851)	(257)
Acquisitions – current rentals, rent amortization and straight-lining of contractual rent	1,419	-	1,419	1,799	-	1,799
Terminated leases due to U.S. bankruptcies	-	(589)	589	32	988	(956)
Total rentals	\$151,344	\$148,999	\$2,345	\$302,567	\$305,291	(\$2,724)

The increase in same-asset current rentals of \$1.4 million for Q2 2010 as compared to Q2 2009 is primarily due to the following items:

- same-asset current rentals from properties in the United States have decreased by \$3.3 million primarily due to the weakening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the three months ended June 30, 2010 was \$1.02 Canadian for each \$1.00 U.S. (Q2 2009 - \$1.17);
- an increase of \$1.2 million in tenant recoveries due to higher property operating expenses;
- an increase of \$1.1 million from rent step ups during the term of tenant leases. This increase is offset by a decrease to the straight-lining of contractual rent which has an inverse relationship with current rentals; and
- an increase of \$2.3 million due to lease terminations and higher recoveries in 2010 as compared to 2009 relating to the final reconciliation of tenant billings for the prior year.

The decrease in same-asset current rentals of \$0.6 million for the six months ended June 30, 2010 as compared to the same 2009 period is primarily due to the following items:

- same-asset current rentals from properties in the United States have decreased by \$7.8 million primarily due to the weakening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the six months ended June 30, 2010 was \$1.03 Canadian for each \$1.00 U.S. (June 30, 2009 - \$1.21);
- a decrease of \$2.1 million in tenant recoveries due to lower property operating expenses;
- an increase of \$4.1 million of additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements;
- an increase of \$2.7 million from rent step ups during the term of tenant leases. This increase is offset by a decrease to the straight-lining of contractual rent which has an inverse relationship with current rentals; and
- an increase of \$2.3 million due to lease terminations and higher recoveries in 2010 as compared to 2009 relating to the final reconciliation of tenant billings for the prior year.

Property Operating Costs

Property operating costs include costs relating to such items as cleaning, interior and exterior building repairs and maintenance, elevator, HVAC and insurance (collectively "building operating costs"); realty taxes; utilities and property management fees among other items. For Q2 2010, building operating costs, realty taxes, utilities and property management fees represented 17.0%, 55.0%, 12.3%, and 6.6% respectively of total property operating costs (Q2 2009 - 15.2%, 58.2%, 10.7% and 5.5%). For the six months ended June 30, 2010, these costs represented 17.6%, 54.5%, 12.9% and 6.3% respectively of total property operating costs (June 30, 2009 - 18.4%, 55.5%, 11.7% and 4.8%).

Property Operating Costs (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Same-asset property operating costs	\$47,580	\$45,632	\$1,948	\$96,909	\$96,689	\$220
Acquisitions	240	-	240	307	-	307
Terminated leases due to U.S. bankruptcies	262	166	96	534	605	(71)
Total property operating costs	\$48,082	\$45,798	\$2,284	\$97,750	\$97,294	\$456

The increase in same-asset property operating costs of \$1.9 million for Q2 2010 as compared to Q2 2009 is due primarily to the following reasons:

- lower expenses related to the REIT's U.S. properties of \$0.5 million due primarily to the change in foreign exchange rates;
- higher regular property operating expenses of \$1.2 million;
- higher capital expenditure expenses of \$0.6 million; and
- higher management fees of \$0.6 million due to an incentive fee of \$0.6 million (Q2 2009 - nil) payable to H&R Property Management Ltd. In 2009, the incentive fee was waived by H&R Property Management Ltd.

The increase in same-asset property operating costs of \$0.2 million for the six months ended June 30, 2010 as compared to the six months ended June 30, 2009 is due primarily to the following reasons:

- lower expenses related to the REIT's U.S. properties of \$1.2 million due primarily to the change in foreign exchange rates;
- lower regular property operating expenses of \$2.1 million;
- higher capital expenditure expenses of \$2.2 million; and
- higher management fees of \$1.3 million due to an incentive fee of \$1.3 million (June 30, 2009 - nil) payable to H&R Property Management Ltd. In 2009, the incentive fee was waived by H&R Property Management Ltd.

Same-Asset Property Operating Income *	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Same-asset current rentals and straight-lining of contractual rent	\$150,863	\$150,598	\$265	\$302,844	\$306,154	(\$3,310)
Same-asset - property operating costs	47,580	45,632	1,948	96,909	96,689	220
Total same-asset - property operating income	103,283	104,966	(1,683)	205,935	209,465	(3,530)
Total same-asset - property operating income excluding straight-lining of contractual rent	\$101,041	\$101,621	(\$580)	\$201,634	\$202,431	(\$797)

* Same-asset property operating income excludes the properties where the tenants have terminated their leases due to U.S. bankruptcies.

Total same-asset property operating income, excluding straight-lining of contractual rent, has decreased by \$0.6 million for the three months and by \$0.8 million for the six months ended June 30, 2010 as compared to the respective 2009 periods. The net change in same-asset property operating income excluding straight-lining of contractual rent resulted from an increase in Canada of \$2.1 million and \$5.9 million respectively, which was offset by a corresponding decrease of \$2.7 million and \$6.7 million respectively in the United States, as shown below:

	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Canada (in thousands of dollars)						
Same-asset current rentals	\$125,460	\$120,835	\$4,625	\$251,718	\$244,454	\$7,264
Same-asset property operating costs	43,691	41,199	2,492	88,966	87,557	1,409
Same-asset property operating income excluding straight-lining of contractual rent	81,769	79,636	2,133	162,752	156,897	5,855
United States (in thousands of dollars)						
Same-asset current rentals	23,161	26,418	(3,257)	46,825	54,666	(7,841)
Same-asset property operating costs	3,889	4,433	(544)	7,943	9,132	(1,189)
Same-asset property operating income excluding straight-lining of contractual rent	19,272	21,985	(2,713)	38,882	45,534	(6,652)
Total same-asset property operating income *	\$101,041	\$101,621	(\$580)	\$201,634	\$202,431	(\$797)

* Same-asset property operating income excludes the properties where the tenants have terminated their leases due to U.S. bankruptcies.

The increase in the Canadian same-asset property operating income of \$2.1 million for Q2 2010 as compared to Q2 2009 is primarily due to lease terminations and an increase in prior year recoveries of \$2.3 million, and increases in rent of \$1.1 million offset by higher capital expenditures of \$0.6 million and higher management fee expenses of \$0.6 million. The increase in the Canadian same-asset property operating income of \$5.9 million for the six months ended June 30, 2010 as compared to the 2009 period is primarily due to increased recoverable amounts from tenants for capital expenditures of \$4.1 million, increases in rent of \$2.7 million and lease terminations and prior year recoveries of \$2.3 million, offset by higher capital expenditures of \$2.2 million and higher management fees of \$1.3 million.

The decrease in the U.S. same-asset property operating income of \$2.7 million for Q2 2010 as compared to Q2 2009 and of \$6.7 million for the six months ended June 30, 2010 as compared to the six months ended June 30, 2009 is due primarily to the weakening of the U.S. dollar. The average exchange rate for the three months ended June 30, 2010 was \$1.02 Canadian for each \$1.00 U.S. (Q2 2009 - \$1.17). For the six months ended June 30, 2010, the average exchange rate was \$1.03 (June 30, 2009 - \$1.21). Had the U.S. same-asset property operating income been reported in U.S. dollars, there would have been minimal changes between the 2010 and 2009 respective periods.

Interest Income

(in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Interest income	\$802	\$1,504	(\$702)	\$2,076	\$2,999	(\$923)

Interest income decreased when comparing Q2 2010 to Q2 2009 and for the six months ended June 30, 2010 as opposed to June 30, 2009. The decrease is primarily due to the collection of a \$16.5 million mortgage receivable in December 2009, and the collection of a \$58 million mortgage receivable in April 2010.

Interest Expense

(in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Contractual interest on mortgages payable	\$43,191	\$45,557	(\$2,366)	\$86,567	\$92,334	(\$5,767)
Contractual interest on debentures payable	10,231	6,191	4,040	21,274	8,077	13,197
Effective interest rate accretion	2,643	806	1,837	5,206	1,332	3,874
Bank interest and charges	556	551	5	943	1,718	(775)
	56,621	53,105	3,516	113,990	103,461	10,529
Capitalized interest	(12,197)	(7,906)	(4,291)	(22,900)	(14,505)	(8,395)
Interest expense	\$44,424	\$45,199	(\$775)	\$91,090	\$88,956	\$2,134

Included in mortgage interest for the three months ended June 30, 2010 is an accrual of \$2.2 million (Q2 2009 - \$2.6 million) which relates to interest accrued for the mortgages on those properties where the tenant has filed for protection under Chapter 11 of the United States Bankruptcy Code. Upon the lender taking title to the properties and releasing the REIT's subsidiaries from all obligations under these mortgages this accrual will be reversed into earnings. The amount expensed for the six months ended June 30, 2010 is \$4.6 million (June 30, 2009 - \$5.0 million). The decrease in the balance is primarily due to a decrease in foreign exchange rates between Q2 2010 and Q2 2009 and for the six months ended June 30, 2010 as compared to the six months ended June 30, 2009. As at both June 30, 2010 and 2009, the REIT's weighted average contractual mortgage rate was 6.2%.

Debenture interest increased for both the three and six month periods ended June 30, 2010 as compared to the respective 2009 periods due to the REIT issuing \$200 million of Non-Convertible Debentures in April 2009 (at a contractual annual interest rate of 11.50%), \$150 million of convertible debentures in July 2009 (at a contractual annual interest rate of 6.75%), and \$175 million of convertible debentures in December 2009 (at a contractual annual interest rate of 6.00%). In February 2010, the REIT issued \$230 million of senior unsecured debentures (at an average contractual annual interest rate of 5.55%) and repaid \$200 million of Non-Convertible Debenture the REIT had issued in April 2009.

Effective interest rate accretion is a non-cash item. This accretion increased by \$1.8 million between Q2 2010 and Q2 2009 and by \$3.9 million for the six months ended June 30, 2010 as compared to the six months ended June 30, 2009 due to the issuance of the above \$555 million of debentures between July 1, 2009 and June 30, 2010. These debentures have a weighted average contractual interest rate of 6.12% as compared to a weighted average effective interest rate of 8.35%.

The amount of capitalized interest will continue to increase as the REIT continues to fund its development projects. The majority of this increase is due to the Bow development.

Net Gain (Loss) on Foreign Exchange

(in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Net gain (loss) on foreign exchange	\$4,730	(\$12,092)	\$16,822	\$1,202	(\$7,197)	\$8,399

The net gain (loss) on foreign exchange, which was recorded in Finance Trust, is due to a difference in exchange rates as the notes receivable from U.S. Holdco are denominated in U.S. dollars while the financial statements of Finance Trust are expressed in Canadian dollars. The notes are eliminated upon combination however, the foreign exchange difference is not eliminated on combination as U.S. Holdco is a self-sustaining operation of the REIT.

Unrealized Gain (Loss) on Derivative Instruments

(in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Unrealized gain (loss) on derivative instruments	(\$7,124)	\$5,767	(\$12,891)	(\$7,055)	\$5,767	(\$12,822)

Upon entering into the construction facility for the Bow, the REIT entered into an interest rate swap which effectively locked the interest rate on the construction facility at 6.90%. At the end of each reporting period, the interest rate swap is marked to market,

resulting in an unrealized gain or loss recorded in net earnings. Upon the construction facility being utilized, the difference between the hedged rate and the actual rate will be recorded as a realized gain or loss in net earnings. A realized gain or loss will be recorded upon maturity of the swap which will coincide with the maturity of the construction facility.

In May 2010, the REIT entered into a foreign exchange forward contract with a Canadian chartered bank which effectively locked the REIT's rate to exchange \$2 million USD per month at 1.0402 for a two-year period in order to lock in a portion of the REIT's projected USD FFO and AFFO at a fixed Canadian dollar amount. The remaining foreign exchange forward contracts are marked to market through earnings each reporting period. As each month's contract is realized, any gain or loss is recorded into earnings at that time.

In June 2010, the REIT secured a floating rate mortgage on a property. In order to fix the interest rate, the REIT entered into an interest rate swap, which is marked to market through earnings each reporting period.

<i>Loss on Repayment of Debentures</i> (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Loss on repayment of debentures	-	-	-	\$38,834	-	\$38,834

In February 2010, the REIT repaid the outstanding Non-Convertible Debentures having an aggregate face value of \$200 million for a total repurchase price of \$230 million. The repurchase price included accrued interest of approximately \$2 million. The REIT recognized a one-time non-recurring charge to the combined statement of earnings of approximately \$39 million, representing the difference between the repurchase price, excluding accrued interest expense, and the carrying value of the Non-Convertible Debentures of \$189 million.

<i>Gain on Extinguishment of Debt</i> (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Gain on extinguishment of debt	\$1,655	-	\$1,655	\$1,655	-	\$1,655

In May 2010, the REIT was legally released from its mortgage on the Circuit City Distribution Warehouse upon the lender accepting title to the property. This released the REIT from the debt owing with respect to the mortgage on this property. As a result, the income property, the mortgage and the accrued interest on the mortgage were all derecognized resulting in a gain on extinguishment of debt of \$1.7 million for both the three and six months ended June 30, 2010.

<i>Trust Expenses</i> (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Trust expenses	\$2,258	\$1,957	\$301	\$4,817	\$3,820	\$997

Trust expenses are primarily comprised of salaries, professional fees and trustee fees. Trust expenses increased quarter over quarter and for the six months ended June 30, 2010 over the respective 2009 periods. The primary reasons for the increases are due to increased stock-based compensation expense, increased professional fees and costs associated with the upcoming implementation of IFRS.

<i>Income Tax Recovery (Expense)</i> (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Current income tax expense	(\$116)	(\$93)	(\$23)	(\$228)	(\$166)	(\$62)
Future income tax recovery (expense)	124,821	(1,544)	126,365	123,303	(6,059)	129,362
Total income tax recovery (expense)	\$124,705	(\$1,637)	\$126,342	\$123,075	(\$6,225)	\$129,300

The REIT is generally subject to tax in Canada under the Tax Act with respect to its taxable income each year, except to the extent such taxable income is paid or made payable to unitholders and deducted by the REIT for tax purposes.

During the second quarter of 2010, the REIT completed the necessary restructuring to qualify for the SIFT Exemption under the SIFT rules commencing January 1, 2011. See the "Tax Risk" section for further discussion. Accordingly, the net future income tax liability has been reversed into earnings. This amount was \$124.8 million for the three months ended June 30, 2010 and \$123.3 million for the six months ended June 30, 2010.

Net Earnings from Discontinued Operations

When the REIT decides to sell an asset that no longer fits its investment strategy and re-distribute the proceeds towards more attractive opportunities or when a tenant exercises an option under the terms of its lease to purchase a property, or when the REIT initiates the sale of an asset, the net property operating income, any gain or loss as a result of the sale and the attributable portion of non-controlling interest for those properties are presented on the income statement in net earnings from discontinued operations as summarized below:

<i>Net Earnings from Discontinued Operations</i> (in thousands of dollars)	Three months ended June 30			Six months ended June 30		
	2010	2009	Change	2010	2009	Change
Net property operating income (loss)	\$34	\$2,017	(\$1,983)	(\$70)	\$3,343	(\$3,413)
Gain (loss) on sale of income properties	(24)	6,441	(6,465)	3,609	6,865	(3,256)
Non-controlling interest	-	(311)	311	(129)	(376)	247
Net earnings from discontinued operations	\$10	\$8,147	(\$8,137)	\$3,410	\$9,832	(\$6,422)

During the three months ended June 30, 2010, the REIT sold no income properties (Q2 2009 - one) for gross proceeds of nil (Q2 2009 - \$18.4 million). For the six months ended June 30, 2010, the REIT sold two income properties (June 30, 2009 - three) for gross proceeds of \$23.3 million (June 30, 2009 - \$39.2 million). The net earnings from discontinued operations include the results from these properties and from four properties sold during the remainder of 2009. The REIT currently has no properties held for sale.

Dispositions from January 1, 2010 to June 30, 2010

Property	Property Type	Date Sold	Square Footage	Gross Proceeds (\$ Millions)	Ownership Interest disposed
2390 Argentia Rd., Mississauga, ON	Industrial	Jan 12, 2010	179,054	\$12.3	100%
110 Sheppard Ave., E., Toronto, ON	Office	Mar 1, 2010	154,022	11.0	50%
Total			333,076	\$23.3	

Dispositions from January 1, 2009 to June 30, 2009

Property	Property Type	Date Sold	Square Footage	Gross Proceeds (\$ Millions)	Ownership Interest disposed
2435 EW Connector, Austell, GA	Retail	Feb 10, 2009	115,396	\$16.4	100%
97 Thames Rd., E. Exeter, ON	Industrial	Mar 16, 2009	84,000	4.4	100%
1711 Springfield Rd., Kelowna, BC	Retail	June 3, 2009	110,178	18.4	100%
Total			309,574	\$39.2	

SEGMENTED INFORMATION

The REIT invests in income producing properties in both Canada and the United States with tenants that are creditworthy and on long-term leases.

The REIT is not required to report in its financial statements on the performance of each class of assets separately due to management's assessment that all assets effectively adhere to the same investment policy of being leased on a long-term basis to creditworthy tenants and the fact that the REIT manages all assets on a similar basis.

Segmented disclosure is provided in the financial statements by net property operating income on a geographic basis as the property operations in the United States are considered to be a geographic segment. This segmented information on net property operating income is as follows:

Net property operating income for the three months ended June 30, 2010

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$127,337	\$24,809	\$152,146
Property operating costs	(43,684)	(4,398)	(48,082)
Interest	(31,365)	(13,059)	(44,424)
Depreciation and amortization	(23,114)	(8,404)	(31,518)
Net property operating income	\$29,174	(\$1,052)	\$28,122

Net property operating income for the three months ended June 30, 2009

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$124,411	\$26,092	\$150,503
Property operating costs	(41,202)	(4,596)	(45,798)
Interest	(30,410)	(14,789)	(45,199)
Depreciation and amortization	(22,734)	(8,357)	(31,091)
Net property operating income	\$30,065	(\$1,650)	\$28,415

Net property operating income for the six months ended June 30, 2010

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$255,546	\$49,097	\$304,643
Property operating costs	(88,965)	(8,785)	(97,750)
Interest	(65,048)	(26,042)	(91,090)
Depreciation and amortization	(45,981)	(16,735)	(62,716)
Net property operating income	\$55,552	(\$2,465)	\$53,087

Net property operating income for the six months ended June 30, 2009

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$252,127	\$56,163	\$308,290
Property operating costs	(87,557)	(9,737)	(97,294)
Interest	(58,320)	(30,636)	(88,956)
Depreciation and amortization	(45,569)	(17,516)	(63,085)
Net property operating income	\$60,681	(\$1,726)	\$58,955

For the three months ended June 30, 2010, the net property operating loss for properties located in the United States was \$1.1 million as compared to a loss of \$1.7 million for the three months ended June 30, 2009. The change of \$0.6 million is primarily due to a change in foreign exchange rates and U.S. property acquisitions. Had the net property income for properties located in the United States been shown in U.S. dollars, and excluding the net property loss from those properties where the tenants have terminated their leases, it would have shown income of \$2.2 million for the three months ended June 30, 2010 as compared to income of \$1.8 million for the three months ended June 30, 2009. The increase of \$0.4 million is due primarily to property acquisitions and a decrease in mortgage interest expense.

For the six months ended June 30, 2010, the net property operating loss from properties located in the United States was \$2.5 million as compared to a loss of \$1.7 million for the six months ended June 30, 2009. The change of \$0.8 million is primarily due to a change in foreign exchange rates and U.S. property acquisitions. Had the net property operating income for properties located in the United States been shown in U.S. dollars and excluding the net property operating loss from these properties where the tenants have terminated their leases, it would have shown income of \$4.3 million for the six months ended June 30, 2010 as compared to \$3.6 million for the six months ended June 30, 2009. The increase of \$0.7 million is due to property acquisitions and a decrease in mortgage interest expense.

ASSETS

Income Properties

Opening balance - December 31, 2009	\$4,124,856
Acquisitions	
Purchase price of acquisitions	61,045
Transaction costs incurred	908
Purchase price allocated to intangible liabilities based on EIC-140 calculation	564
Mark to market adjustment of mortgages payable	<u>(1,186)</u>
	61,331
Expenditures capitalized to building improvements	9,491
Foreign exchange difference	11,807
Depreciation and amortization	(62,109)
Income property removed from financial statements upon lender taking title to property	(20,609)
Closing balance - June 30, 2010	\$4,124,767

The REIT acquired four properties during the six months ended June 30, 2010. These acquisitions less mortgages assumed were funded from the REIT's general operating facility and from funds received upon the sale of properties. There were no properties acquired during the year ended December 31, 2009.

2010 Acquisitions:

Property	Year Built	Property Type	Date Acquired	Square Footage	Purchase Price (\$ Millions)	Tenant Name	Remaining Lease Term (years)
7919 Day Dr., Parma, OH	2008	Retail	Feb 26, 2010	92,634	\$18.9	Giant Eagle	20
2951 SW Wanamaker Rd., Topeka, KS	2008	Retail	Mar 12, 2010	75,149	14.9	Hy-Vee	20
115-118 Wilmar Ave., Grand Island, NE	2008	Retail	Mar 12, 2010	83,331	13.2	Hy-Vee	20
9400 E. 350 Highway, Raytown, MO	2009	Retail	Mar 12, 2010	66,900	14.1	Hy-Vee	20
Total				318,014	\$61.1		

The dollar figures shown above for U.S. acquisitions are in Canadian dollars and are based on the exchange rates at the date of such acquisitions.

On acquisition of the above properties, the REIT assumed \$36.3 million of mortgages payable, bearing interest at a contractual rate of 6% per annum. Each mortgage is for a term of twenty years and is non-recourse to the REIT but has recourse to the specific property to which the mortgage applies. The REIT's initial levered return from these acquisitions is expected to be 10.0%.

The portfolio continues to remain in good condition. The average age of the total portfolio from the date built or renovated is 16.6 years at June 30, 2010 (December 31, 2009 - 16.3 years) and the average age of properties by type of asset is as follows:

Average Age by Type of Asset	June 30, 2010 (years)	December 31, 2009 (years)
Office	18.9	18.4
Industrial	17.3	16.9
Retail	12.2	12.1
Total	16.6	16.3

Legal title to each of the United States properties is held by a separate legal entity which is 100% owned, directly or indirectly, by U.S. Holdco, a subsidiary of the REIT. The assets of each such separate entity are not available to satisfy the debts or obligations of any other person or entity; each such separate entity maintains separate books and records. The identity of the owner of a particular U.S. property is available from U.S. Holdco. This structure does not prevent distributions to U.S. Holdco provided there are no conditions of default.

The composition of the net book value of income properties expressed by type of asset and by region is as follows:

Net Book Value by Type of Asset (millions)	June 30, 2010	December 31, 2009
Office	\$1,552	\$1,565
Industrial	1,350	1,388
Retail	1,223	1,172
	\$4,125	\$4,125

Net Book Value by Region (millions)	June 30, 2010	December 31, 2009
Ontario	\$1,741	\$1,763
Alberta	589	595
Other	426	433
Quebec	238	238
Canada	2,994	3,029
United States	1,131	1,096
Total	\$4,125	\$4,125

Capital expenditures are now either capitalized and depreciated or expensed in the year incurred. As a result, the REIT expects to incur the following costs:

Year	Total Amount Expected to be Incurred	Amount Expected to be Capitalized	Amount Expected to be Expensed to Property Operating Costs	Total Expected Recovery	Amount Expected to be Recovered in the Year Incurred	Amount Expected to be Recovered thereafter
2010 *	\$12 million	\$5 million	\$7 million	\$11 million	\$8 million	\$3 million
2011	\$15 million	\$10 million	\$5 million	\$13 million	\$11 million	\$2 million

* For the balance of the year

The information contained in the table above is based on current tenancies in place and management's estimates of these costs being recovered through tenants leases.

Properties Under Development

The REIT entered into agreements to develop the Bow, a 2 million square foot head office complex in Calgary, Alberta for a budgeted cost of approximately \$1.5 billion, including expected capitalized interest, and net of rent received during the construction period. The budget includes the cost to construct 1,360 parking stalls. The total budget includes approximately \$31 million in development cost contingencies. The REIT has entered into fixed price contracts amounting to approximately 85% of the budgeted \$1.1 billion of hard construction costs. As a result, together with the costs incurred to date, the REIT has effectively locked in approximately 91% of the total budget before contingencies. See Section V for a discussion on development and financing risk relating to the Bow.

The REIT is expecting to incur approximately \$234 million of the Bow's development costs over the next six months. See "Liquidity and Capital Resources" for the budget breakdown and the anticipated sources of funds.

The building is fully pre-leased, on a triple net basis, to EnCana Corporation for 25 years. The REIT has now established the first four tranche completion dates upon which floors are scheduled to be delivered to EnCana Corporation as follows. Floors 1-14 by July 3, 2011, floors 15-23 by August 29, 2011, floors 24-29 by September 10, 2011 and floors 30-41 by October 12, 2011. The delivery schedule of floors 42-59 is expected to be set by the end of November 2011. The total annualized year one projected income from the Bow is expected to be approximately \$94 million. Rent step ups will be 0.75% per annum on the office space and 1.5% per annum on the parking income for the full 25-year term. During the six months ended June 30, 2010, the REIT incurred additional costs of \$218.7 million in this project to bring the REIT's total investment to \$937.9 million (December 31, 2009 - \$719.2 million). Structural steel erection has now reached the 54th floor. Metal deck installation is complete to the 44th floor with installation progressing on levels above.

Accrued Rent Receivable

Certain leases call for rental payments that increase over the lease term. To comply with Canadian GAAP, the rental revenue from these leases are recorded on a straight-line basis, resulting in accruals for rents that are not billable or due until future periods. Accrued rent receivable has increased by 4% or \$5.1 million from \$125.2 million at December 31, 2009 to \$130.3 million at June 30, 2010 with a corresponding increase to rentals from income properties.

Cash and cash equivalents

Cash and cash equivalents decreased to \$18.2 million at June 30, 2010 from \$109.2 million at December 31, 2009 primarily due to the continued funding of properties under development and the purchase of income properties.

Mortgages and amount receivable

Mortgages and amount receivable decreased from \$63.8 million to \$3.0 million from December 31, 2009 to June 30, 2010. The decrease of \$60.8 million is primarily due to the collection of a \$58 million mortgage receivable in April 2010 along with the collection of \$3.2 million of a mortgage receivable which was granted to the REIT's partner in the Airport Road lands during 2008.

<i>Other Assets (in thousands of dollars)</i>	June 30, 2010	December 31, 2009
Tenant inducements	\$34,809	\$29,797
Leasing expenses	26,528	27,542
Prepaid expenses and sundry assets	21,314	12,811
Restricted cash	13,144	20,001
Future income tax asset	-	14,316
Accounts receivable	8,895	6,543
Swap derivatives	-	3,463
Other Assets	\$104,690	\$114,473

Tenant inducements increased by \$5.0 million in the six months ended June 30, 2010 due primarily to one inducement for a tenant at 310-330 Front Street offset by normal periodic amortization.

Prepaid expenses and sundry assets have increased from \$12.8 million at December 31, 2009 to \$21.3 million at June 30, 2010 primarily due to an increase in prepaid realty taxes.

Restricted cash decreased from \$20.0 million at December 31, 2009 to \$13.1 million at June 30, 2010 due primarily to a reduction in funds being held from one tenant who paid their rent for the majority of 2010 in December 2009.

Future income tax asset has decreased from \$14.3 million at December 31, 2009 to nil as at June 30, 2010 as the REIT has now completed the necessary restructuring to permit the REIT to qualify for the REIT Exemption beginning in 2011. Accordingly, this balance has been reversed into earnings.

Swap derivatives represent the fair value of the interest rate swap on the Bow construction facility. As at June 30, 2010, this amount is included in derivative instruments which is a liability of \$3.6 million as compared to an asset of \$3.5 million as at December 31, 2009. The liability also includes the fair value of the remaining monthly future foreign exchange forward contracts, which were entered into in May 2010 along with the fair value of the previously mentioned interest rate swap on a mortgage.

LIABILITIES

The REIT's Declaration of Trust limits the indebtedness of the REIT (subject to certain exceptions) to a maximum of 65% of the gross book value ("GBV") of the REIT.

	June 30, 2010	December 31, 2009
Total debt to GBV per the Declaration of Trust ⁽¹⁾	50.6%	52.5%
Total debt to GBV of combined financial statements	57.0%	56.8%
Non-recourse debt as a percentage of total debt	44.3%	44.9%
Floating rate debt as a percentage of total debt	1.5%	0.4%
Canadian properties total debt to GBV	54.3%	56.6%
U.S. properties total debt to GBV	66.5%	66.5%

⁽¹⁾ Total debt per the REIT's Declaration of Trust is based on the gross book value of the REIT and excludes all convertible debentures. At the annual general meeting of the REIT in June 2010, the REIT's Declaration of Trust was amended to exclude certain guarantees provided by the REIT of debt assumed by purchasers, on a primary obligor basis, in connection with past dispositions of properties and for which the purchaser has provided the REIT an indemnity or similar arrangement from the REIT's calculation of debt to GBV as per the Declaration of Trust. In December 2009, the amount of these guarantees was \$119.2 million. The REIT's calculation of total debt to GBV is not recognized under GAAP and therefore does not have a standardized meaning prescribed by GAAP.

There were no material changes in the debt ratios above. The high percentage of non-recourse debt in the REIT's portfolio is a deliberate strategy adopted by the REIT to reduce risk within the property portfolio.

Mortgages Payable

Opening balance - December 31, 2009	\$2,818,476
Principal payments	(48,022)
Mortgage repaid upon maturity	(3,161)
New mortgages	47,741
Mortgage payable released upon lender taking title to property	(20,805)
Foreign exchange difference	10,392
Closing balance - June 30, 2010	\$2,804,621

The mortgages bear interest at the weighted average rate of 6.2% (December 31, 2009 – 6.2%) and mature between 2010 and 2035. The weighted average term to maturity of the REIT's mortgages is 8.0 years (December 31, 2009 - 8.3 years). Going forward based on current market conditions and current lenders, the REIT anticipates being able to refinance all its debt as it matures. Notwithstanding this, the REIT may choose to repay some of its mortgages as they mature. Of the total mortgages (excluding mortgages due on demand), 2.2% will mature during the balance of 2010 and 6.4% will mature in 2011. The mortgages coming due before the end of 2010 bear interest at a weighted average rate on maturity of 6.0% while mortgages coming due during 2011 bear

interest at a weighted average rate on maturity of 6.5%. For a further discussion of interest rate risk, please see "Risks and Uncertainties".

Debt related to certain Canadian properties is held by separate legal entities, where the rent received from each property is first used to satisfy the related debt obligations with any balance then available to satisfy the cash flow requirements of the REIT.

Segmented disclosure by geographic location is provided as follows:

(in thousands of dollars)	June 30, 2010	December 31, 2009
Mortgages payable - Canada	\$1,912,339	\$1,950,224
Mortgages payable - United States	892,282	868,252
Total	\$2,804,621	\$2,818,476

Debentures Payable

	Maturity Date	Contractual Interest Rate	Effective Interest Rate	Conversion Price	Face Value (in millions)	Carrying Value June 30, 2010 (in millions)	Carrying Value December 31, 2009 (in millions)
2013 Convertible Debentures	June 30, 2013	6.65%	9.10%	\$23.11	\$115.0	\$107.7	\$106.8
2014 Convertible Debentures	December 31, 2014	6.75%	12.30%	\$14.00	\$149.9	\$121.7	\$119.4
2017 Convertible Debentures	June 30, 2017	6.00%	8.60%	\$19.00	\$175.0	\$152.0	\$150.8
Series A Senior Debentures	February 3, 2015	5.20%	5.40%	n/a	\$115.0	\$114.0	-
Series B Senior Debentures	February 3, 2017	5.90%	6.06%	n/a	\$115.0	\$114.0	-
Non-Convertible Debentures	-	11.50%	12.90%	n/a	-	-	\$188.8
					\$669.9	\$609.4	\$565.8

Debentures payable increased by \$43.6 million to \$609.4 million at June 30, 2010 from \$565.8 million at December 31, 2009. During the six months ended June 30, 2010, the REIT issued Series A and Series B Senior Debentures with a carrying value of \$228 million in aggregate, and repaid in full the Non-Convertible Debentures which had a carrying value of \$188.8 million at December 31, 2009.

Series A Senior Debentures and Series B Senior Debentures:

In February 2010, the REIT issued \$115 million Series A unsecured senior debentures (the "Series A Senior Debentures"), bearing interest at the annual contractual rate of 5.20% and an effective interest rate of 5.40%. The Series A Senior Debentures mature on February 3, 2015, and interest is paid semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$114.0 million, net of issue costs of \$1.0 million.

In February 2010, the REIT issued \$115 million Series B unsecured senior debentures (the "Series B Senior Debentures"), bearing interest at the annual contractual rate of 5.90% and an effective interest rate of 6.06%. The Series B Senior Debentures mature on February 3, 2017, and interest is paid semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$114.0 million, net of issue costs of \$1.0 million.

At its option, the REIT may redeem any of the Series A Senior Debentures or Series B Senior Debentures, (collectively "Senior Debentures"), in whole at any time, or in part from time to time, prior to maturity on payment of a redemption price equal to the greater of (i) the Canada Yield Price as defined in the Supplemental Trust Indenture and (ii) par, together in each case with accrued and unpaid interest to the date fixed for redemption. The REIT will give notice of any redemption at least 30 days but not more than 60 days before the date fixed for redemption. Where less than all of any Senior Debentures are to be redeemed pursuant to their terms, the Senior Debentures to be so redeemed will be redeemed on a pro rata basis according to the principal amount of Senior Debentures registered in the respective name of each holder of Senior Debentures or in such other manner as the Indenture Trustee may consider equitable.

The Senior Debentures have covenants relating to the maintenance of an adjusted interest coverage ratio of 1.65 or better, the limiting of indebtedness to asset of 65% and the maintenance of an Adjusted Unitholders' Equity of not less than \$1 billion. The Senior Debentures are rated BBB (with a Stable trend) by Dominion Bond Rating Services Limited ("DBRS").

In February 2010, the REIT repaid the outstanding Non-Convertible Debentures having an aggregate face value of \$200 million for a total repurchase price of \$230 million. The repurchase price included accrued interest of approximately \$2 million. The REIT recognized a one-time non-recurring charge to the combined statement of earnings of approximately \$39 million, representing the difference between the repurchase price, excluding accrued interest expense, and the carrying value of the Non-Convertible Debentures of \$189 million.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities increased by \$28.1 million from \$167.0 million at December 31, 2009 to \$195.1 million at June 30, 2010. The change is mainly due to an increase in accruals relating to properties under development and tenant inducements. These accruals at June 30, 2010 totalled \$90.2 million as compared to \$74.5 million at December 31, 2009. Also included in accrued liabilities is the total interest accrued to date on the non-recourse mortgages under default of \$15.1 million (December 31, 2009 - \$11.7 million). Other payables and accruals increased as a result of transactions occurring in the normal course of business operations including an increase of \$5.2 million due to increased interest accrued on the Senior Debentures as interest is not paid on these debentures until August 2010.

Future Income Tax Liability

As at June 30, 2010, the REIT has qualified for the REIT Exemption beginning in 2011. Accordingly, the REIT and holders of REIT units will not become subject to the SIFT Rules, and the REIT will not be liable to pay tax, provided that the REIT does not exceed the normal growth guidelines at any time prior to 2011 and continues to qualify for the REIT Exemption at all times after 2010. As a result, the future income tax liability of \$138.1 million recorded as at December 31, 2009 has been reversed into income.

EQUITY

Unitholders' Equity

Unitholders' equity increased by \$83.1 million between December 31, 2009 and June 30, 2010. The increase is due primarily to net earnings offset by the distributions paid to unitholders.

The majority of the accumulated other comprehensive loss is made up of the net adjustment to the equity invested in U.S.Holdco with the REIT's debt being held in U.S. dollars currently acting as a natural hedge against its total investment in U.S. dollars.

LIQUIDITY AND CAPITAL RESOURCES

Funds from Operations, Normalized Funds from Operations and Adjusted Funds from Operations

Funds from operations ("FFO"), normalized funds from operations ("NFFO") and adjusted funds from operations ("AFFO") are not measures recognized under GAAP and do not have standardized meanings prescribed by GAAP. FFO, NFFO and AFFO should not be construed as alternatives to net earnings or cash provided by operations determined in accordance with GAAP as an indicator of the Trusts' performance (see also "Non-GAAP Financial Measures"). However, FFO, and AFFO are operating performance measures which are widely used by the real estate industry (and in particular, by a number of other Canadian real estate investment trusts). The Trusts have calculated FFO in accordance with the recommendations of the Real Property Association of Canada which does not include any adjustment for realized or unrealized losses on foreign exchange or derivative instruments in the calculation of FFO. The Trusts' method of calculating FFO, NFFO and AFFO may differ from other issuers' methods and accordingly may not be comparable to similar measures presented by other issuers.

The use of FFO, NFFO and AFFO, combined with the required GAAP presentations, have been presented for the purpose of improving the understanding of operating results of the Trusts by the investing public.

FUNDS FROM OPERATIONS AND NORMALIZED FUNDS FROM OPERATIONS

(in thousands of dollars except per unit amounts)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Net earnings	\$144,665	\$18,901	\$127,405	\$40,999
Add (deduct)				
Depreciation and amortization	31,518	31,091	62,716	63,085
Impairment loss on income properties	-	6,763	-	14,992
(Gain) loss on sale of income properties	24	(6,441)	(3,609)	(6,865)
Future income tax (recovery) expense	(124,821)	1,544	(123,303)	6,059
Net earnings attributable to non-controlling interest	5,175	1,290	4,447	1,697
Operating (income) loss from discontinued operations	(34)	(2,017)	70	(3,343)
Funds from operations – continuing operations	56,527	51,131	67,726	116,624
Funds from operations – discontinued operations	34	2,249	(29)	4,794
Funds from operations	\$56,561	\$53,380	\$67,697	\$121,418
Add (deduct)				
Net loss on derivative instruments and foreign exchange	2,394	6,325	5,853	1,430
Mortgage interest accruals on non-recourse mortgage defaults	2,213	2,624	4,623	4,965
Additional recoveries for capital expenditures in excess of items expensed in property operating costs	(2,138)	(2,695)	(5,570)	(3,746)
Gain on extinguishment of debt	(1,655)	-	(1,655)	-
Lease terminations and other non-recurring items	(2,311)	-	(2,311)	-
Loss on repayment of debentures	-	-	38,834	-
Normalized funds from operations	\$55,064	\$59,634	\$107,471	\$124,067
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	149,469	147,784	149,389	147,641
Diluted weighted average number of units (in thousands of units) for the calculation of FFO ⁽¹⁾ ⁽²⁾ ⁽³⁾	169,904	156,395	149,873	156,252
Funds from operations per unit (basic – adjusted for conversion of non-controlling interest)	\$0.38	\$0.36	\$0.45	\$0.82
Funds from operations per unit (diluted)	\$0.37	\$0.34	\$0.45	\$0.78
Diluted weighted average number of units (in thousands of units) for the calculation of NFFO ⁽¹⁾ ⁽²⁾ ⁽⁴⁾	169,904	156,395	169,798	156,252
Normalized funds from operations per unit (basic - adjusted for conversion of non-controlling interest)	\$0.37	\$0.40	\$0.72	\$0.84
Normalized funds from operations - diluted	\$0.36	\$0.38	\$0.71	\$0.79

⁽¹⁾ For the three and six months ended June 30, 2009, the Fairfax warrants are included in the denominator of diluted FFO and NFFO per unit for the period in which they were outstanding. For the three and six months ended June 30, 2009, the number of units was 8,611,349. The warrants were redeemed in December 2009.

⁽²⁾ For the three and six months ended June 30, 2010, 510,255 and 483,679 units respectively are included in the determination of diluted FFO and NFFO with respect to the unit option plan.

⁽³⁾ The 2014 and 2017 convertible debentures are dilutive for the three months ended June 30, 2010. Debenture interest for the three months ended June 30, 2010 of \$6.9 million is added to FFO and 19,924,812 units are included in the diluted weighted average number of units outstanding for that period.

⁽⁴⁾ The 2014 and 2017 convertible debentures are dilutive for the three and six months ended June 30, 2010. Debenture interest for the three and six months ended June 30, 2010 of \$6.9 million and \$13.6 million respectively is added to NFFO and 19,924,812 units are included in the diluted weighted average number of units outstanding for each period.

Normalized funds from operations adjusts funds from operations for: the net gain or loss on derivative instruments and foreign exchange as these are non-cash items which will vary from quarter to quarter; the additional recoveries for capital expenditures in excess of items expensed in property operating costs as these also vary from quarter to quarter and in the view of the Trusts' management, this volatility is not indicative of the Trusts' performance, and the loss on repayment of debentures is a one-time, non-recurring item and as such is not in the normal course of operations. In addition, the Trusts have adjusted its normalized funds from operations for mortgage interest accruals on non-recourse mortgage defaults, the gain on extinguishment of debt along with other non-recurring items such as lease termination fees. FFO is reconciled to AFFO which is reconciled to cash provided by operations.

The primary reasons for the decrease of \$4.6 million in normalized funds from operations between Q2 2010 and Q2 2009 are generally due to the following items:

- A decrease of \$2.7 million in property operating income due to the average U.S./Canadian dollar foreign exchange rate of \$1.02 for Q2 2010 as compared to \$1.17 during Q2 2009;
- A decrease of \$2.2 million from properties sold between April 1, 2009 and June 30, 2010;
- A decrease of \$1.0 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$0.6 million due to higher property management fees;
- An increase of \$1.2 million in property operating income due to acquisitions during 2010;
- An increase of \$0.4 million due to lower interest expense; and
- An increase of \$0.5 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases.

The primary reasons for the decrease of \$16.6 million in normalized funds from operations between the six months ended June 30, 2010 as compared to the same period in 2009 are generally due to the following items:

- A decrease of \$6.7 million in property operating income due to the average U.S./Canadian dollar foreign exchange rate of \$1.03 as compared to \$1.21 for the six months ended June 30, 2009;
- A decrease of \$4.8 million from properties sold between January 1, 2009 and June 30, 2010;
- A decrease of \$2.0 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$1.3 million due to higher property management fees;
- A decrease of \$2.5 million due to higher interest expense;
- A decrease of \$0.9 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases; and
- An increase of \$1.5 million in property operating income due to acquisitions during 2010.

ADJUSTED FUNDS FROM OPERATIONS

(in thousands of dollars except per unit amounts)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Funds from operations	\$56,561	\$53,380	\$67,697	\$121,418
Add (deduct)				
Straight-lining of contractual rent	(2,252)	(2,750)	(4,182)	(6,771)
Rent amortization	922	1,109	2,092	2,038
Effective interest rate accretion	2,643	905	5,206	1,485
Mortgage interest accruals on non-recourse mortgage defaults	2,213	2,624	4,623	4,965
Gain on extinguishment of debt	(1,655)	-	(1,655)	-
Unit-based compensation	307	118	604	181
Additions to tenant expenditures	(1,352)	(666)	(2,747)	(2,282)
Capital expenditures	(4,007)	(2,531)	(9,491)	(2,653)
Net loss on derivative instruments and foreign exchange	2,394	6,325	5,853	1,430
Adjusted funds from operations	\$55,774	\$58,514	\$68,000	\$119,811
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	149,469	147,784	149,389	147,641
Diluted weighted average number of units (in thousands of units) for the calculation of AFFO ^{(1) (2) (3) (4)}	169,904	161,371	149,873	161,228
Adjusted funds from operations per unit (basic - adjusted for conversion of non-controlling interest)	\$0.37	\$0.40	\$0.46	\$0.81
Adjusted funds from operations per unit (diluted)	\$0.36	\$0.37	\$0.45	\$0.77
Cash distributions paid	\$0.18	\$0.18	\$0.36	\$0.36
Payout ratio	48.6%	45.0%	78.3%	44.4%

⁽¹⁾ The 2014 and 2017 convertible debentures are dilutive for the three months ended June 30, 2010. Contractual debenture interest for the three months ended June 30, 2010 of \$5.1 million is added to AFFO and 19,924,812 units are included in the diluted weighted average number of units outstanding for that period.

⁽²⁾ For the three and six months ended June 30, 2009, the Fairfax warrants are included in the denominator of diluted AFFO per unit for the period in which they were outstanding. For the three and six months ended June 30, 2009, the number of units was 8,611,349. The warrants were redeemed in December 2009.

⁽³⁾ For the three and six months ended June 30, 2010, 510,255 and 483,679 units respectively are included in the determination of diluted AFFO with respect to the unit option plan.

⁽⁴⁾ The 2013 convertible debentures are dilutive for the three and six months ended June 30, 2009. Contractual debenture interest for the three and six months ended June 30, 2009 of \$1.9 million and \$3.8 million respectively is added to AFFO and 4,976,201 units are included in the diluted weighted average number of units outstanding for each period.

Excluding the non-recurring charge to redeem the Non-Convertible Debentures and the lease terminations and other non-recurring items, basic AFFO per unit would have been \$53.5 million for the three months ended June 30, 2010 (\$0.36 per unit) and would have been \$104.5 million for the six months ended June 30, 2010 (\$0.70 per unit).

The primary reasons for the decrease of \$2.7 million in AFFO for the three months ended June 30, 2010 as compared to the same periods last year are due the following items:

- A decrease of \$2.7 million in property operating income due to the average U.S./Canadian dollar foreign exchange rate of \$1.02 for Q2 2010 as compared to \$1.17 during Q2 2009;

- A decrease of \$2.2 million due to higher capital and tenant expenditures;
- A decrease of \$2.0 million from properties sold between April 1, 2009 and June 30, 2010;
- An decrease of \$1.0 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$0.6 million due to higher property management fees;
- A decrease of \$0.6 million in additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements net of items which were expenses in property operating costs;
- A decrease of \$0.5 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases;
- An increase of \$2.2 million due to lower interest expense;
- An increase of \$2.3 million due to lease terminations and other non-recurring items;
- An increase of \$1.2 million in property operating income due to acquisitions during 2010; and
- An increase of \$1.1 million due to rent increases throughout the portfolio.

The primary reasons for the decrease of \$51.8 million in AFFO for the six months ended June 30, 2010 as compared to the same period last year are due the following items:

- A decrease of \$38.8 million due to the one-time loss on the repayment of the Non-Convertible Debentures;
- A decrease of \$7.3 million due to higher capital and tenant expenditures;
- A decrease of \$6.7 million in property operating income due to the average U.S./Canadian dollar foreign exchange rate of \$1.03 for the six months ended June 30, 2010 as compared to \$1.21 during the six months ended June 30, 2009;
- A decrease of \$4.2 million from properties sold between January 1, 2009 and June 30, 2010;
- A decrease of \$1.9 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases;
- A decrease of \$2.0 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$1.3 million due to higher property management fees;
- An increase of \$2.7 million due to rent increases throughout the portfolio;
- An increase of \$2.3 million due to lease terminations and other non-recurring items;
- An increase of \$1.4 million due to lower interest expense;
- An increase of \$1.8 million in additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements net of items which were expenses in property operating costs; and
- An increase of \$1.5 million in property operating income due to acquisitions during 2010.

The following is a reconciliation of the Trusts' adjusted funds from operations to cash provided by operations.

(in thousands of dollars)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Adjusted funds from operations	\$55,774	\$58,514	\$68,000	\$119,811
Straight-lining of contractual rent	2,252	2,750	4,182	6,771
Additions to tenant expenditures	1,352	666	2,747	2,282
Capital expenditures	4,007	2,531	9,491	2,653
Change in other non-cash operating items	(11,515)	(10,783)	(6,716)	(6,009)
Mortgage interest accruals on non-recourse mortgage defaults	(2,213)	(2,624)	(4,623)	(4,965)
Loss on repayment of debentures	-	-	38,834	-
Realized loss on foreign exchange	-	-	(2)	(20)
Cash provided by operations	\$49,657	\$51,054	\$111,913	\$120,523

Capital Resources

In accordance with National Policy 41-201, the Trusts are required to provide the following additional disclosure relating to cash distributions.

(in thousands of dollars)	Three months ended	Six months ended	Year ended	Year ended
	June 30, 2010	June 30, 2010	December 31, 2009	December 31, 2008
Cash provided by operating activities	\$49,657	\$111,913	\$238,941	\$233,200
Net earnings	144,665	127,405	86,525	97,706
Actual cash distributions paid or payable relating to the period	23,359	48,149	97,726	161,839
Excess of cash provided by operating activities over cash distributions paid	26,298	63,764	141,215	71,361
Excess (shortfall) of net earnings over cash distributions paid	121,306	79,256	(11,201)	(64,133)

For the three and six months ended June 30, 2010 and years ended December 31, 2009 and 2008, cash provided by operating activities exceeded cash distributions. Management expects this trend to continue.

Net earnings exceed cash distributions paid for the three and six months ended June 30, 2010 due to non-cash items which are deducted or added in determining net earnings. Non-cash items such as impairment losses, gain on extinguishment of debt, future income tax recoveries, unrealized gains or losses, depreciation and amortization, while deducted from or added to net earnings have no impact on cash available to pay current distributions.

Subject to market conditions, management expects to be able to meet all of the Trusts' ongoing obligations and to finance short-term development commitments through the issue of new securities, as well as by using conventional real estate debt, selling or refinancing other assets, short-term financing from the bank and the Trusts' cash flow from operations. As at June 30, 2010, the REIT is not in default or arrears on any of its obligations including distribution payments, interest or principal payments on debt and any debt covenant with the exception of the non payment of principal and interest for the seven Boscov's Department Stores and the two Bruno's Supermarkets mortgages following the Chapter 11 filings of the tenants. The REIT has handed over control of seven of the properties to the respective mortgage companies and is waiting for them to legally release the REIT's subsidiaries from their debt obligations.

Short-term bank financing has been provided by the same chartered bank since the REIT's inception. This general operating facility expires on December 31, 2011 and is secured by income properties. Management believes this facility will continue to be made available in the future as it represents a typical or standard loan facility provided by numerous financial institutions in the industry. At June 30, 2010, approximately \$203.7 million was still available under this facility.

Other than the Bow development which is described in greater detail under "Funding of Future Commitments", the following is a summary of material contractual obligations of the REIT (excluding mortgages related to discontinued operations) including payments due as at June 30, 2010 for the next 4.50 years and thereafter:

Contractual Obligations (in thousands of dollars)	Payments Due by Period				Total
	2010 *	2011- 2012	2013- 2014	2015 and thereafter	
Mortgages payable	\$59,752	\$540,462	\$476,007	\$1,600,102	\$2,676,323
2013 Convertible debentures	-	-	115,000	-	115,000
2014 Convertible debentures	-	-	149,990	-	149,990
2107 Convertible debentures	-	-	-	175,000	175,000
Series A Senior Debentures				115,000	115,000
Series B Senior Debentures				115,000	115,000
Total Contractual Obligations	\$59,752	\$540,462	\$740,997	\$2,005,102	\$3,346,313

* For the balance of the year

Dominion Bond Rating Service ("DBRS") provides credit ratings of debt securities for commercial entities. A credit rating generally provides an indication of the risk that the borrower will not fulfill its obligations in a timely manner with respect to both interest and principal commitments. Rating categories range from highest credit quality (generally AAA) to default payment (generally D).

DBRS has confirmed that H&R REIT has a credit rating of BBB with a Stable trend as at June 30, 2010. A credit rating of BBB by DBRS is generally an indication of adequate credit quality, where protection of interest and principal is considered acceptable. A credit rating of BBB - or higher is an investment grade rating. There can be no assurance that any rating will remain in effect for any given period of time or that any rating will not be withdrawn or revised by DBRS at any time. The credit rating is reviewed periodically by DBRS.

The REIT has no material capital or operating lease obligations.

Funding of Future Commitments

The following table shows the budgeted costs for the Bow and actual costs to date.

(in thousands of dollars)	Costs incurred to date	Remaining Costs	Budget
Land	\$60,804	\$ -	\$60,804
Financing costs	18,101	36,792	54,893
Capitalized interest on the REIT's costs as incurred	91,547	124,175	215,722
Soft costs	124,281	69,598	193,879
Hard costs	677,977	423,476	1,101,453
Recoveries and other income	(34,775)	(76,116)	(110,891)
Contingency	-	30,862	30,862
Cost incurred to date/remaining costs/budget	937,935	608,787	1,546,722
Less capitalized interest on the REIT's costs incurred	(91,547)	(124,175)	(215,722)
Total costs incurred to date/ remaining costs/budget less capitalized interest	\$846,388	\$484,612	\$1,331,000

Both the REIT and Altus Group Cost Consulting believe the remaining contingencies to be sufficient at this stage of the project.

The REIT believes that through the undrawn construction facility of \$425 million and the available cash and undrawn credit facility of \$222 million, it has enough funds to complete the Bow. However, there is no assurance that such funds will be available to the REIT

as the availability of any such funds will be subject to market conditions and other factors beyond the REIT's control. Please see "Forward-Looking Disclaimer" and "Risks and Uncertainties".

The REIT's capacity to fund future acquisitions, capital expenditures and commitments was in excess of \$2 billion as at June 30, 2010. This represents the amount by which the REIT can increase its debt, subject to market availability, before the REIT reached its maximum debt limitation of 65% of debt to its GBV of assets under the Declaration of Trust.

The following summarizes term debt maturities for existing mortgages:

Year	Mortgage Debt due on Maturity (\$000's)	Number of Mortgages	2010 Estimated Property Operating Income (\$000's) ⁽¹⁾	Loan to Value ⁽²⁾
2010 *	\$10,719	5	\$3,299	27%
2011	70,246	11	16,157	33%
2012	269,501	21	47,101	43%
2013	101,450	10	22,159	34%
2014	182,632	8	26,811	51%
	\$634,548	55	\$115,527	41%

* For the balance of the year

⁽¹⁾ Converting U.S. dollars to Canadian dollars at an exchange rate of 1.06

⁽²⁾ Using a 7.5% capitalization rate ("cap rate")

OFF-BALANCE SHEET ITEMS

The REIT has certain co-owners or partners in various projects. As a rule the REIT does not provide guarantees or indemnities for these co-owners pursuant to property acquisitions because should such guarantees be provided, recourse would be available against the REIT in the event of a default of the borrowers, in which case the REIT would have a claim against the underlying real estate investment. However, in certain circumstances, where absolutely required but subject to compliance with the REIT's Declaration of Trust and also, when management has determined that the fair value of the borrower's investment in the real estate investment is greater than the mortgages payable for which the REIT has provided guarantees, such guarantees will be provided.

At June 30, 2010, such guarantees amounted to \$42.3 million (December 31, 2009 - \$43.3 million), expiring between 2011 and 2016 and no amount has been provided for in the combined financial statements for these items. These amounts arise where the REIT has guaranteed a co-owner's share of the mortgage liability. The REIT, however, customarily guarantees or indemnifies the obligations of its nominee companies which hold separate title to each of its properties owned.

In addition, the REIT continued to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable thereunder until such debts are extinguished or the lenders agree to release the REIT's covenants. At June 30, 2010, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$117.8 million (December 31, 2009 - \$119.2 million) with expiries between 2013 and 2018. There have been no defaults by the primary obligor for debts on which the REIT has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in the financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Where appropriate, the REIT uses forward contracts to lock in lending rates on certain anticipated mortgages. This strategy provides certainty in the rate of interest on borrowings when the REIT is involved in transactions that close further into the future than during the normal timeframe of a transaction. At June 30, 2010, the REIT had no forward contracts in place.

Where appropriate, the REIT uses forward exchange contracts to lock in foreign exchange rates. This strategy provides certainty in the foreign exchange rates on transactions that will occur in the future. The REIT has entered into a forward exchange forward contract with a Canadian chartered bank, which effectively locks in the REIT's rate to exchange \$2 million USD per month at a rate of 1.0402. This forward exchange contract expires in April 2012.

The REIT has entered into interest rate swaps on the Bow credit facility and on one mortgage which effectively locked the interest rate at 6.90% and 5.25% respectively. At the end of each reporting period, the interest rate swaps are marked to market resulting in an unrealized gain or loss recorded in earnings.

SECTION III

SUMMARY OF QUARTERLY RESULTS

(unaudited) (in thousands of dollars except per unit amounts)	June 30, 2010	March 31, 2010 ⁽¹⁾	December 31, 2009 ⁽¹⁾	September 30, 2009 ⁽¹⁾
Rentals from income properties	\$151,344	\$151,223	\$151,668	\$148,209
Mortgage interest and other income	802	1,274	1,621	1,602
Net property operating income	28,122	24,965	21,606	23,898
Net earnings (loss) from continuing operations	144,655	(20,660)	31,488	7,643
Net earnings (loss) per unit from continuing operations				
(basic)	1.00	(0.14)	0.22	0.05
(diluted)	0.91	(0.14)	0.20	0.05
Net earnings (loss)	\$144,665	(\$17,260)	\$29,870	\$15,656
Net earnings (loss) per unit				
(basic)	1.00	(0.12)	0.21	0.11
(diluted)	0.91	(0.12)	0.19	0.10
	June 30, 2009 ⁽¹⁾	March 31, 2009 ⁽¹⁾	December 31, 2008 ⁽¹⁾	September 30, 2008 ⁽¹⁾
Rentals from income properties	\$148,999	\$156,292	\$151,257	\$146,863
Mortgage interest and other income	1,504	1,495	1,045	1,015
Net property operating income	28,415	30,540	26,507	25,891
Net earnings (loss) from continuing operations	10,754	20,413	5,140	(28,066)
Net earnings (loss) per unit from continuing operations				
(basic)	0.07	0.15	0.04	(0.20)
(diluted)	0.07	0.14	0.03	(0.20)
Net earnings (loss)	\$18,901	\$22,098	\$45,826	(\$20,706)
Net earnings (loss) per unit				
(basic)	0.13	0.16	0.33	(0.15)
(diluted)	0.13	0.15	0.32	(0.15)

⁽¹⁾ Certain items for all periods have been reclassified to conform with the presentation adopted in the current period.

Changes to the quarterly financial information are not reflective of seasonality or cyclicity but generally from retroactive changes in accounting policy, new property acquisitions, dispositions and income taxes.

SECTION IV

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Trusts' combined financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. The Trusts' combined financial statements have been prepared in accordance with Canadian GAAP.

Management believes the policies which are most subject to estimation and judgements are outlined below. For a detailed description of these and other accounting policies refer to note 1 of the December 31, 2009 audited combined financial statements of the Trusts.

Impairment of Assets

The REIT is required to write down to fair value any of its income properties that were determined to have been impaired. The analysis required is dependent upon a review of estimated undiscounted future cash flows from operations over the anticipated holding period. This review involves subjective assumptions of, among other things, estimated occupancy and rental rates, all of which can affect the ultimate value of the property. In the event these factors result in a carrying value that exceeds the sum of future undiscounted cash flows expected to result from the ongoing use and ultimate residual value of the properties, an impairment would be recognized. During 2010, no impairments were recorded. During 2009, the REIT recorded an impairment loss of \$14.8 million relating to the properties formerly tenanted by Circuit City and Bruno's Supermarkets.

The REIT also evaluates the fair value of mortgages receivable to determine whether any impairment provisions are required. Impairment is recognized when the carrying value of the mortgage receivable will not be recovered as determined by the economic value of the underlying security and/or the financial covenant of the issuer of the security. No impairments of mortgages receivable were recorded during 2010 or 2009.

Depreciation of Income Properties

Upon the acquisition of a property, a significant portion of the cost is allocated per management's determination to the building component of the property. In addition, the REIT is required to assess the useful lives of its income properties in order to determine the amount of building depreciation to record on a quarterly and annual basis.

The REIT depreciates its income properties and building improvements on a straight-line basis over their estimated useful lives. In the event the allocation to either the building or paving and equipment component is inappropriate or the estimated useful life of the properties are not correct, the amount of depreciation expensed quarterly and annually, which affects the REIT's future net earnings might not be appropriate.

Property Acquisitions

For acquisitions of properties initiated on or after September 12, 2003, the CICA has issued guidance for accounting for operating leases assumed in connection with these acquisitions. Through management's judgment and estimates, the purchase price must be allocated to land site improvements, building, the above- and below-market value of in-place operating leases, the fair value of tenant improvements, in-place leasing costs and the value of the relationship with the existing tenants.

These estimates will impact rentals from income properties, depreciation expense and amortization expense recorded on both a quarterly and annual basis.

Income Tax

During the second quarter of 2010, the REIT completed necessary restructuring to qualify for the REIT Exemption commencing January 1, 2011. Accordingly, management believes the REIT will not be subject to the SIFT Rules provided that the REIT does not exceed the normal growth guidelines at any time prior to 2011 and qualifies for the REIT Exemption at all times after 2010. See the "Tax Risk" section for further discussion.

Prior to the SIFT Rules, income earned by the REIT and distributed annually to unitholders was not, and would not be, subject to taxation in the REIT, but was taxed at the unitholder level. For financial statement reporting purposes, the tax deductibility of the REIT's distributions was treated as an exemption from taxation as the REIT distributed and intended to continue distributing all of its income to its unitholders. Accordingly, prior to the SIFT Rules, the REIT did not record a provision for income taxes, or future income tax assets or liabilities, in respect of the REIT or its investments in its subsidiary trusts.

Accordingly, the net future income tax liability of \$125.3 million recorded as at March 31, 2010 was reversed into net earnings as at June 30, 2010. The REIT uses the asset and liability method of accounting for income taxes.

Future income taxes are recognized for the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that are expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. The effect on future income tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the date of enactment or substantive enactment.

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)

The discussion in this section should be read in conjunction with the Trusts’ annual MD&A for the two years ended December 31, 2009 and 2008, and contains an update as at the reporting date.

The Canadian Accounting Standards Board (“AcSB”) has mandated the adoption of IFRS effective for interim and annual periods beginning on or after January 1, 2011 for Canadian publicly accountable profit-oriented enterprises. IFRS will replace Canada’s current GAAP for these enterprises. Comparative IFRS information for the 2010 fiscal year will also have to be reported. These new standards will be effective for the Trusts during the first quarter of 2011. The Trusts are in the process of evaluating the potential impact of IFRS on the consolidated financial statements. The Trusts’ combined financial performance and financial position as disclosed in the current GAAP financial statements may be significantly different when presented in accordance with IFRS. Additional information will be provided as the conversion efforts progress and as the transition date approaches.

Implementing IFRS will have an impact on accounting, financial reporting and supporting IT systems and processes. It may also have an impact on contractual commitments involving GAAP based clauses (including debt covenants), and performance metrics. Accordingly, the Trusts’ implementation plan has included measures to provide extensive training to key finance personnel, to review relevant contracts and agreements and to increase the level of awareness and knowledge amongst management, the Boards of Trustees and the audit committees of both Trusts.

The following provides a summary of the Trusts’ IFRS Implementation Plan and status of our activities:

Status of Convergence Plan

An analysis of the impact of the majority of IFRS standards has been assessed and recommendations on policy choices, where applicable, have been presented to the Boards of Trustees of both Trusts. While preliminary decisions regarding policy choices have been made, final decisions are still under review due to some areas of uncertainty. As such, action plans have been created to implement these policy choices. These plans detail what is required to implement each standard and the information and related systems requirements to gather and track data for the extensive accounting and disclosure requirements under the transition to IFRS and on a continual basis once the adoption of these new standards has been completed.

Where significant impacts of the transition have already been identified, work has commenced on solutions which require a significant amount of time to resolve. These issues include but may not be limited to, the identification of proposed information technology initiatives, the possibility of amendments to the respective Declarations of Trust and components of debt covenants which need to be addressed to ensure they are completed on time. As the review of accounting policies is completed, appropriate changes to ensure the integrity of internal controls over financial reporting and disclosure controls and procedures will be made. For example, changes in accounting policies could result in changes to controls or procedures to address reporting of first time adoption as well as ongoing IFRS reporting requirements. The Trusts have held IFRS information sessions with members of the Boards of Trustees of both Trusts and separately with Audit Committee members of both Trusts. During these sessions, management and external consultants provided both Boards of Trustees with a review of the timeline for implementation, the implications of IFRS standards to the business and an overview of the impact to the financial statements (as experienced in Europe by comparable companies). Both Audit Committees continue to receive quarterly updates from management.

Significant Elements of the Trust's IFRS conversion plan include:

Area	Key Activities	Progress to Date
Financial Statement Presentation and Disclosure	Identification of differences between IFRS and Canadian GAAP	Complete
	Assess and select accounting policy choices	In progress
	Quantify the effects of the difference based on accounting policies selected	In progress
	Prepare opening and quarterly financial statements and related note disclosures	In progress
Business Impacts	Identify required resources - valuation and accounting - for technical analysis and implementation during the transition	Complete
	Develop a real estate valuation strategy	Complete
	Complete real estate valuation for the opening balance sheet as at January 1, 2010	In progress
	Identify impact on contractual agreements and financial covenants	In progress
	Where required, make amendments to agreements	In progress
Processes and Systems	Identify changes required to current financial reporting systems	Significant system changes have been identified
	Identify data collection requirements and implement process to collect data	In progress
	Evaluate and select methods to address the need for dual record keeping during 2010	In progress
Internal Controls over Financial Reporting and Disclosure	Ensure documentation of processes and system are in place	In progress
	Ensure appropriate changes to internal controls to address existing accounting policies and requirement for dual record keeping during 2010	In progress
	Assess effectiveness of controls	Ongoing
Training	Technical training of accounting staff	Ongoing
	Educate Boards of Trustees, Audit Committees and Senior Management on the effects of IFRS	Senior management is updated regularly. Boards of Trustees and Audit Committees are updated quarterly
	Communication to all other internal and external stakeholders	Ongoing quarterly external communication through MD&A

The significant IFRS differences that will potentially have an impact on the Trusts' financial statements include the following:

- Under Canadian GAAP, issued units of the Trusts are presented as equity in the combined balance sheet. A trust unit is a financial instrument for both Canadian GAAP and IFRS purposes. Under IFRS if there is a mandatory requirement to distribute taxable income or distributable cash (a "contractual requirement to deliver cash"), this would result in trust units being considered as a liability. At the June 2010 annual meeting of the REIT, an amendment was made to the REIT's Declaration of Trust whereby distributions are no longer mandatory, rather they are now to be made at the discretion of the trustees, thereby eliminating this potential issue under IFRS. Finance Trust is still reviewing this issue.
- IFRS defines investment property as property held by the Trusts to earn rental income, capital appreciation or both. Assets classified as income properties on the balance sheet of the Trusts qualify as investment property under IFRS.

Under IFRS, the REIT has a choice of measuring an investment property using the historical cost model or the fair value model. The cost model is generally consistent with Canadian GAAP and would require that the fair value be disclosed in the notes to the financial statements. Under the fair value model, investment property is measured at fair value, and changes in fair value are recorded through earnings each reporting period, which could lead to income statement volatility in future periods. Under the fair value model there are no charges for depreciation as there are under the cost model.

In addition, the REIT may also elect under IFRS 1 to use the fair value as the deemed cost of certain income properties upon the initial implementation of IFRS. At conversion the adjustments resulting from this election are recorded directly to unitholders' equity. The REIT will finalize its decision once management and the Board of Trustees have reviewed the property valuations prepared by the external appraisers.

Management has hired external appraisers to provide a valuation of each property as at January 1, 2010. These valuations will be completed in Q3 2010. For subsequent reporting of the fair value of income properties, the REIT hired Gary Wener (AACI, MRICS) in July 2009. Mr. Wener will have the responsibility of periodically updating the fair values after taking into account any changes to the property status, condition, tenants, leases, net operating income and changes to discount and capitalization rates as well as market rental rates. Mr. Wener was previously the managing director of Colliers International in Toronto. Prior to that Mr. Wener worked at Altus Group as a director and also spent 8 years at Bentall Investment Management as their Director-Valuations.

This change is not expected to require any major change to our IT systems. Management is working on controls and procedures to ensure accurate reporting. This is expected to be completed by the end of Q3 2010.

The REIT is required to meet financial covenants included in its Declaration of Trust and in banking and debenture agreements. Within each of the previously mentioned documents, the REIT's debt cannot exceed 65% of the gross book value (GBV). Should the REIT elect to report its investment properties at fair value, this could lead to volatility in the debt to GBV ratio in future periods. Implementation and controls surrounding this area are being planned should the REIT elect the fair value method.

- 3) Canadian GAAP generally uses a two-step approach to impairment testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists, and then measuring impairment by comparing asset carrying values to their fair value (which is calculated using discounted cash flows). IAS 36 Impairment of Assets (IAS 36) uses a one-step approach for testing and measuring impairment, with asset carrying values compared directly with the higher of fair value less costs to sell and value in use (which uses discounted cash flows). This may potentially result in write-downs where the carrying value of assets were previously supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis. Unlike Canadian GAAP, which does not permit reversals, IFRS requires the reversal of an impairment loss when the recoverable amount is higher than the carrying value (to no more than what the depreciated amount of the asset would have been had the impairment not occurred). These differences could lead to earnings statement and earnings volatility in future periods. There is no change expected to the REIT's current IT systems for this accounting change but the REIT is in the process of designing controls and procedures for this change.
- 4) Under Canadian GAAP, upon the purchase of a property, all transaction costs (i.e. commissions, land transfer tax, appraisals, etc.) associated with the purchase are capitalized to the cost of the property. Under IFRS, these costs must be expensed as part of operations. This may have a material impact on the REIT's net earnings and could lead to earnings statement and earnings volatility in future periods. The REIT's IT systems have already been updated for this change and controls and procedures will be completed by the end of Q3 2010.
- 5) Certain leases call for rental payments that increase over their term. Under Canadian GAAP, rental revenue is recognized on a straight-line basis over the term of the lease, resulting in accruals for rents that are not billable or due until future years. Under Canadian GAAP, this accounting policy change came into effect on January 1, 2004, as a prospective change. Only lease information from this time forward was applicable for this standard. Under IFRS, the accrued rent receivable amount is determined from the latter of inception of each lease or the date the REIT assumed the lease rather than from January 1, 2004.

The REIT has already made the necessary changes to its IT system and is currently completing the testing of these modifications. There will not be any changes to disclosure or internal controls as the existing controls have been deemed to be appropriate by the REIT.

- 6) The Trusts may be required under IAS 32, Financial Instruments: Presentation, to present the Class B units of HRLP as a liability upon initial adoption of IFRS. This presentation may be required because each Class B unit is exchangeable for a Stapled Unit that has a redemption feature on the REIT portion. The impact of this change will be to increase liabilities and decrease unitholders' equity. Distributions on the Class B units will then be reflected as a component of interest expense in earnings.

First Time Adoption of IFRS

Upon adoption of IFRS, the Trusts are required to apply IFRS 1, which provides guidance for the initial adoption of IFRS. Included in IFRS 1 are certain optional exemptions from full retrospective applications of IFRS. The optional exemptions expected to be applied are described below:

a) Deemed Fair Value

As discussed under the "Status of Convergence Plan", the REIT may, under IFRS 1, choose to adopt the fair value model for its income properties prospectively. If the REIT decides to use the cost method to account for its income properties, the REIT may also elect under IFRS 1 to use the fair value as the deemed cost of certain income properties upon initial implementation of IFRS. At conversion the resulting adjustments of this election are recorded directly to unitholders' equity. The REIT will finalize its decision once it has reviewed the property valuations prepared by the external appraisers.

b) Business Combinations

The REIT expects to apply the business combination exemption offered in IFRS 1 to not apply IFRS 3 business combinations retrospectively to past business combinations. Accordingly, the REIT will not restate business combinations that took place prior to the January 1, 2010 transition date. There is no change expected to the REIT's current IT systems or controls and procedures for this election.

c) Cumulative Translation Difference

The REIT expects to elect this exemption to set the previous foreign exchange cumulative translation balance to zero at January 1, 2010, with the balance reclassified to retained earnings. The only effect of this will be a restatement within the accounts of the unitholders equity. The effect at this time would be to reduce the accumulated other comprehensive loss by \$27.5 million and to reduce the value of units by a similar amount. There is no change expected to the REIT's IT systems or controls and procedures for this election.

d) Borrowing Costs

The REIT is evaluating whether to (i) derecognize the carrying amounts of previously capitalized interest to the construction cost of a qualifying asset or (ii) capitalize amounts on qualifying assets which had not been previously capitalized. The effect of derecognizing previously capitalized interest would be to reduce the cost of the Bow and other properties developed and a reduction to unitholders' equity of approximately \$66 million as at January 1, 2010. The effect for the six months ended June 30, 2010 would be a reduction to the cost of The Bow and an increase to interest expense of approximately \$23 million. The effect of capitalizing amounts not previously capitalized would be an increase to the cost of properties developed and an increase to unitholders' equity of approximately \$11 million as at January 1, 2010 and no impact for the six months ended June 30, 2010. The REIT expects to finalize this election during Q3 2010.

The REIT is required to meet financial covenants included in the Declaration of Trust and in banking and debenture agreements. Within each of the previously mentioned documents, the REIT's debt cannot exceed 65% of the gross book value (GBV). As at June 30, 2010, the debt to GBV ratio in accordance with the Declaration of Trust is 50.6%. Should the REIT elect to derecognize previously capitalized interest, this ratio would increase to 51.4%.

The reader should be cautioned that these optional exemptions are considered forward looking information and certain project activities and choices may change. The process is on-going as new standards and recommendations are issued by the IASB.

Testing & Implementation Phase

During the remainder of 2010, the Trusts will be completing and testing its IFRS-IASB systems, processes, financial statements, notes, policies, internal controls and internal reporting throughout the period in preparation for the trusts' conversion date of January 1, 2011. Training of accounting and operational staff is well underway.

INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes were made to the design of the Trusts' internal control over financial reporting during the six months ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Trusts' internal control over financial reporting.

The financial statements and MD&A were reviewed by the respective audit committees and the Boards of Trustees, which approved them prior to their publication.

The Trusts' management, including the CEO and CFO, does not expect that the Trusts' controls and procedures will prevent or detect all misstatements due to error or fraud. Due to the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute assurance, that all control issues and instances of fraud or error, if any, within the Trusts have been detected. The Trusts are continually evolving and enhancing its systems of controls and procedures.

The Trusts have also established adequate disclosure controls and procedures and internal control over financial reporting to provide reasonable assurance regarding their responsibility of the Trusts' financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP. The Trusts' CEO and CFO assessed, or caused an assessment under their direct supervision, of the design and operating effectiveness of the REIT's disclosure controls and procedures and internal control over financial reporting (as defined in *National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*) as at June 30, 2010. Based on this assessment, it was determined that the Trusts' disclosure controls and procedures and internal control over financial reporting were appropriately designed and are operating effectively as at June 30, 2010.

SECTION V

RISKS AND UNCERTAINTIES

All income property investments are subject to a degree of risk and uncertainty. They are affected by various factors including general market conditions and local market circumstances. An example of general market conditions would be the availability of long-term mortgage financing whereas local conditions would relate to factors affecting specific properties such as an oversupply of space or a reduction in demand for real estate in a particular area. Management attempts to manage these risks through geographic, type of asset and tenant diversification in the REIT's portfolio. The major risk factors are outlined in the Trusts' annual MD&A for the year ended December 31, 2009, in the REIT's Annual Information Form and below.

Availability of Cash for Distributions

The Trusts' current proposed distribution policy is outlined in the Outlook. As the monthly cash distribution paid by Finance Trust fluctuates monthly, the monthly cash distribution paid by the REIT will also fluctuate in order to result in an aggregate monthly cash distribution as previously outlined. Although the Trusts intend to make distributions of its available cash to unitholders in accordance with its distribution policy, these cash distributions may be reduced or suspended. The actual amount distributed by the REIT will depend on numerous factors including monthly cash distributions paid by Finance Trust, capital market conditions, the financial performance of the properties, the REIT's debt covenants and obligations, its working capital requirements, its future capital requirements, its development commitments and fluctuations in interest rates. The REIT's construction facility for the Bow provides, among other things, that distributions (other than certain unit distributions) cannot exceed 70% of funds from operations (as defined for such purpose). Cash available to the REIT for distributions may be reduced from time to time because of items such as principal repayments on debt, tenant allowances, leasing commissions and capital expenditures. The REIT may be required to use part of its debt capacity in order to accommodate any or all of the above items. The market value of Stapled Units may decline significantly if the REIT and/or Finance Trust suspends or reduces distributions. The REIT may reduce distributions if the trustees anticipate a cash shortfall and determine that such a reduction would be in the best interests of the REIT.

Development and Financing Risk Relating to the Bow Development

The REIT entered into agreements to develop the Bow consisting of approximately 2.0 million square foot office and retail complex in Calgary. The Bow, budgeted to cost approximately \$1.5 billion (including capitalized interest), is pre-leased, on a triple net basis, to EnCana Corporation for an initial term of approximately 25 years. Construction commenced during the spring of 2007 and is expected to be completed in 2012. The REIT is currently bearing the risk for construction overruns and project delays as the REIT does not have a fixed price contract for the entire project cost. To mitigate this, the REIT has entered into fixed price contracts amounting to approximately 85% of the hard cost budget. Together with costs incurred to date, the REIT has effectively locked in approximately 91% of the total budget before contingencies. The REIT is also at risk for interest rate fluctuations on this project during the construction period. To mitigate this risk, the REIT entered into an interest rate swap which is intended to limit the interest rate to an effective annual rate of 6.9%.

The REIT secured a \$425 million construction facility during April 2009. There were amendments to the construction facility in the first six months of 2010. The initial maturity date of the facility is October 22, 2012. The agreements and indentures governing indebtedness of this construction facility contain certain covenants and conditions applicable to the REIT, including without limitation,

those requiring the REIT to maintain, at all times on a combined basis with Finance Trust, the following financial ratios (i) indebtedness to gross asset value of not greater than 0.65:1.0; (ii) debt service coverage of not less than 1.25:1.0 and (iii) unitholders equity of not less than the sum of \$1.35 billion plus 75% of net cash proceeds received in connection with any equity offering after April 24, 2009. In addition, the REIT is required to have not less than \$906 million of cash equity being invested by the REIT and to have in place a committed revolving credit facility of not less than \$300 million (subject to reduction to \$200 million in certain circumstances) with a maturity date of not less than 11 months from the date of the initial borrowing under the facility, and imposing on the REIT certain restrictions including without limitation regarding: the disposition of the Bow project, lands related to the Bow, or any other properties or assets in excess of certain thresholds; the creation of liens or granting of negative pledges; creation or incurrence of debt; the making of distributions; the purchase or redemption of securities; the entering into of any merger or similar transaction with any person; changes of a fundamental nature (including senior management, business objectives, purposes or operations, capital structure, constating documents, and subordinated debt); the cancellation or waiver of material contracts; the making of any investment in excess of certain thresholds; the repayment or repurchase of any subordinated indebtedness; the involvement of other real estate development or construction projects in excess of certain thresholds; and changes to the Bow project budget. Included in the construction facility, the terms of which provide, among other things, that distributions (other than certain unit distributions) cannot exceed 70% of funds from operations (as defined for such purpose). As a result, the REIT is limited by such covenants and restrictions. These conditions have not been satisfied as at June 30, 2010 nor has any amount been drawn upon the credit facility. Please see note 24 of the June 30, 2010 unaudited combined financial statements for further information.

Credit Risk and Tenant Concentration

The REIT is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties (office, industrial and retail) and acquires properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, account for a significant portion of the cash flow. The only tenants which individually account for more than 5% of the rentals from income properties of the REIT are Bell Canada, TransCanada PipeLines Limited, Telus Communications and Bell Mobility. Each of these companies that have a public debt rating is rated with at least an A (low) rating by a recognized rating agency.

Tax Risk

The REIT currently qualifies as a mutual fund trust for Canadian income tax purposes.

On June 22, 2007, legislation relating to the federal income taxation of a SIFT, received royal assent (the "SIFT Rules"). A SIFT includes certain publicly listed or traded partnerships and trusts and generally includes an income trust. The REIT is a SIFT until December 31, 2010, as discussed below.

Under the SIFT Rules, following a transition period for qualifying SIFTs, certain distributions from a SIFT will no longer be deductible in computing the SIFT's taxable income, and the SIFT will be subject to tax on an amount equal to the amount of such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid by a SIFT as returns of capital will not be subject to such tax.

A SIFT which was publicly listed before November 1, 2006 (an "Existing Trust") will become subject to the tax on distributions commencing with the 2011 taxation year end. However, an Existing Trust may become subject to this tax prior to the 2011 taxation year end if its equity capital increases beyond certain limits measured against the market capitalization of the Existing Trust at the close of trading on October 31, 2006. The REIT has not exceeded such limits.

Under the SIFT Rules, the new taxation regime will not apply to a real estate investment trust that meets prescribed conditions relating to the nature of its income and investments throughout the taxation year (the "REIT Exemption").

During the second quarter of 2010, the REIT completed necessary restructuring to qualify for the REIT Exemption commencing January 1, 2011. Accordingly, management believes the REIT will not be subject to the SIFT Rules provided that the REIT does not exceed the normal growth guidelines at any time prior to 2011 and qualifies for the REIT Exemption at all times after 2010.

Management of the REIT intends to conduct the affairs of the REIT so that it qualifies for the REIT Exemption at all times after 2010; however, as the requirements of the REIT Exemption include complex revenue and asset tests, no assurances can be provided that the REIT will in fact so qualify at any time.

The REIT operates in the United States through U.S. Holdco which is capitalized with equity provided by the REIT and debt in the form of U.S. Holdco notes owed to Finance Trust and H&R Portfolio Limited Partnership. As at June 30, 2010, U.S. Holdco owed \$135.5 million to Finance Trust and H&R Portfolio Limited Partnership which is eliminated on the combined financial statements.

U.S. Holdco intends to treat the U.S. Holdco notes as indebtedness for U.S. federal income tax purposes. If the Internal Revenue Service ("IRS") or a court were to determine that the U.S. Holdco notes should be treated for U.S. federal income tax purposes as equity rather than debt, the interest on the notes could be treated as a dividend, and interest on the notes would not be deductible for U.S. federal income tax purposes. In addition, if the IRS were to determine that the interest rate on the U.S. Holdco notes did not represent an arm's length rate, any excess amount over arm's length would not be deductible and could be recharacterized as a dividend payment instead of an interest payment. This would significantly increase the U.S. federal income tax liability of U.S. Holdco, potentially including the tax liability for prior years in which U.S. Holdco has claimed a deduction for interest paid on the U.S. Holdco Notes. In addition, U.S. Holdco could be subject to penalties. The increase in tax liability could materially adversely affect U.S. Holdco's ability to make interest payments on the U.S. Holdco notes or the REIT's ability to make distribution on its units. Additionally, payments of interest on the U.S. Holdco notes to non-U.S. holders of Stapled Units could be subject to withholding taxes.

To the extent that the REIT or a related party provided debt financing to U.S. Holdco (e.g., by acquiring U.S. Holdco notes), in determining income for U.S. tax purposes, U.S. Holdco is subject to possible limitations on the deductibility of interest, if any, paid to the REIT. Section 163(j) of the Internal Revenue Code (the "Code") applies to defer U.S. Holdings' deduction of interest paid on debt to the REIT in years that (i) the debt to equity ratio of U.S. Holdings exceeded 1.5:1, and (ii) the net interest expense exceeds an amount equal to 50% of its "adjusted taxable income" (generally, earnings before interest, taxes, depreciation, and amortization). For the year ended December 31, 2009, USD \$0.1 million of USD \$0.1 million interest expense was disallowed by Section 163(j) of the Code, but such disallowance had no cash effect on U.S. Holdco. The REIT intends to take the position that, due to the treatment of the Finance Trust as a grantor trust that is disregarded for U.S. federal tax purposes, the interest paid to Finance Trust is treated as having been paid to the holders of the Finance Trust units and is therefore not subject to section 163(j). If section 163(j) applied to interest paid to the Finance Trust, depending on the facts and circumstances and the availability of net operating losses to U.S. Holdco (which are subject to normal assessment by the Internal Revenue Service), the U.S. federal income tax liability of U.S. Holdings could increase. In such case, the amount of income available for distribution by the REIT to its unitholders could be reduced.

A foreign corporation will be classified as a passive foreign investment company ("PFIC") for United States federal income tax purposes if either (i) 75% or more of its gross income is passive income or (ii) on average for the taxable year, 50% or more of its assets (by value) produce or are held for the production of passive income. The properties of the REIT are managed by a third party rather than directly by its own employees. Although the REIT's officers and employees oversee the activities of the manager, it is likely that the REIT will be characterized as a PFIC for U.S. federal income tax purposes, though this conclusion is uncertain. In the absence of certain elections being made by a U.S. holder of REIT Units, any distributions in respect of the REIT Units which exceed 125% of the average amount of distributions in respect of such REIT Units during the preceding three years, or, if shorter, during the preceding years in the U.S. holder's holding period ("excess distributions") and any gain on a sale or other disposition of the REIT Units will be treated as ordinary income and will be subject to special tax rules, including an interest charge. US holders should consult with their own tax advisors regarding the implications of these rules and the advisability of making one of the applicable PFIC elections, taking into account their particular circumstances.

In compliance with U.S. Treasury Department Circular 230, which provides rules governing certain conduct of U.S. tax advisors giving advice with respect to U.S. tax matters, please be aware that: (i) any U.S. federal tax advice contained herein is not intended to be used and cannot be used by the reader for the purpose of avoiding penalties that may be imposed under the Code; (ii) such advice was prepared in the expectation that it may be used in connection with the promotion or marketing (within the meaning of U.S. Treasury Department Circular 230) of Stapled Units; and (iii) prospective investors should seek advice based on their particular circumstances from an independent tax advisor.

Construction Risks

It is likely that, subject to compliance with the Declaration of Trust, the REIT will be involved in various development projects. The REIT's obligations in respect of properties under construction, or which are to be constructed, are subject to risks which include (i) the potential insolvency of a third party developer (where the REIT is not the developer); (ii) a third party developer's failure to use advanced funds in payment of construction costs; (iii) construction or other unforeseeable delays; (iv) cost overruns; (v) the failure of tenants to occupy and pay rent in accordance with existing lease agreements, some of which are conditional; (vi) the incurring of construction costs before ensuring rental revenues will be earned from the project; and (vii) increases in interest rates during the period of the development. See also "Development and Financing Risk relating to the Bow Development" above. Management

strives to mitigate these risks where possible by entering into fixed price construction contracts with general contractors (and to the extent possible, on a bonded basis) and by attempting to obtain long-term financing as early as possible during construction.

Debentures

The likelihood that purchasers of the 2013 Convertible Debentures, the 2014 Convertible Debentures, the 2017 Convertible Debentures and the Series A and B Senior Debentures (as defined in the financial statements) will receive payments owing to them under the terms of such debentures will depend on the financial health of the REIT and its creditworthiness. In addition, such debentures are unsecured obligations of the REIT and are subordinate in right of payment to all the REIT's existing and future senior indebtedness as defined in each such respective trust indenture. Therefore, if the REIT becomes bankrupt, liquidates its assets, reorganizes or enters into certain other transactions, the REIT's assets will be available to pay its obligations with respect to such debentures only after it has paid all of its senior indebtedness in full. There may be insufficient assets remaining following such payments to pay amounts due on any or all of the debentures then outstanding.

The debentures are also effectively subordinate to claims of creditors (including trade creditors) of the REIT's subsidiaries except to the extent the REIT is a creditor of such subsidiaries ranking at least *pari passu* with such other creditors. Finance Trust is a creditor of U.S. Holdco, a subsidiary of the REIT. A parent entity is entitled only to the residual equity of its subsidiaries after all debt obligations of its subsidiaries are discharged. In the event of bankruptcy, liquidation or reorganization of the REIT, holders of indebtedness of the REIT (including holders of the 2013 Convertible Debentures, the 2014 Convertible Debentures and the 2017 Convertible Debentures) may become subordinate to lenders to the subsidiaries of the REIT. The indentures governing such debentures do not prohibit or limit the ability of the REIT or its subsidiaries to incur additional debt or liabilities (including senior indebtedness), to amend and modify the ranking of any indebtedness or to make distributions, except, in respect of distributions, where an event of default has occurred and such default has not been cured or waived. The indentures do not contain any provision specifically intended to protect holders of debentures in the event of a future leveraged transaction involving the REIT.

SUBSEQUENT EVENTS

In July 2010, the REIT completed a public offering of \$100 million of 5.90% Series D convertible unsecured subordinated debentures due June 30, 2020 (the "2020 Convertible Debentures"). Each 2020 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at a conversion price of \$23.50 per Stapled Unit at (i) any time prior to the maturity date and (ii) the business day immediately preceding the date specified by the REIT for redemption of the 2020 Convertible Debentures.

In August 2010, the REIT completed the acquisition of a retail property comprising approximately 14,800 square feet located in Tyler, Texas for a purchase price of approximately \$6.6 million.

In August 2010, the REIT completed the acquisition of two retail properties located in Taylor and Wilkes-Barre, Pennsylvania comprising approximately 133,100 square feet for a total purchase price of approximately \$18.4 million.

ADDITIONAL INFORMATION

Additional information relating to the REIT and Finance Trust, including the REIT's Annual Information Form, is available on SEDAR at www.sedar.com.