



**H&R Real Estate Investment Trust  
H&R Finance Trust**



Q3

QUARTERLY REPORT  
TO UNITHOLDERS

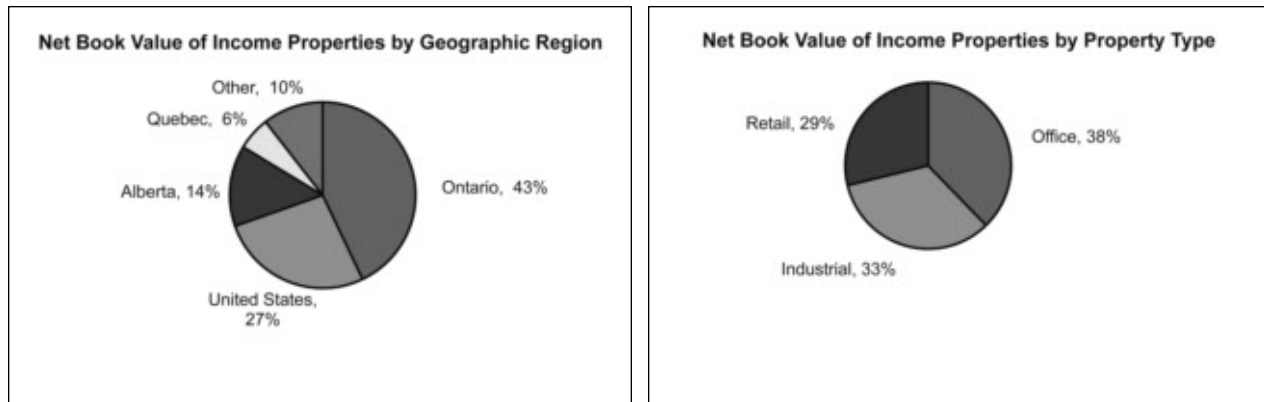
FOR THE NINE MONTHS  
ENDED SEPTEMBER 30, 2010

## H&R Profile

H&R Real Estate Investment Trust (“H&R REIT”) is an open-ended real estate investment trust, which owns and manages a North American portfolio of 281 office, industrial and retail properties comprising over 39 million square feet with a net book value of \$4.1 billion at September 30, 2010.

H&R Finance Trust is an unincorporated investment trust, which primarily invests in notes issued by a subsidiary of H&R REIT. The units of H&R REIT trade together with the units of H&R Finance Trust as “stapled units” (HR.UN) on the Toronto Stock Exchange. In this annual report, we refer to the combination of these two trusts as “H&R” or “the Trusts”.

Additional information regarding H&R REIT and H&R Finance Trust is available at [www.hr-reit.com](http://www.hr-reit.com) and on [www.sedar.com](http://www.sedar.com).



## Primary Objectives

H&R strives to achieve two primary objectives: to provide unitholders with stable and growing cash distributions generated by revenues it derives from a diversified portfolio of income properties, and to increase the value of units through active management of H&R’s assets, accretive acquisition of additional properties, and development of new projects. We are committed to maximizing cash distributions and capital appreciation for unitholders while maintaining prudent risk management and conservative use of financial leverage.

## Front and back cover images

Photos and renderings show H&R’s \$1.5-billion, two-million-square-foot office complex *The Bow* in downtown Calgary. The 58-storey, Class AAA office tower will be the largest and tallest in Canada west of Toronto. It is 100% leased for 25 years to EnCana Corporation, the leading North American unconventional natural gas producer and one of Canada’s largest public companies. When it opens in 2012, *The Bow* will be one of a cluster of three office towers owned and managed by H&R with 3.3 million square feet of prime space in Calgary’s financial district. Front cover photo courtesy of Matthews Development; back cover photo courtesy of Karl B. Staddon.



## Summary Report to Unitholders: Third Quarter 2010

### Financial Highlights

The following table includes non-GAAP (Generally Accepted Accounting Principles) information that should not be construed as an alternative to net earnings or cash provided by operations and may not be comparable to similar measures presented by other issuers as there is no standardized meaning of funds from operations (“FFO”), normalized funds from operations (“NFFO”) and adjusted funds from operations (“AFFO”) under GAAP. Management believes that these are meaningful measures of operating performance. Readers are encouraged to refer to H&R’s MD&A for further discussion of non-GAAP information presented.

	3 months ended September 30		9 months ended September 30	
	2010	2009	2010	2009
FFO (millions) <sup>(1)</sup>	\$67.2	\$41.7	\$134.9	\$163.1
FFO per Stapled Unit (basic)	\$0.45	\$0.28	\$0.90	\$1.10
NFFO (millions) <sup>(1) (2)</sup>	\$54.8	\$55.4	\$162.2	\$179.5
NFFO per Stapled Unit (basic)	\$0.37	\$0.37	\$1.09	\$1.21
AFFO (millions) <sup>(1)</sup>	\$55.2	\$52.5	\$123.2	\$172.3
AFFO per Stapled Unit (basic)	\$0.37	\$0.35	\$0.82	\$1.17
Cash distributions paid (millions)	\$27.1	\$24.2	\$75.2	\$73.4
Cash distributions per Stapled Unit	\$0.21	\$0.18	\$0.57	\$0.54

(1) H&R’s MD&A includes reconciliations of: net earnings to FFO and NFFO; FFO to AFFO; and AFFO to cash provided by operations. Readers are encouraged to review such reconciliations in the MD&A.

(2) NFFO adjusts FFO for additional recoveries of capital expenditures in excess of items expensed in property operating costs, the net loss on derivative instruments and foreign exchange, the mortgage interest accruals on non-recourse mortgage defaults and other non-recurring items.

For the 9 months ended September 30, 2010, FFO and AFFO were each reduced by a one-time, non-recurring loss of \$38.8 million on early repayment of the Fairfax non-convertible debentures in February 2010. Excluding this one-time debenture repayment loss, FFO and AFFO for the 9 months ended September 30, 2010 would have been \$1.16 and \$1.08 respectively per Stapled Unit. The following table includes results reported in accordance with Canadian GAAP.

	3 months ended September 30		9 months ended September 30	
	2010	2009	2010	2009
Rentals from income properties (millions)	\$152.7	\$148.2	\$455.3	\$453.5
Net earnings (millions)	\$34.4	\$15.7	\$161.8	\$56.7
Net earnings per Stapled Unit (basic)	\$0.24	\$0.11	\$1.12	\$0.40
Cash provided by operations (millions)	\$51.6	\$51.8	\$163.5	\$172.3

### Capital Transaction Highlights

During the third quarter 2010, H&R REIT:

- issued \$100 million of 5.9% convertible unsecured debentures maturing in June 2020;
- issued \$125 million of 5.0% unsecured debentures maturing in December 2018;
- acquired nine retail properties in the United States for approximately CAD \$58 million, leased for a weighted average term of 20 years. H&R REIT assumed CAD \$35 million of mortgages and expects the levered return from these acquisitions to be over 9%.



### Construction Facility Amendment

In October 2010, H&R REIT's construction facility was amended. The amendments included eliminating the limit on distributions and reducing the annual effective interest rate, including the cost of the swap, from 6.9% to 4.65%.

### Distribution Policy Adopted

H&R REIT previously announced that its trustees have adopted a distribution policy pursuant to which the monthly combined distribution is intended to be increased as shown in the following table.

Distribution Period	Monthly Distribution Per Stapled Unit	Annualized Distribution Per Stapled Unit
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

H&R's payout ratio is projected to remain one of the lowest in the Canadian REIT sector, even with these anticipated distribution increases. By the end of the second quarter 2012, upon completion and full occupancy of *The Bow*, the trustees will review this distribution policy taking into account the additional cash being generated by *The Bow*. The trustees retain the right to re-evaluate this distribution policy from time to time as they consider appropriate. As all distributions are at the sole discretion of the Trustees, and remain subject to the declaration by the trustees, there is no assurance that the actual distributions declared, if any, will be as provided in this distribution policy.

*Tom Hofstedter*  
President and Chief Executive Officer  
November 11, 2010

Unaudited Combined Financial Statements of

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

For the three and nine months ended September 30, 2010 and 2009

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Combined Balance Sheets  
(In thousands of dollars)

	September 30 2010	December 31 2009
	(unaudited)	
<b>Assets</b>		
Income properties (note 3)	<b>\$ 4,063,728</b>	\$ 4,124,856
Properties under development (note 4)	<b>1,138,131</b>	794,534
Accrued rent receivable	<b>132,110</b>	125,212
Other assets (note 5)	<b>110,913</b>	178,262
Cash and cash equivalents (note 6)	<b>41,753</b>	109,224
Assets held for sale and discontinued operations (note 23)	-	19,035
	<b>\$ 5,486,635</b>	\$ 5,351,123
<b>Liabilities and Unitholders' Equity</b>		
<b>Liabilities:</b>		
Mortgages payable (note 7)	<b>\$ 2,716,449</b>	\$ 2,818,476
Debentures payable (note 8)	<b>823,015</b>	565,758
Accounts payable and accrued liabilities	<b>190,383</b>	166,971
Future income tax liability	-	138,122
Intangible liabilities	<b>57,658</b>	57,237
Bank indebtedness (note 9)	<b>6,198</b>	13,556
Derivative instruments (notes 7, 9(b) and 19(c))	<b>4,707</b>	-
Liabilities related to discontinued operations (note 23)	-	2,215
	<b>3,798,410</b>	3,762,335
Non-controlling interest (note 10)	<b>77,841</b>	75,122
Unitholders' equity (notes 11 and 12)	<b>1,610,384</b>	1,513,666
Commitments and contingencies (note 24)		
Subsequent events (notes 9(b) and 26)		
	<b>\$ 5,486,635</b>	\$ 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 September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Operating revenue:				
Rentals from income properties (note 13)	\$ 152,743	\$ 148,206	\$ 455,310	\$ 453,497
Interest income	248	1,602	2,324	4,601
	<b>152,991</b>	149,808	<b>457,634</b>	458,098
Operating expenses:				
Property operating costs	50,654	47,786	148,404	145,080
Interest (note 14)	44,166	47,432	135,256	136,388
Depreciation and amortization (note 15)	31,466	30,694	94,182	93,779
	<b>126,286</b>	125,912	<b>377,842</b>	375,247
Net property operating income (note 21)	<b>26,705</b>	23,896	<b>79,792</b>	82,851
Net loss on foreign exchange	(3,524)	(11,187)	(2,322)	(18,384)
Impairment gain (loss) on income properties (note 3)	-	496	-	(14,496)
Unrealized gain (loss) on derivative instruments (notes 7, 9(b) and 19(c))	(1,114)	(1,091)	(8,169)	4,676
Loss on repayment of debentures (note 8(d))	-	-	(38,834)	-
Gain on extinguishment of debt (note 3)	15,973	-	17,628	-
Trust expenses	(2,288)	(2,131)	(7,105)	(5,951)
Net earnings before income taxes, non-controlling interest and discontinued operations	<b>35,752</b>	9,983	<b>40,990</b>	48,696
Income tax recovery (expense) (note 22)	(185)	(1,921)	122,890	(8,146)
Net earnings before non-controlling interest and discontinued operations	<b>35,567</b>	8,062	<b>163,880</b>	40,550
Non-controlling interest (note 10)	(1,366)	(421)	(5,684)	(1,742)
Net earnings from continuing operations	<b>34,201</b>	7,641	<b>158,196</b>	38,808
Net earnings from discontinued operations (note 23)	153	8,015	3,563	17,847
Net earnings	<b>\$ 34,354</b>	\$ 15,656	<b>\$ 161,759</b>	\$ 56,655
Basic net earnings per unit (note 16):				
Continuing operations	\$ 0.24	\$ 0.05	\$ 1.10	\$ 0.27
Discontinued operations	-	0.06	0.02	0.13
	<b>\$ 0.24</b>	\$ 0.11	<b>\$ 1.12</b>	\$ 0.40
Diluted net earnings per unit (note 16):				
Continuing operations	\$ 0.24	\$ 0.05	\$ 1.09	\$ 0.25
Discontinued operations	-	0.05	0.02	0.12
	<b>\$ 0.24</b>	\$ 0.10	<b>\$ 1.11</b>	\$ 0.37

See accompanying notes to combined financial statements.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

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	Accumulated	Total	
					warrants and debentures	other comprehensive loss (note 12)		
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	8,967	-	-	-	-	-	8,967	
Issue costs	(820)	-	-	-	-	-	(820)	
Issuance of warrants, net of costs	-	-	-	-	8,533	-	8,533	
Equity component from issuance of convertible debentures, net of costs	-	-	-	-	26,305	-	26,305	
Net earnings	-	56,655	-	-	-	-	56,655	
Distributions to unitholders (note 11(b))	-	-	(76,853)	-	-	-	(76,853)	
Unit-based compensation (note 11(a))	358	-	-	-	-	-	358	
Other comprehensive income	-	-	-	-	-	(12,985)	(12,985)	
Unitholders' equity, September 30, 2009	2,196,557	801,432	(1,345,576)	-	41,605	(32,190)	1,661,828	
Proceeds from issuance of units	14,474	-	-	-	-	-	14,474	
Issue costs	(46)	-	-	-	-	-	(46)	
Equity component from issuance of convertible debentures, net of costs	-	-	-	-	17,021	-	17,021	
Net earnings	-	29,870	-	-	-	-	29,870	
Distributions to unitholders	-	-	(25,752)	-	-	-	(25,752)	
Redemption of units	(28,873)	-	-	28,873	-	-	-	
Redemption of warrants	-	(148,308)	-	(28,873)	(8,533)	-	(185,714)	
Unit-based compensation	177	-	-	-	-	-	177	
Other comprehensive loss	-	-	-	-	-	1,808	1,808	
Unitholders' equity, December 31, 2009	2,182,289	682,994	(1,371,328)	-	50,093	(30,382)	1,513,666	
<b>Proceeds from issuance of units</b>	<b>10,896</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,896</b>	
<b>Equity component from issuance of convertible debentures, net of costs (note 8(b))</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,572</b>	<b>-</b>	<b>6,572</b>	
<b>Net earnings</b>	<b>-</b>	<b>161,759</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>161,759</b>	
<b>Distributions to unitholders (note 11(b))</b>	<b>-</b>	<b>-</b>	<b>(82,127)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(82,127)</b>	
<b>Redemption of convertible debentures (note 8(a))</b>	<b>553</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(100)</b>	<b>-</b>	<b>453</b>	
<b>Unit-based compensation (note 11(a))</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>915</b>	<b>-</b>	<b>-</b>	<b>915</b>	
<b>Other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,750)</b>	<b>(1,750)</b>	
<b>Unitholders' equity, September 30, 2010</b>	<b>\$ 2,193,738</b>	<b>\$ 844,753</b>	<b>\$ (1,453,455)</b>	<b>\$ 915</b>	<b>\$ 56,565</b>	<b>\$ (32,132)</b>	<b>\$ 1,610,384</b>	
<b>COMPREHENSIVE INCOME</b>					Three Months Ended September 30 2010	September 30 2009	Nine Months Ended September 30 2010	September 30 2009
Net earnings					\$ 34,354	\$ 15,656	\$ 161,759	\$ 56,655
Unrealized loss on translation of self-sustaining foreign operations					(3,061)	(8,604)	(2,531)	(14,443)
Transfer of realized loss on cash flow hedges to net earnings					94	186	278	547
Future income taxes (note 22)					-	1	503	911
Other comprehensive loss					(2,967)	(8,417)	(1,750)	(12,985)
Comprehensive income					\$ 31,387	\$ 7,239	\$ 160,009	\$ 43,670

See accompanying notes to combined financial statements.



# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Cash provided by (used in):				
Operations:				
Net earnings	\$ 34,354	\$ 15,656	\$ 161,759	\$ 56,655
Items not affecting cash:				
Rent amortization (notes 13 and 23)	972	842	3,064	2,880
Depreciation and amortization (notes 15 and 23)	31,466	30,863	94,223	95,399
Gain on sale of income properties (note 23)	(7)	(6,902)	(3,616)	(13,767)
Gain on extinguishment of debt (note 3)	(15,973)	-	(17,628)	-
Impairment (gain) loss on income properties (note 3)	-	(496)	-	14,496
Future income tax expense (recovery) (note 22)	-	1,808	(123,303)	7,867
Unrealized (gain) loss on derivative instruments (notes 7, 9(b) and 19(c))	1,114	1,091	8,169	(4,676)
Loss on repayment of debentures (note 8(d))	-	-	38,834	-
Effective interest rate accretion (notes 14 and 23)	3,001	1,973	8,207	3,458
Unrealized loss on foreign exchange	3,524	11,185	2,320	18,362
Unit-based compensation (note 11(a))	311	177	915	358
Net earnings attributable to non-controlling interest (note 10)	1,371	727	5,818	2,424
Change in other non-cash operating items (note 17)	(8,578)	(5,102)	(15,294)	(11,111)
	<b>51,555</b>	<b>51,822</b>	<b>163,468</b>	<b>172,345</b>
Financing:				
Bank indebtedness	(45,692)	(18,178)	(7,362)	(111,549)
Mortgages payable:				
New mortgages payable	(325)	82,134	11,140	82,134
Principal repayments	(27,940)	(60,497)	(79,123)	(112,680)
Proceeds from issuance of debentures payable (notes 8(b) and 8(c))	217,991	143,885	445,924	342,514
Repayment of debentures payable (note 8(d))	-	-	(227,752)	-
Proceeds from issuance of units, net	866	(373)	903	1,708
Distributions to unitholders (note 11(b))	(25,943)	(23,208)	(72,134)	(70,414)
Distributions to non-controlling interest (note 10)	(1,141)	(978)	(3,099)	(2,936)
	<b>117,816</b>	<b>122,785</b>	<b>68,497</b>	<b>128,777</b>
Investments:				
Properties under development	(121,492)	(95,345)	(331,303)	(243,052)
Income properties:				
Net proceeds on disposition of income properties	7	23,277	22,223	48,991
Acquisitions (note 3)	(24,161)	-	(48,652)	-
Capital expenditures	(2,452)	(2,038)	(11,943)	(4,691)
Mortgages and amounts receivable	-	(155)	60,789	(527)
Restricted cash (note 5)	2,312	(10,466)	9,169	(13,170)
	<b>(145,786)</b>	<b>(84,727)</b>	<b>(299,717)</b>	<b>(212,449)</b>
Increase (decrease) in cash and cash equivalents	23,585	89,880	(67,752)	88,673
Cash and cash equivalents, beginning of period (notes 6 and 23)	18,168	16,476	109,505	17,683
Cash and cash equivalents, end of period	\$ 41,753	\$ 106,356	\$ 41,753	\$ 106,356

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 three and nine months ended September 30, 2010 and 2009**

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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 September 30, 2010 and December 31, 2009 and the results of operations and cash flows for the three and nine months ended September 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.

# 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 three and nine months ended September 30, 2010 and 2009**

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### 1. Significant accounting policies (continued):

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

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:

September 30, 2010	Cost	Accumulated depreciation and amortization	Net book value
Land	\$ 881,836	\$ -	\$ 881,836
Buildings	3,270,573	(494,042)	2,776,531
Building improvements	35,212	(7,916)	27,296
Paving and equipment	121,453	(57,784)	63,669
	4,309,074	(559,742)	3,749,332
Intangible assets	458,724	(144,328)	314,396
	\$ 4,767,798	\$ (704,070)	\$ 4,063,728

# 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 three and nine months ended September 30, 2010 and 2009**

### 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 nine months ended September 30, 2009, the REIT recorded an impairment charge of \$14,496 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 charge was recorded during the three and nine months ended September 30, 2010.

During the three months ended September 30, 2010, the lender accepted title to four U.S. income properties previously occupied by Boscov's Department Stores and during the nine months ended September 30, 2010, the lenders accepted title to five U.S. income properties, one previously occupied by Circuit City and four previously occupied by Boscov's Department Stores, thereby releasing the REIT from any further obligation with respect to the mortgages on such properties. The REIT recorded a gain on the extinguishment of this debt of \$15,973 for the three months ended September 30, 2010 and \$17,628 for the nine months ended September 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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### 3. Income properties (continued):

#### Acquisitions:

During the nine months ended September 30, 2010, the REIT acquired 13 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:

<b>Assets</b>	
Land	\$ 29,438
Building	74,760
Paving and equipment	3,486
Intangible acquired in-place lease costs	12,198
Above-market leases	5,836
Customer relationship value	1,157
	<b>126,875</b>
<b>Liabilities</b>	
Mortgages payable, net of mark to market adjustments	74,479
Intangible below-market rent leases	3,744
Net assets acquired and settled by cash	<b>\$ 48,652</b>

### 4. Properties under development:

Project	Address	September 30	December 31
		2010	2009
The Bow (note 24(a))	5th Ave. at Centre Street, Calgary, AB	\$ 1,060,540	\$ 719,173
Heart Lake	Mayfield West Business Park, Caledon, ON	39,921	39,809
Airport Road	7900 Airport Road, Brampton, ON	37,670	35,552
		<b>\$ 1,138,131</b>	<b>\$ 794,534</b>

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### 5. Other assets:

	September 30	December 31
	2010	2009
Tenant inducements (net of accumulated amortization of \$12,030 (2009 - \$9,807))	\$ 34,007	\$ 29,797
Prepaid expenses and sundry assets	27,032	12,811
Leasing expenses (net of accumulated amortization of \$22,361 (2009 - \$19,145))	26,493	27,542
Restricted cash	10,832	20,001
Accounts receivable	9,549	6,543
Mortgages and amount receivable	3,000	63,789
Future income tax asset	-	14,316
Swap derivatives (note 9(b))	-	3,463
	<b>\$ 110,913</b>	<b>\$ 178,262</b>

### 6. Cash and cash equivalents:

Cash and cash equivalents at September 30, 2010 includes cash on hand of \$8,208 (December 31, 2009 - \$9,281) and bank term deposits of \$33,545 (December 31, 2009 - \$99,943) at rates of interest varying between 0.54% to 1.05% (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 September 30, 2010 are U.S. dollar denominated mortgages of U.S. \$801,778 (December 31, 2009 - U.S. \$826,906). The Canadian equivalents of these amounts are \$825,831 (December 31, 2009 - \$868,252).

During the nine months ended September 30, 2010, the REIT entered into an interest rate swap on one mortgage. The fair value of this interest rate swap as at September 30, 2010 is a liability of \$700 resulting in an unrealized loss of \$300 for the three months and an unrealized loss of \$700 for the nine months ended September 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 *		\$ 28,799
2011		171,266
2012		367,421
2013		197,359
2014		279,319
2015		312,129
Thereafter		1,305,421
		<u>2,661,714</u>
Mortgages payable due on demand **		58,995
Financing cost and mark-to-market adjustment arising on acquisitions		(4,260)
		<u><b>\$ 2,716,449</b></u>

\* For the balance of the year

\*\* Relates to five 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 three 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:

							September 30	December 31
							2010	2009
Contractual								
	Maturity	interest rate	Effective interest rate	Conversion price	Face value	Carrying value	Carrying value	
2013 Convertible Debentures	June 30, 2013	6.65%	9.10%	\$ 23.11	\$115,000	<b>\$108,275</b>	\$106,734	
2014 Convertible Debentures (a)	December 31, 2014	6.75%	12.30%	14.00	149,447	<b>122,435</b>	119,427	
2017 Convertible Debentures	June 30, 2017	6.00%	8.60%	19.00	175,000	<b>152,611</b>	150,830	
2020 Convertible Debentures (b)	June 30, 2020	5.90%	7.53%	23.50	100,000	<b>89,031</b>	-	
Series A Senior Debentures (c)	February 3, 2015	5.20%	5.40%	-	115,000	<b>114,095</b>	-	
Series B Senior Debentures (c)	February 3, 2017	5.90%	6.06%	-	115,000	<b>114,028</b>	-	
Series C Senior Debentures (c)	December 1, 2018	5.00%	5.30%	-	125,000	<b>122,540</b>	-	
Non-Convertible Debentures (d)	-	11.50%	12.90%	-	-	-	188,767	
					<u>\$894,447</u>	<u><b>\$823,015</b></u>	<u>\$565,758</u>	

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### 8. Debentures payable (continued):

#### (a) 2014 Convertible Debentures:

During the three months ended September 30, 2010, holders of \$543 (September 30, 2009 - nil) of 2014 Convertible Debentures at face value exercised their option to convert to units. Of the \$543, \$99 was recorded as a reduction of the original equity component and \$444 was recorded as a reduction of the debt component. This ratio is consistent with the original equity and debt ratio. A total of 38,782 Stapled Units were issued on conversion.

During the nine months ended September 30, 2010, holders of \$553 (September 30, 2009 - nil) of 2014 Convertible Debentures at face value exercised their option to convert to units. Of the \$553, \$100 was recorded as a reduction of the original equity component and \$453 was recorded as a reduction of the debt component. This ratio is consistent with the original equity and debt ratio. A total of 39,496 Stapled Units were issued on conversion.

#### (b) 2020 Convertible Debentures:

In July 2010, the REIT completed a public offering of \$100,000 Series D convertible unsecured subordinated debentures (the "2020 Convertible Debentures"), bearing interest at the annual contractual rate of 5.90% and an effective interest rate of 7.53%. The 2020 Convertible Debentures mature on June 30, 2020, and interest is payable semi-annually on June 30 and December 31. Each 2020 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option 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, at a conversion price of \$23.50 per Stapled Unit, being a conversion rate of approximately 42.5532 Stapled Units per \$1 principal amount, subject to adjustment upon the occurrence of certain events in accordance with the Indenture governing the 2020 Convertible Debentures.

On redemption or maturity of the 2020 Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the 2020 Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing to be issued) a variable number of Stapled Units equal to the principal amount of the 2020 Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units. The 2020 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2014. Thereafter, but prior to June 30, 2016, the 2020 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2016 and prior to the maturity date, the 2020 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest.

The REIT accounted for the 2020 Convertible Debentures by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability and classifying such value as debt. The remaining value of the 2020 Convertible Debentures is classified as equity.

On issuance, the REIT recorded a liability of \$88,893, net of issue costs of \$4,223, and equity, which represents the holders' option to convert the 2020 Convertible Debentures into Stapled Units, of \$6,572, net of issue costs of \$312. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the 2020 Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding 2020 Convertible Debentures.



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### 8. Debentures payable (continued):

#### (c) *Series A Senior Debentures, Series B Senior Debentures and Series C 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.

In September 2010, the REIT issued \$125,000 Series C unsecured senior debentures (the "Series C Senior Debentures"), bearing interest at the annual contractual rate of 5.00% and an effective interest rate of 5.30%. The Series C Senior Debentures mature on December 1, 2018, and interest is paid semi-annually on June 1 and December 1. On issuance, the REIT recorded a liability of \$122,525, net of issue costs of \$2,475.

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, Series B Senior Debentures and Series C 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.

#### (d) *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, 2012. The total facility as at September 30, 2010 is \$277,924 (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 September 30, 2010, after taking into account the bank indebtedness drawn of \$6,198 (including amounts in note 23) (December 31, 2009 - \$13,560) and the outstanding letters of credit and other items, is \$242,025 (December 31, 2009 - \$236,716). The Canadian dollar bank indebtedness bears interest at rates approximating the prime rate of a Canadian chartered bank. At September 30, 2010, the Canadian prime interest rate was 3.00% (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. Subsequent to September 30, 2010, the facility increased to \$295,300.

Included in bank indebtedness at September 30, 2010 is U.S. \$143 (December 31, 2009 - U.S. \$33). The Canadian equivalents of these amounts are \$147 (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 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 were not satisfied as at September 30, 2010 nor has any amount been drawn upon the credit facility. Conditions (i) and (iii) were satisfied subsequent to September 30, 2010. As a result of an amendment to the facility subsequent to September 30, 2010, condition (ii) noted above is no longer a condition precedent for borrowing under the facility, but must be satisfied prior to first occupancy of the Bow.

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. As at September 30, 2010, the expected annual effective interest rate for this facility, including the cost of the swap, is 6.90%. As a result of an amendment to the facility subsequent to September 30, 2010, the expected annual effective interest rate, including the cost of the swap, was reduced from 6.90% to 4.65%. The fair value of this interest rate swap as at September 30, 2010 is a liability of \$4,138 resulting in an unrealized gain (loss) of (\$2,159) for the three months ended September 30, 2010 (September 30, 2009 - (\$1,091)) and an unrealized gain (loss) of (\$7,601) for the nine months ended September 30, 2010 (September 30, 2009 - \$4,676).

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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	1,742	-
Non-controlling interest from discontinued operations (note 23)	682	-
Distributions on Class B units of HRLP	(2,936)	-
As at September 30, 2009	74,855	5,437,565
Non-controlling interest from continuing operations	1,307	-
Non-controlling interest from discontinued operations	(61)	-
Distributions on Class B units of HRLP	(979)	-
As at December 31, 2009	75,122	5,437,565
<b>Non-controlling interest from continuing operations</b>	<b>5,684</b>	<b>-</b>
<b>Non-controlling interest from discontinued operations (note 23)</b>	<b>134</b>	<b>-</b>
<b>Distributions on Class B units of HRLP</b>	<b>(3,099)</b>	<b>-</b>
<b>As at September 30, 2010</b>	<b>\$ 77,841</b>	<b>5,437,565</b>

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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")	1,081,157
	<b>148,114,008</b>
Stapled Units held by a subsidiary	(5,437,565)
As at September 30, 2009	<b>142,676,443</b>
As at September 30, 2009	148,114,008
Issued under the DRIP	180,587
Stapled Units redeemed from a subsidiary	(5,437,565)
Options exercised	968,232
As at December 31, 2009	<b>143,825,262</b>
<b>As at December 31, 2009</b>	<b>143,825,262</b>
<b>Issued under the DRIP</b>	<b>593,086</b>
<b>2014 Convertible Debentures converted into Stapled Units (note 8(a))</b>	<b>39,496</b>
<b>Options exercised</b>	<b>86,766</b>
<b>As at September 30, 2010</b>	<b>144,544,610</b>

#### (a) Unit option plan:

As at September 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 nine months ended September 30, 2010, 600,000 options were granted (September 30, 2009 - 600,000). The fair value of the unit options used to compute compensation cost is the estimated fair value of each option granted 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 \$311 for the three months ended September 30, 2010 (September 30, 2009 - \$177) and \$915 for the nine months ended September 30, 2010 (September 30, 2009 - \$358) 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 September 30, 2010 and 2009 and the changes during the nine 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
Exercised	(86,766)	9.46	-	-
Outstanding, as at September 30	2,599,668	\$ 13.71	3,054,666	\$ 12.86
Options exercisable, as at September 30	1,399,668	\$ 13.84	2,054,660	\$ 13.18

The options outstanding at September 30, 2010 are exercisable at varying prices ranging from \$9.30 to \$16.56 (September 30, 2009 - \$9.30 to \$16.56) with a weighted average remaining life of 6.3 years (September 30, 2009 - 5.1 years). The vested options are exercisable at varying prices ranging from \$9.30 to \$16.56 (September 30, 2009 - \$12.01 to \$16.56) with a weighted average remaining life of 4.1 years (September 30, 2009 - 3.0 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 September 30, 2010 of \$0.21 (September 30, 2009 - \$0.18) and for the nine months ended September 30, 2010 of \$0.57 (September 30, 2009 - \$0.54).

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### 11. Unitholders' equity (continued):

	Three months ended		Nine months ended	
	September 30		September 30	
	2010	2009	2010	2009
Cash distributions to unitholders	\$ 25,943	\$ 23,208	\$ 72,134	\$ 70,414
Unit distributions (issued under the DRIP)	4,362	2,452	9,993	6,439
	<b>\$ 30,305</b>	<b>\$ 25,660</b>	<b>\$ 82,127</b>	<b>\$ 76,853</b>

### (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	547	-	547
Future income taxes (note 22)	911	-	911
Unrealized loss on translation of self-sustaining foreign operation	-	(14,443)	(14,443)
Balance as at September 30, 2009	(6,812)	(25,378)	(32,190)
Transfer of realized loss on cash flow hedges to net earnings	3,897	-	3,897
Future income taxes	73	-	73
Unrealized loss on translation of self-sustaining foreign operation	-	(2,162)	(2,162)
Balance as at December 31, 2009	(2,842)	(27,540)	(30,382)
Transfer of realized loss on cash flow hedges to net earnings	278	-	278
Future income taxes (note 22)	503	-	503
Unrealized gain on translation of self-sustaining foreign operation	-	(2,531)	(2,531)
Balance as at September 30, 2010	<b>\$ (2,061)</b>	<b>\$ (30,071)</b>	<b>\$ (32,132)</b>

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### 13. Rentals from income properties:

	Three months ended		Nine months ended	
	September 30		September 30	
	2010	2009	2010	2009
Rentals from income properties	\$151,740	\$ 145,949	\$452,088	\$447,108
Straight-lining of contractual rent	1,975	3,100	6,286	9,185
Rent amortization of tenant inducements	(780)	(656)	(2,480)	(2,039)
Rent amortization of above- and below-market rents	(192)	(187)	(584)	(757)
	<b>\$152,743</b>	<b>\$148,206</b>	<b>\$455,310</b>	<b>\$453,497</b>

### 14. Interest:

	Three months ended		Nine months ended	
	September 30		September 30	
	2010	2009	2010	2009
Contractual interest on mortgages payable	\$ 42,194	\$ 45,074	\$128,761	\$137,408
Contractual interest on debentures payable	11,800	9,473	33,074	17,550
Effective interest rate accretion	3,001	1,846	8,207	3,178
Bank interest and charges	909	285	1,852	2,003
	<b>57,904</b>	<b>56,678</b>	<b>171,894</b>	<b>160,139</b>
Capitalized interest	(13,738)	(9,246)	(36,638)	(23,751)
	<b>\$ 44,166</b>	<b>\$ 47,432</b>	<b>\$135,256</b>	<b>\$136,388</b>

### 15. Depreciation and amortization:

	Three months ended		Nine months ended	
	September 30		September 30	
	2010	2009	2010	2009
Depreciation of income properties	\$ 23,943	\$ 23,252	\$ 71,941	\$ 71,092
Amortization of intangible assets on acquisitions	5,965	6,000	17,662	18,576
Amortization of leasing expenses	1,558	1,442	4,579	4,111
	<b>\$ 31,466</b>	<b>\$ 30,694</b>	<b>\$ 94,182</b>	<b>\$ 93,779</b>

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### 16. Net earnings per unit:

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Net earnings	\$ 34,354	\$ 15,656	\$ 161,759	\$ 56,655
Add net earnings attributable to non-controlling interest (note 10)	1,371	727	5,818	2,424
Add convertible debenture interest	-	-	20,664	-
<b>Diluted net earnings</b>	<b>\$ 35,725</b>	<b>\$ 16,383</b>	<b>\$ 188,241</b>	<b>\$ 59,079</b>

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

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Basic Stapled Units	144,291,727	142,552,968	144,066,402	142,321,100
Effect of dilutive securities:				
Unit option plan	721,608	-	569,720	-
Convertible debentures	-	-	19,919,032	-
Warrants	-	12,909,722	-	11,315,173
Non-controlling interest conversion to Stapled Units (note 10)	5,437,565	5,437,565	5,437,565	5,437,565
<b>Diluted units</b>	<b>150,450,900</b>	<b>160,900,255</b>	<b>169,992,719</b>	<b>159,073,838</b>

Net earnings per Stapled Unit:

Basic	\$ 0.24	\$ 0.11	\$ 1.12	\$ 0.40
Diluted	\$ 0.24	\$ 0.10	\$ 1.11	\$ 0.37

The 2013 and 2020 convertible debentures are anti-dilutive for the three and nine months ended September 30, 2010. The 2014 and 2017 convertible debentures are anti-dilutive for the three months ended September 30, 2010; therefore, the potential conversion of these debentures into Stapled Units has not been included in the calculation of diluted units.

The convertible debentures and the unit option plan were anti-dilutive for the three and nine months ended September 30, 2009; 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 nine months ended September 30, 2010 and 2009 are as follows:

	Three months ended		Nine months ended	
	September 30		September 30	
	2010	2009	2010	2009
Leasing expenses and tenant inducements	\$ (1,523)	\$ (1,643)	\$ (4,270)	\$ (3,925)
Accrued rent receivable	(1,784)	(2,630)	(6,769)	(9,040)
Prepaid expenses and sundry assets	(5,718)	(2,988)	(14,116)	(11,856)
Accounts receivable	(771)	(775)	(3,087)	2,292
Accounts payable and accrued liabilities	1,218	2,934	12,948	11,418
	\$ (8,578)	\$ (5,102)	\$ (15,294)	\$ (11,111)

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

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2010	2009	2010	2009
Acquisition of income properties through assumption of mortgages payable, net of mark to market adjustments	\$ 38,203	\$ -	\$ 74,479	\$ -
Release of mortgage obligations upon lenders consent	(72,294)	(5,791)	(93,099)	(10,424)
Non-cash transfer of income properties to lenders	65,097	-	85,706	-
Non-cash transfer of property from properties under development to income properties	-	-	-	117,007
Non-cash distributions to unitholders (note 11(b))	4,362	2,452	9,993	6,439
Non-cash conversion of convertible debentures (note 8(a))	543	-	553	-
Non-cash assumption of mortgage payable on disposition	-	13,730	-	25,631
Non-cash issuance of warrants	-	-	-	8,533
Additions to properties under development included in accounts payable	2,692	(6,374)	12,294	22,643
Additions to tenant inducements included in accounts payable	-	-	6,142	-

During the three months ended September 30, 2010, interest paid amounted to \$47,862 (September 30, 2009 - \$42,848) and during the nine months ended September 30, 2010, interest paid amounted to \$147,995 (September 30, 2009 - \$143,747).

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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, 2020 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 September 30, 2010, this ratio was 49.5% (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:

	<b>Covenant</b>	<b>September 30 2010</b>	December 31 2009
(a) Maximum indebtedness to gross book value	65%	<b>49.5%</b>	50.5%
(b) Minimum debt service coverage ratio	1.20 : 1	<b>1.46 : 1</b>	1.55 : 1
(c) Minimum equity	\$1,300,000 plus 75% of net cash proceeds from future equity offerings	<b>\$1,610,384</b>	\$1,513,666

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### 18. Capital risk management (continued):

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

The REIT's mortgage providers also have minimum limits on debt-to-service coverage ratios ranging from 1.10 to 1.50 as at September 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. Once the Bow is completed, EnCana Corporation is expected to also account for more than 5% of the rentals from income properties. EnCana Corporation's current public debt rating is A (low).

#### (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.

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### 19. Risk management (continued):

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 declaration and payment 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.

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 September 30, 2010 is \$131 resulting in an unrealized gain of \$1,345 for the three months and \$132 for the nine months ended September 30, 2010.

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.04 for the nine months ended September 30, 2010 (September 30, 2009 - \$1.17) would have decreased other comprehensive income by approximately \$12,000 (September 30, 2009 - \$18,800) and increased (decreased) net earnings by approximately (\$1,500) (September 30, 2009 - \$4,500). 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 September 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 September 30, 2010, the percentage of fixed rate debt to total debt was 99.8% (December 31, 2009 - 99.6%). As at September 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.

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### 19. Risk management (continued):

The bank indebtedness is subject to variable interest rates. An increase in interest rates of 100 basis points for the three months ended September 30, 2010 would have decreased net earnings by approximately \$100 (September 30, 2009 - nil) and for the nine months ended September 30, 2010 would have decreased net earnings by approximately \$200 (September 30, 2009 - \$500). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

### 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 September 30, 2010, the REIT recorded fees pursuant to this agreement of \$3,913 (September 30, 2009 - \$3,397), of which \$377 (September 30, 2009 - nil) was capitalized to the cost of the income properties acquired, \$698 (September 30, 2009 - \$537) was capitalized to properties under development and \$661 (September 30, 2009 - \$733) 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 September 30, 2010, a further amount of \$625 (September 30, 2009 - \$540) 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 (September 30, 2009 - \$540) has been waived by the Property Manager and \$625 (September 30, 2009 - nil) has been expensed in the combined statements of earnings.

During the nine months ended September 30, 2010, the REIT recorded fees pursuant to this agreement of \$11,099 (September 30, 2009 - \$10,367), of which \$787 (September 30, 2009 - nil) was capitalized to the cost of the income properties acquired, \$1,756 (September 30, 2009 - \$1,539) was capitalized to properties under development and \$1,508 (September 30, 2009 - \$1,961) 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 nine months ended September 30, 2010, a further amount of \$1,875 (September 30, 2009 - \$2,780) 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 (September 30, 2009 - \$2,780) has been waived by the Property Manager and \$1,875 (September 30, 2009 - nil) has been expensed in the combined statements of earnings.

Pursuant to the above agreements, as at September 30, 2010, \$1,924 (December 31, 2009 - \$857) was payable to the Property Manager.

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### 20. Related party transactions (continued):

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the three months ended September 30, 2010 is \$324 (September 30, 2009 - \$321) and for the nine months ended September 30, 2010 is \$990 (September 30, 2009 - \$935).

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

### 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.

	September 30	December 31
	2010	2009
<b>Income properties and properties under development</b>		
Canada	\$ 4,112,564	\$ 3,823,522
United States	1,089,295	1,095,868
	<b>\$ 5,201,859</b>	<b>\$ 4,919,390</b>

Net property operating income for the three months ended September 30, 2010	United		
	Canada	States	Total
Operating revenue	\$ 126,992	\$ 25,999	\$ 152,991
Property operating costs	(45,936)	(4,718)	(50,654)
Interest	(32,017)	(12,149)	(44,166)
Depreciation and amortization	(23,156)	(8,310)	(31,466)
Net property operating income	<b>\$ 25,883</b>	<b>\$ 822</b>	<b>\$ 26,705</b>

Net property operating income for the three months ended September 30, 2009	United		
	Canada	States	Total
Operating revenue	\$ 125,040	\$ 24,768	\$ 149,808
Property operating costs	(43,154)	(4,632)	(47,786)
Interest	(33,684)	(13,748)	(47,432)
Depreciation and amortization	(23,028)	(7,666)	(30,694)
Net property operating income	<b>\$ 25,174</b>	<b>\$ (1,278)</b>	<b>\$ 23,896</b>

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### 21. Segmented disclosures (continued):

Net property operating income for the nine months ended September 30, 2010	United		Total
	Canada	States	
Operating revenue	\$ 382,538	\$ 75,096	\$ 457,634
Property operating costs	(134,901)	(13,503)	(148,404)
Interest	(97,065)	(38,191)	(135,256)
Depreciation and amortization	(69,137)	(25,045)	(94,182)
Net property operating income	\$ 81,435	\$ (1,643)	\$ 79,792

Net property operating income for the nine months ended September 30, 2009	United		Total
	Canada	States	
Operating revenue	\$ 377,165	\$ 80,933	\$ 458,098
Property operating costs	(130,711)	(14,369)	(145,080)
Interest	(92,004)	(44,384)	(136,388)
Depreciation and amortization	(68,597)	(25,182)	(93,779)
Net property operating income	\$ 85,853	\$ (3,002)	\$ 82,851

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

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Income tax recovery (expense) included in the determination of net earnings from continuing operations:				
Current	\$ (185)	\$ (113)	\$ (413)	\$ (279)
Future	-	(1,808)	123,303	(7,867)
	(185)	(1,921)	122,890	(8,146)
Future income tax included in the determination of other comprehensive income	-	1	503	911
	\$ (185)	\$ (1,920)	\$ 123,393	\$ (7,235)

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### **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").

The REIT completed the necessary restructuring as of June 30, 2010 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 was reversed into earnings as of June 30, 2010.



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### 23. Assets held for sale and discontinued operations:

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

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

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	December 31
	2009
<b>Assets</b>	
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
<b>Liabilities</b>	
Accounts payable and accrued liabilities	\$ 2,211
Bank indebtedness	4
	<hr/> \$ 2,215

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

The REIT sold two properties during the first nine 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		Nine Months Ended	
	September 30		September 30	
<b>Net earnings from discontinued operations</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Operating revenue:				
Rentals from income properties	\$ 171	\$ 3,831	\$ 571	\$ 14,206
Straight-lining of contractual rent	-	322	(129)	1,008
Rent amortization of tenant inducements	-	-	-	(92)
Rent amortization of above- and below-market rents	-	1	-	8
	<b>171</b>	<b>4,154</b>	<b>442</b>	<b>15,130</b>
Interest income	-	2	-	3
	<b>171</b>	<b>4,156</b>	<b>442</b>	<b>15,133</b>
Operating expenses:				
Property operating costs	20	1,110	320	3,766
Contractual interest on mortgages payable	-	1,323	-	4,696
Effective interest rate accretion	-	127	-	280
Bank interest and charges	-	8	-	9
Depreciation and amortization	-	169	41	1,620
	<b>20</b>	<b>2,737</b>	<b>361</b>	<b>10,371</b>
Net property operating income	<b>151</b>	<b>1,419</b>	<b>81</b>	<b>4,762</b>
Gain on sale of income properties	<b>7</b>	<b>6,902</b>	<b>3,616</b>	<b>13,767</b>
Non-controlling interest (note 10)	<b>(5)</b>	<b>(306)</b>	<b>(134)</b>	<b>(682)</b>
Net earnings from discontinued operations	<b>\$ 153</b>	<b>\$ 8,015</b>	<b>\$ 3,563</b>	<b>\$ 17,847</b>

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### 24. Commitments and contingencies:

- (a) The REIT is currently constructing 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 \$486,000, including capitalized interest, over the remaining construction period, of which approximately \$390,000 is expected to be incurred during the next twelve months. As at September 30, 2010, the total cost incurred on the project amounted to \$1,060,540 (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 15-24 by August 29, 2011 and floors 25-42 by October 12, 2011. The delivery schedule of floors 43-59 is expected to be set by the end of November 2010. 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.
- (b) In the normal course of operations, the REIT has issued letters of credit in connection with developments, financings, operations and acquisitions. As at September 30, 2010, the REIT has outstanding letters of credit totalling \$29,676 (December 31, 2009 - \$34,349), including \$18,091 (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 September 30, 2010, the REIT issued guarantees amounting to \$41,811 (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 September 30, 2010 the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$117,070 (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.

# 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 three and nine months ended September 30, 2010 and 2009**

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**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 October 2010, the REIT completed the acquisition of a property under development comprising approximately 92 acres located in Caledon, Ontario for a purchase price of approximately \$31,500 and a vendor take back mortgage of \$18,000 bearing interest at 4.0% per annum and maturing in October 2015.
- (b) In October 2010, the REIT amended the Bow construction financing facility. The amendments included the following:
  - (1) the expected annual effective interest rate, including the cost of the swap, was reduced from 6.90% to 4.65%;
  - (2) there is no longer a limit on annual distributions; and
  - (3) the execution of an acceptable management agreement for the project is no longer a condition precedent for borrowing, but must be satisfied prior to first occupancy.

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

**For the Three and Nine months ended September 30, 2010**

Dated: November 11, 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 nine months ended September 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, impact of adopting Internal Financial Reporting Standards ("IFRS"). 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 November 11, 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 nine months ended September 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 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. See "Funding of Future Commitments" for further information.

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 September 30, 2010, Finance Trust holds U.S. \$122.9 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)	<b>September 30, 2010</b>	December 31, 2009
Total assets	<b>\$5,486,635</b>	\$5,351,123
Debt to gross book value of assets (per the REIT's Declaration of Trust)	<b>49.5%</b>	52.5%
Debt to gross book value of assets	<b>57.3%</b>	56.8%
Units outstanding	<b>144,545</b>	143,825
Class B units of H&R Limited Partnership outstanding	<b>5,438</b>	5,438
	<b>Three months ended September 30, 2010</b>	Three months ended September 30, 2009
Property rental revenue	<b>\$152,743</b>	\$148,206
Net property operating income	<b>26,705</b>	23,896
Normalized funds from operations ("NFFO")	<b>54,775</b>	55,445
Weighted average number of basic units for NFFO	<b>149,729</b>	147,991
Normalized funds from operations per basic unit	<b>0.37</b>	0.37
Distributions paid per unit	<b>0.21</b>	0.18
Payout ratio per unit as a % of basic NFFO	<b>56.8%</b>	48.6%

Net earnings is reconciled to FFO which is reconciled 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 24-28.

## 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**

<b>OPERATIONS</b>		Office	Industrial	Retail	Total*
<i>Occupancy as at September 30 <sup>(1)</sup></i>	<b>2010</b>	<b>98.9%</b>	<b>98.6%</b>	<b>99.9%</b>	<b>98.9%</b>
	2009	98.6%	98.9%	99.9%	99.1%
<i>Occupancy – same asset as at September 30 <sup>(2)</sup></i>	<b>2010</b>	<b>99.2%</b>	<b>98.6%</b>	<b>99.9%</b>	<b>99.0%</b>
	2009	98.9%	98.9%	99.9%	99.1%
<i>Average contractual rent per square foot for the three months ended September 30 <sup>(3)</sup></i>	<b>2010</b>	<b>\$19.82</b>	<b>\$5.82</b>	<b>\$13.02</b>	<b>\$10.28</b>
	2009	\$19.64	\$5.74	\$12.64	\$10.08

\* weighted average total

(1) Excluding those properties whose 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 21- month period ended September 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 properties whose tenants who have filed for protection under Chapter 11 of the United States Bankruptcy Code.

	September 30, 2010	December 31, 2009
<b>Average remaining term to maturity of leases (years)</b>	<b>10.1</b>	10.5
<b>Average remaining term to maturity of mortgages payable (years)</b>	<b>8.2</b>	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 September 30, 2010 is outlined in the charts below:

<b>NUMBER OF PROPERTIES</b>	Ontario	United States	Alberta	Quebec	Other	Total
Office	22	2	4	1	4	33
Industrial	53	16	19	11	19	118
Retail	32	85	5	5	3	130
<b>Total</b>	<b>107</b>	<b>103</b>	<b>28</b>	<b>17</b>	<b>26</b>	<b>281</b>

<b>Square Feet (in thousands)</b>	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	4,901	515	498	524	8,197
<b>Total</b>	<b>16,417</b>	<b>11,473</b>	<b>4,731</b>	<b>3,800</b>	<b>2,584</b>	<b>39,005</b>

**Properties under development (in thousands of dollars)**

Project	Address	September 30, 2010	December 31, 2009
The Bow	5 <sup>th</sup> Ave. At Centre Street, Calgary, AB	<b>\$1,060,540</b>	\$719,173
Heart Lake	Mayfield West Business Park, Caledon, ON	<b>39,921</b>	39,809
Airport Road	7900 Airport Rd., Brampton, ON	<b>37,670</b>	35,552
		<b>\$1,138,131</b>	\$794,534

**Top Twenty Sources of Revenue by Tenant**

	<b>Tenant</b>	<b>% of rentals from income properties <sup>(1)</sup></b>	<b>Number of locations</b>	<b>REIT owned sq.ft. (in 000's)</b>	<b>Average lease term to maturity (in years)</b>
1.	Bell Canada	11.4	4	1,734	15.0
2.	TransCanada Pipelines Limited	7.0	2	950	10.5
3.	Telus Communications	5.9	2	943	12.6
4.	Bell Mobility	5.5	2	775	15.1
5.	Rona Inc.	3.9	14	2,151	9.2
6.	Versacold Logistics Canada Inc.	3.3	12	1,733	16.3
7.	Canadian Tire Corp.	3.3	4	2,189	16.0
8.	Royal Bank of Canada	3.1	4	466	6.0
9.	Lowes Companies Inc.	2.3	11	1,435	8.5
10.	Nestle USA	1.9	3	2,168	7.0
11.	Nestle Canada Inc.	1.8	1	170	8.9
12.	Shell Oil Products	1.8	18	249	11.9
13.	Purolator Courier	1.7	12	1,071	10.7
14.	Public Works of Canada	1.5	3	277	6.5
15.	Finning International	1.5	16	893	11.6
16.	Marsh Supermarkets	1.4	9	548	16.2
17.	Hudson's Bay Company	1.1	3	937	8.5
18.	Sobey's Inc.	1.1	10	347	11.4
19.	Loblaw Properties Limited	1.0	1	716	12.3
20.	BJ's Wholesale Club Inc.	0.9	4	452	11.6
	<b>Total</b>	<b>61.4%</b>	<b>135</b>	<b>20,204</b>	

(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.

<b>LEASE EXPIRIES</b>	<b>Office</b>		<b>Industrial</b>		<b>Retail</b>		<b>Total</b>	
	<b>% of sq.ft.</b>	<b>Rent per sq.ft. (\$) on expiry</b>	<b>% of sq.ft.</b>	<b>Rent per sq.ft. (\$) on expiry</b>	<b>% of sq.ft.</b>	<b>Rent per sq.ft. (\$) on expiry</b>	<b>% of sq.ft.</b>	<b>Rent per sq.ft. (\$) on expiry</b>
2010 *	0.1	20.93	0.1	6.01	0.1	25.24	0.3	17.39
2011	0.4	22.43	0.8	8.72	0.1	10.52	1.3	13.08
2012	0.7	17.82	1.8	5.30	0.1	20.42	2.6	9.25
2013	0.5	18.42	4.0	5.60	0.4	10.08	4.9	7.27
2014	1.4	16.51	3.5	4.49	0.4	7.01	5.3	7.86
2015	1.1	22.39	1.3	7.57	0.3	27.93	2.7	15.87
	<b>4.2</b>	<b>19.16</b>	<b>11.5</b>	<b>5.66</b>	<b>1.4</b>	<b>14.88</b>	<b>17.1</b>	<b>9.73</b>

\* For the balance of the year

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

<b>MORTGAGES PAYABLE</b>	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2010 *	\$24,848	\$3,951	\$28,799	1.1%	7.6%
2011	101,020	70,246	171,266	6.4%	6.5%
2012	100,328	267,093	367,421	13.8%	6.7%
2013	96,033	101,326	197,359	7.4%	7.5%
2014	96,687	182,632	279,319	10.5%	6.2%
2015	95,158	216,971	312,129	11.7%	5.4%
Thereafter			1,305,421	49.1%	
			2,661,714	100%	
Mortgages payable due on demand <sup>(1)</sup>			58,995		
Financing cost and mark-to-market adjustment arising on acquisitions <sup>(2)</sup>			(4,260)		
<b>Total</b>			<b>\$2,716,449</b>		

\* For the balance of the year

<sup>(1)</sup> Relates to five 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 three 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.

<sup>(2)</sup> 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 has progressed nicely on the Bow, our \$1.5-billion office development in downtown Calgary, which is currently 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. See "Funding of Further Commitments" for further information.

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. The REIT issued \$100 million of convertible debentures in July 2010 for a 10-year term at a contractual interest rate of 5.90% and \$125 million senior debentures were issued in September 2010 at an interest rate of 5.00% for an eight-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.

During the nine months ended September 30, 2010, the REIT acquired 13 newly constructed retail properties in the United States for \$119 million. The REIT assumed \$74 million of mortgages payable at an average contractual interest rate of 6.3% for an average term of over twenty years. The REIT's initial levered return from these acquisitions is expected to be approximately 9.5%. We expect to continue our acquisition strategy 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 high-quality properties becoming increasingly available at attractive pricing.

In Q2 2010, 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 trustees retain the right to re-evaluate the 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. The REIT's portfolio is performing well as it was specifically designed to do, and management expects continued growth from our contracted rental escalations and accretive acquisitions. There appears to be minimal pressure for rising interest rates in the near term, and management expects continued demand for our units as investor demand for yield continues to grow. In short, management remains very optimistic and excited about its 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
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

**SECTION II**

**RESULTS OF OPERATIONS**

(in thousands of dollars except per unit amounts)	Three months ended September 30			Nine months ended September 30		
	2010	2009	% Change	2010	2009	% Change
Operating revenue:						
Rentals from income properties	\$152,743	\$148,206	3	\$455,310	\$453,497	-
Interest income	248	1,602	(85)	2,324	4,601	(49)
	<b>152,991</b>	149,808	2	<b>457,634</b>	458,098	-
Operating expenses:						
Property operating costs	50,654	47,786	6	148,404	145,080	2
Interest	44,166	47,432	(7)	135,256	136,388	(1)
Depreciation and amortization	31,466	30,694	3	94,182	93,779	-
	<b>126,286</b>	125,912	-	<b>377,842</b>	375,247	1
Net property operating income	26,705	23,896	12	79,792	82,851	(4)
Net loss on foreign exchange	(3,524)	(11,187)		(2,322)	(18,384)	
Impairment gain (loss) on income properties	-	496		-	(14,496)	
Unrealized gain (loss) on derivative instruments	(1,114)	(1,091)		(8,169)	4,676	
Loss on repayment of debentures	-	-		(38,834)	-	
Gain on extinguishment of debt	15,973	-		17,628	-	
Trust expenses	(2,288)	(2,131)		(7,105)	(5,951)	
Net earnings before income taxes, non-controlling interest and discontinued operations	35,752	9,983		40,990	48,696	
Income tax recovery (expense)	(185)	(1,921)		122,890	(8,146)	
Net earnings before non-controlling interest and discontinued operations	35,567	8,062		163,880	40,550	
Non-controlling interest	(1,366)	(421)		(5,684)	(1,742)	
Net earnings from continuing operations	34,201	7,641		158,196	38,808	
Net earnings from discontinued operations	153	8,015		3,563	17,847	
Net earnings	<b>\$34,354</b>	\$15,656		<b>\$161,759</b>	\$56,655	
Basic net earnings per unit						
Continuing operations	\$0.24	\$0.05		\$1.10	\$0.27	
Discontinued operations	-	0.06		0.02	0.13	
	<b>\$0.24</b>	\$0.11		<b>\$1.12</b>	\$0.40	
Diluted net earnings per unit						
Continuing operations	\$0.24	\$0.05		\$1.09	\$0.25	
Discontinued operations	-	0.05		0.02	0.12	
	<b>\$0.24</b>	\$0.10		<b>\$1.11</b>	\$0.37	

The net change in net earnings for both the three months and nine months ended September 30, 2010 as compared to the respective 2009 periods is mainly due to the income tax recovery, loss on repayment of debentures, change in impairment loss on

income properties, gain on extinguishment of debt, net earnings from discontinued operations 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 nine months ended September 30, 2010 and 2009.

<b>Rentals from Income Properties (in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	<b>2010</b>	2009	Change	<b>2010</b>	2009	Change
Same-asset – current rentals	<b>\$150,006</b>	\$146,005	\$4,001	<b>\$448,547</b>	\$445,125	\$3,422
Same-asset – straight-lining of contractual rent	<b>1,953</b>	3,069	(1,116)	<b>6,255</b>	10,103	(3,848)
Same-asset rent amortization	<b>(1,007)</b>	(839)	(168)	<b>(3,116)</b>	(2,690)	(426)
Acquisitions – current rentals, rent amortization and straight-lining of contractual rent	<b>1,788</b>	-	1,788	<b>3,589</b>	-	3,589
Terminated leases due to U.S. bankruptcies	<b>3</b>	(29)	32	<b>35</b>	959	(924)
<b>Total rentals</b>	<b>\$152,743</b>	\$148,206	\$4,537	<b>\$455,310</b>	\$453,497	\$1,813

The increase in same-asset current rentals of \$4.0 million for Q3 2010 as compared to Q3 2009 is primarily due to the following items:

- an increase of \$2.4 million of additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements;
- 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;
- an increase of \$0.7 million in tenant recoveries due to higher regular property operating expenses; offset by
- same-asset current rentals from properties in the United States which have decreased by \$0.5 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 September 30, 2010 was \$1.06 Canadian for each \$1.00 U.S. (Q3 2009 - \$1.09);

The increase in same-asset current rentals of \$3.4 million for the nine months ended September 30, 2010 as compared to the same 2009 period is primarily due to the following items:

- an increase of \$6.5 million of additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements;
- an increase of \$3.8 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;
- 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; offset by
- same-asset current rentals from properties in the United States which have decreased by \$8.4 million primarily due to the weakening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the nine months ended September 30, 2010 was \$1.04 Canadian for each \$1.00 U.S. (September 30, 2009 - \$1.17); and
- a decrease of \$1.3 million in tenant recoveries due to lower regular property operating expenses;

**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 Q3 2010, building operating costs, realty taxes, utilities and property management fees represented 20.2%, 51.5%, 12.1%, and 5.6% respectively of total property operating costs (Q3 2009 - 19.2%, 54.7%, 11.4% and 4.4%). For the nine months ended September 30, 2010, these costs represented 18.5%, 53.5%, 12.6% and 6.1% respectively of total property operating costs (September 30, 2009 - 18.7%, 55.2%, 11.6% and 4.7%).

<b>Property Operating Costs</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Same-asset property operating costs	\$50,375	\$47,253	\$3,122	\$147,283	\$143,942	\$3,341
Acquisitions	254	-	254	562	-	562
Terminated leases due to U.S. bankruptcies	25	533	(508)	559	1,138	(579)
<b>Total property operating costs</b>	<b>\$50,654</b>	<b>\$47,786</b>	<b>\$2,868</b>	<b>\$148,404</b>	<b>\$145,080</b>	<b>\$3,324</b>

The increase in same-asset property operating costs of \$3.1 million for Q3 2010 as compared to Q3 2009 is due primarily to the following reasons:

- higher regular property operating expenses of \$0.7 million;
- higher management fees of \$0.6 million due to an incentive fee of \$0.6 million (Q3 2009 - nil) payable to H&R Property Management Ltd. In 2009, the incentive fee was waived by H&R Property Management Ltd.; and
- higher capital expenditure expenses of \$1.4 million.

The increase in same-asset property operating costs of \$3.3 million for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 is due primarily to the following reasons:

- lower expenses related to the REIT's U.S. properties of \$0.9 million due primarily to the change in foreign exchange rates;
- lower regular property operating expenses of \$1.3 million;
- higher management fees of \$1.9 million due to an incentive fee of \$1.9 million (September 30, 2009 - nil) payable to H&R Property Management Ltd. In 2009, the incentive fee was waived by H&R Property Management Ltd., and
- higher capital expenditure expenses of \$3.6 million.

<b>Same-Asset Property Operating Income *</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Same-asset current rentals and straight-lining of contractual rent	\$151,959	\$149,074	\$2,885	\$454,802	\$455,228	(\$426)
Same-asset - property operating costs	50,375	47,253	3,122	147,283	143,942	3,341
<b>Total same-asset - property operating income</b>	<b>\$101,584</b>	<b>\$101,821</b>	<b>(\$237)</b>	<b>\$307,519</b>	<b>\$311,286</b>	<b>(\$3,767)</b>
<b>Total same-asset – property operating income excluding straight-lining of contractual rent</b>	<b>\$99,631</b>	<b>\$98,752</b>	<b>\$879</b>	<b>\$301,264</b>	<b>\$301,183</b>	<b>\$81</b>

\* 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 increased by \$0.9 million for the three months and has increased by \$0.1 million for the nine months ended September 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 \$1.8 million and \$7.6 million respectively, which was offset by a corresponding decrease of \$0.9 million and \$7.5 million respectively in the United States, as shown below:

	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
<b>Canada (in thousands of dollars)</b>						
Same-asset current rentals	\$125,993	\$121,460	\$4,533	\$377,709	\$365,914	\$11,795
Same-asset property operating costs	45,931	43,154	2,777	134,907	130,711	4,196
Same-asset property operating income excluding straight-lining of contractual rent	80,062	78,306	1,756	242,802	235,203	7,599
<b>United States (in thousands of dollars)</b>						
Same-asset current rentals	24,013	24,545	(532)	70,838	79,211	(8,373)
Same-asset property operating costs	4,444	4,099	345	12,376	13,231	(855)
Same-asset property operating income excluding straight-lining of contractual rent	19,569	20,446	(877)	58,462	65,980	(7,518)
<b>Total same-asset property operating income *</b>	<b>\$99,631</b>	<b>\$98,752</b>	<b>\$879</b>	<b>\$301,264</b>	<b>\$301,183</b>	<b>\$81</b>

\* 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 \$1.8 million for Q3 2010 as compared to Q3 2009 is primarily due to increases in rent of \$1.1 million and increased recoverable amounts from tenants for capital expenditures of \$2.4 million, offset by higher capital expenditures of \$1.4 million and higher management fees of \$0.6 million. The increase in the Canadian same-asset property operating income of \$7.6 million for the nine months ended September 30, 2010 as compared to the 2009 period is primarily due to increased recoverable amounts from tenants for capital expenditures of \$6.5 million, increases in rent of \$3.8 million and lease terminations and prior year recoveries of \$2.3 million, offset by higher capital expenditures of \$3.6 million and higher management fees of \$1.9 million.

The decrease in the U.S. same-asset property operating income of \$0.9 million for Q3 2010 as compared to Q3 2009 and of \$7.5 million for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 is due primarily to the weakening of the U.S. dollar and an increase in provision for doubtful accounts of \$0.4 million. The average exchange rate for the three months ended September 30, 2010 was \$1.06 Canadian for each \$1.00 U.S. (Q3 2009 - \$1.09). For the nine months ended September 30, 2010, the average exchange rate was \$1.04 (September 30, 2009 - \$1.17). 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 (without the above mentioned provision).

**Interest Income**

(in thousands of dollars)	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Interest income	\$248	\$1,602	(\$1,354)	\$2,324	\$4,601	(\$2,277)

Interest income decreased when comparing the three and nine months ended September 30, 2010 as opposed to the respective 2009 periods. 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**

<b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	<b>2010</b>	2009	Change	<b>2010</b>	2009	Change
Contractual interest on mortgages payable	<b>\$42,194</b>	\$45,074	(\$2,880)	<b>\$128,761</b>	\$137,408	(\$8,647)
Contractual interest on debentures payable	<b>11,800</b>	9,473	2,327	<b>33,074</b>	17,550	15,524
Effective interest rate accretion	<b>3,001</b>	1,846	1,155	<b>8,207</b>	3,178	5,029
Bank interest and charges	<b>909</b>	285	624	<b>1,852</b>	2,003	(151)
	<b>57,904</b>	56,678	1,226	<b>171,894</b>	160,139	11,755
Capitalized interest	<b>(13,738)</b>	(9,246)	(4,492)	<b>(36,638)</b>	(23,751)	(12,887)
Interest expense	<b>\$44,166</b>	\$47,432	(\$3,266)	<b>\$135,256</b>	\$136,388	(\$1,132)

The decrease in contractual interest on mortgages payable for the three and nine months ended September 30, 2010 compared to the respective periods is primarily due to a decrease in foreign exchange rates along with the lenders taking back title to four mortgages during the three months ended September 30, 2010 and five mortgages during the nine months ended September 30, 2010. Included in mortgage interest for the three months ended September 30, 2010 is an accrual of \$1.0 million (Q3 2009 - \$2.7 million) and for the nine months ended September 30, 2010 is an accrual of \$5.6 million (September 30, 2009 - \$7.6 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. As at both September 30, 2010 and 2009, the REIT's weighted average contractual mortgage rate was 6.2%.

Debenture interest increased for both the three and nine month periods ended September 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. In July 2010, the REIT issued \$100 million of convertible debentures (at a contractual annual interest rate of 5.90%) and in September 2010, the REIT issued \$125 million of senior unsecured debentures (at a contractual annual interest rate of 5.00%).

Effective interest rate accretion is a non-cash item. This accretion increased by \$1.2 million between Q3 2010 and Q3 2009 and by \$5.0 million for the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009 due to the issuance of the above \$780 million of debentures between July 1, 2009 and September 30, 2010. These debentures have a weighted average contractual interest rate of 5.94% as compared to a weighted average effective interest rate of 7.81%.

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 loss on Foreign Exchange**

<b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	<b>2010</b>	2009	Change	<b>2010</b>	2009	Change
Net loss on foreign exchange	<b>\$3,524</b>	\$11,187	(\$7,663)	<b>\$2,322</b>	\$18,384	(\$16,062)

The net 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**

<b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	<b>2010</b>	2009	Change	<b>2010</b>	2009	Change
Unrealized gain (loss) on derivative instruments	<b>(\$1,114)</b>	(\$1,091)	(\$23)	<b>(\$8,169)</b>	\$4,676	(\$12,845)

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%. The interest expense on this facility is capitalized to properties under development during the eligible period. 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 completion of the property under development and cessation of capitalizing interest, the difference between the hedged rate and the actual rate will be recorded as a realized gain or loss in net earnings.

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.

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

<b>Gain on Extinguishment of Debt</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Gain on extinguishment of debt	<b>\$15,973</b>	-	\$15,973	<b>\$17,628</b>	-	\$17,628

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. In September 2010, the REIT was legally released from its mortgages on four of the Boscov Department Stores; Marley Station, Owing Mills, South Hills and White Marsh. This released the REIT from the debt owing with respect to the mortgages on these properties. As a result, the income properties, the mortgages and the accrued interest on the mortgages were all derecognized resulting in a gain on extinguishment of debt of \$16.0 million for the three months and \$17.6 million for the nine months ended September 30, 2010.

<b>Trust Expenses</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Trust expenses	<b>\$2,288</b>	\$2,131	\$157	<b>\$7,105</b>	\$5,951	\$1,154

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

<b>Income Tax Recovery (Expense)</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Current income tax expense	<b>(\$185)</b>	(\$113)	(\$72)	<b>(\$413)</b>	(\$279)	(\$134)
Future income tax recovery (expense)	-	(1,808)	1,808	<b>123,303</b>	(7,867)	131,170
Total income tax recovery (expense)	<b>(\$185)</b>	(\$1,921)	\$1,736	<b>\$122,890</b>	(\$8,146)	\$131,036

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 nil for the three months ended September 30, 2010 and \$123.3 million for the nine months ended September 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:

<b>Net Earnings from Discontinued Operations</b> <b>(in thousands of dollars)</b>	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Net property operating income	\$151	\$1,419	(\$1,268)	\$81	\$4,762	(\$4,681)
Gain (loss) on sale of income properties	7	6,902	(6,895)	3,616	13,767	(10,151)
Non-controlling interest	(5)	(306)	301	(134)	(682)	548
Net earnings from discontinued operations	\$153	\$8,015	(\$7,862)	\$3,563	\$17,847	(\$14,284)

During the three months ended September 30, 2010, the REIT sold no income properties (Q3 2009 - three) for gross proceeds of nil (Q3 2009 - \$37.4 million). For the nine months ended September 30, 2010, the REIT sold two income properties (September 30, 2009 - six) for gross proceeds of \$23.3 million (September 30, 2009 - \$76.6 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 September 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 September 30, 2009**

Property	Property Type	Date Sold	Square Footage	Gross Proceeds (\$ Millions)	Ownership Interest disposed
2435 EW Connector, Austell, GA	Retail	Feb 10, 09	115,396	\$16.4	100%
97 Thames Rd., E. Exeter, ON	Industrial	Mar 16, 09	84,000	4.4	100%
1711 Springfield Rd., Kelowna, BC	Retail	June 3, 09	110,178	18.4	100%
6660 Financial Drive, Mississauga, ON	Industrial	July 16, 09	164,236	11.8	100%
2089 West Neways Dr., Springville, UT	Office	July 28, 09	84,511	8.6	55%
75 Frontenac Dr., Markham, ON	Industrial	Aug 4, 09	243,614	17.0	100%
<b>Total</b>			<b>801,935</b>	<b>\$76.6</b>	

**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 September 30, 2010**

(in thousands of dollars)	Canada	United States	Total
<b>Operating revenue</b>	<b>\$126,992</b>	<b>\$25,999</b>	<b>\$152,991</b>
<b>Property operating costs</b>	<b>(45,936)</b>	<b>(4,718)</b>	<b>(50,654)</b>
<b>Interest</b>	<b>(32,017)</b>	<b>(12,149)</b>	<b>(44,166)</b>
<b>Depreciation and amortization</b>	<b>(23,156)</b>	<b>(8,310)</b>	<b>(31,466)</b>
<b>Net property operating income</b>	<b>\$25,883</b>	<b>\$822</b>	<b>\$26,705</b>

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

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$125,040	\$24,768	\$149,808
Property operating costs	(43,154)	(4,632)	(47,786)
Interest	(33,684)	(13,748)	(47,432)
Depreciation and amortization	(23,028)	(7,666)	(30,694)
Net property operating income	\$25,174	(\$1,278)	\$23,896

**Net property operating income for the nine months ended  
September 30, 2010**

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$382,538	\$75,096	\$457,634
Property operating costs	(134,901)	(13,503)	(148,404)
Interest	(97,065)	(38,191)	(135,256)
Depreciation and amortization	(69,137)	(25,045)	(94,182)
<b>Net property operating income</b>	<b>\$81,435</b>	<b>(\$1,643)</b>	<b>\$79,792</b>

**Net property operating income for the nine months ended  
September 30, 2009**

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$377,165	\$80,933	\$458,098
Property operating costs	(130,711)	(14,369)	(145,080)
Interest	(92,004)	(44,384)	(136,388)
Depreciation and amortization	(68,597)	(25,182)	(93,779)
<b>Net property operating income</b>	<b>\$85,853</b>	<b>(\$3,002)</b>	<b>\$82,851</b>

For the three months ended September 30, 2010, the net property operating income for properties located in the United States was \$0.8 million as compared to a loss of \$1.3 million for the three months ended September 30, 2009. The change of \$2.1 million is primarily due to a change in foreign exchange rates, net property operating income generated from U.S. property acquisitions and decreased net property operating loss for those properties upon which the lender has taken back title for certain mortgages related to properties where the tenant has filed for protection under Chapter 11 of the United States Bankruptcy Code. 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 and the acquisitions during 2010, it would have shown income of \$1.9 million for the three months ended September 30, 2010 as compared to income of \$1.8 million for the three months ended September 30, 2009. The increase of \$0.1 million is due primarily to a decrease in mortgage interest expense offset by an increase in provision for doubtful accounts.

For the nine months ended September 30, 2010, the net property operating loss for properties located in the United States was \$1.7 million as compared to a loss of \$3.0 million for the nine months ended September 30, 2009. The change of \$1.3 million is primarily due to a change in foreign exchange rates, net property operating income generated from U.S. properties acquired and decreased net property operating loss for those properties upon which the lender has taken back title for certain mortgages related to properties where the tenant has filed for protection under Chapter 11 of the United States Bankruptcy Code. 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 and the acquisitions during 2010, it would have shown income of \$6.0 million for the nine months ended September 30, 2010 as compared to \$5.5 million for the nine months ended September 30, 2009. The increase of \$0.5 million is due to a decrease in mortgage interest expense offset by an increase in provision for doubtful accounts.

**ASSETS**

***Income Properties***

Opening balance - December 31, 2009		\$4,124,856
Acquisitions		
Purchase price of acquisitions	118,694	
Transaction costs incurred	2,494	
Purchase price allocated to intangible liabilities based on EIC-140 calculation	3,744	
Mark to market adjustment of mortgages payable	<u>1,943</u>	126,875
Expenditures capitalized to building improvements		11,943
Foreign exchange difference		(21,006)
Depreciation and amortization		(93,234)
Income properties removed from financial statements upon lender taking title to the properties		<u>(85,706)</u>
<b>Closing balance - September 30, 2010</b>		<b>\$4,063,728</b>

The REIT acquired 13 properties during the nine months ended September 30, 2010. These acquisitions less mortgages assumed were funded from the REIT's general operating facility from debentures issued 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
110 SSW Loop 323, Tyler, TX	2008	Retail	Aug 9, 2010	14,820	6.6	Walgreens	23
1510 South Main Ave., Taylor, PA	2000	Retail	Aug 11, 2010	68,622	7.9	Price Chopper	15
245 Wilkes Barre Township Blvd., Wilkes Barre, PA	2008	Retail	Aug 11, 2010	64,252	10.5	Price Chopper	23
400 E FM 2410 Rd., Harker Heights, TX	2007	Retail	Sep 30, 2010	14,731	3.9	Walgreens	21
4746 Twin City Hwy., Groves, TX	2007	Retail	Sep 30, 2010	14,538	4.8	Walgreens	22
3822 Old Spanish Tr., Houston, TX	2007	Retail	Sep 30, 2010	14,490	6.7	Walgreens	22
101 S Washington Ave., Cleveland, TX	2008	Retail	Sep 30, 2010	13,805	5.4	Walgreens	23
1790 Texas Ave., Bridge City, TX	2008	Retail	Sep 30, 2010	14,513	5.8	Walgreens	23
1220 W University Ave., Georgetown, TX	2009	Retail	Sep 30, 2010	14,545	6.0	Walgreens	23
<b>Total</b>				<b>552,330</b>	<b>\$118.7</b>		

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 \$74.5 million of mortgages payable, bearing interest at an average contractual rate of 6.30% per annum. The mortgages have terms ranging from 15 years to 23 years and are non-recourse to the REIT but have recourse to the specific properties to which each mortgage applies. The REIT's initial levered return from these acquisitions is expected to be 9.5%.

The portfolio continues to remain in good condition. The average age of the total portfolio from the date built or renovated is 16.8 years at September 30, 2010 (December 31, 2009 - 16.3 years) and the average age of properties by type of asset is as follows:

<b>Average Age by Type of Asset</b>	<b>September 30, 2010 (years)</b>	<b>December 31, 2009 (years)</b>
Office	19.2	18.4
Industrial	17.6	16.9
Retail	12.2	12.1
<b>Total</b>	<b>16.8</b>	<b>16.3</b>

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:

<b>Net Book Value by Type of Asset (millions)</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Office	\$1,541	\$1,565
Industrial	1,331	1,388
Retail	1,192	1,172
	<b>\$4,064</b>	<b>\$4,125</b>

<b>Net Book Value by Region (millions)</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Ontario	\$1,731	\$1,763
Alberta	586	595
Other	422	433
Quebec	236	238
Canada	<b>2,975</b>	<b>3,029</b>
United States	<b>1,089</b>	<b>1,096</b>
<b>Total</b>	<b>\$4,064</b>	<b>\$4,125</b>

Significant costs associated with income properties are either capitalized and depreciated or expensed in the year incurred. As a result, the REIT expects to incur the following costs:

<b>Year</b>	<b>Total Amount Expected to be Incurred</b>	<b>Amount Expected to be Capitalized</b>	<b>Amount Expected to be Expensed to Property Operating Costs</b>	<b>Total Expected Recovery</b>	<b>Amount Expected to be Recovered in the Year Incurred</b>	<b>Amount Expected to be Recovered thereafter</b>
2010 *	\$9 million	\$3 million	\$6 million	\$8 million	\$6 million	\$2 million
2011	18 million	12 million	6 million	16 million	12 million	4 million
2012	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 \$40 million in development cost contingencies. The REIT has entered into fixed price contracts amounting to approximately 88% 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 94% 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 \$195 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 15-24 by August 29, 2011 and floors 25-42 by October 12, 2011. The delivery schedule of floors 43-59 is expected to be set by the end of November 2010. Based on the current anticipated tranche completion dates, there is a possibility that there could be a slight delay in delivery. See "Funding of Future Commitments" for further information. 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 nine months ended September 30, 2010, the REIT incurred additional costs of \$341.4 million in this project to bring the REIT's total investment to \$1,061 million (December 31, 2009 - \$719.2 million). Structural steel erection has now reached the 58<sup>th</sup> floor. Metal deck installation is complete to the 54<sup>th</sup> floor. Concrete is up to level 51 with cladding underway from the 18<sup>th</sup> floor to the 44<sup>th</sup> floor depending on the cladding type. Fireproofing is at the 48<sup>th</sup> floor. Drywall is underway from the 7<sup>th</sup> floor to the 49<sup>th</sup> floor.

**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 6% or \$6.9 million from \$125.2 million at December 31, 2009 to \$132.1 million at September 30, 2010 with a corresponding increase to rentals from income properties.

**Cash and cash equivalents**

Cash and cash equivalents decreased to \$41.8 million at September 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.

<b>Other Assets (in thousands of dollars)</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Tenant inducements	\$34,007	\$29,797
Prepaid expenses and sundry assets	27,032	12,811
Leasing expenses	26,493	27,542
Restricted cash	10,832	20,001
Accounts receivable	9,549	6,543
Mortgages and amount receivable	3,000	63,789
Future income tax asset	-	14,316
Swap derivatives	-	3,463
<b>Other Assets</b>	<b>\$110,913</b>	<b>\$178,262</b>

Tenant inducements increased by \$4.2 million in the nine months ended September 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 \$27.0 million at September 30, 2010 primarily due to an increase in prepaid realty taxes at September 30, 2010 as compared to December 31, 2009.

Restricted cash decreased from \$20.0 million at December 31, 2009 to \$10.8 million at September 30, 2010 due primarily to a reduction in funds being held from one tenant, occupying three properties, who paid their rent for the majority of 2010 in December 2009 along with a decrease in funds being held in escrow relating to costs to complete for Bell Phase III.

Mortgages and amount receivable decreased from \$63.8 million to \$3.0 million from December 31, 2009 to September 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 had been granted to the REIT's partner in the Airport Road lands during 2008.

Future income tax asset has decreased from \$14.3 million at December 31, 2009 to nil as at September 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, 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 interest rate swap on one U.S. mortgage held by a subsidiary of the REIT. As at September 30, 2010, the amount included in derivative instruments is a liability of \$4.7 million as compared to an asset of \$3.5 million as at December 31, 2009. This amount fluctuates between an asset and a liability depending on period end rates and the value at each period end of each derivative instrument.

## 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.

	September 30, 2010	December 31, 2009
Total debt to GBV per the Declaration of Trust <sup>(1)</sup>	49.5%	52.5%
Total debt to GBV of the combined financial statements	57.3%	56.8%
Non-recourse debt as a percentage of total debt	41.2%	44.9%
Floating rate debt as a percentage of total debt	0.2%	0.4%
Canadian properties total debt to GBV	55.7%	56.6%
U.S. properties total debt to GBV	63.2%	66.5%

<sup>(1)</sup> Total debt per the REIT's Declaration of Trust is based on the gross book value of the REIT and excludes all convertible debentures and the notes payable to Finance Trust. 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	(71,868)
Mortgage repaid upon maturity	(7,255)
New mortgages	85,619
Mortgages payable released upon lender taking title to properties	(93,099)
Foreign exchange difference	(15,424)
<b>Closing balance - September 30, 2010</b>	<b>\$2,716,449</b>

The mortgages bear interest at a 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 8.2 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), only 1.1% will mature during the balance of 2010 and 7.6% 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)	September 30, 2010	December 31, 2009
Mortgages payable - Canada	<b>\$1,890,618</b>	\$1,950,224
Mortgages payable - United States	<b>825,831</b>	868,252
<b>Total</b>	<b>\$2,716,449</b>	\$2,818,476

**Debentures Payable**

	Maturity Date	Contractual Interest Rate	Effective Interest Rate	Conversion Price	Face Value (in millions)	Carrying Value September 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	<b>\$108.3</b>	\$106.7
2014 Convertible Debentures	December 31, 2014	6.75%	12.30%	\$14.00	\$149.5	<b>122.4</b>	\$119.4
2017 Convertible Debentures	June 30, 2017	6.00%	8.60%	\$19.00	\$175.0	<b>152.6</b>	\$150.8
2020 Convertible Debentures	June 30, 2020	5.90%	7.53%	\$23.50	\$100.0	<b>89.0</b>	-
Series A Senior Debentures	February 3, 2015	5.20%	5.40%	n/a	\$115.0	<b>114.1</b>	-
Series B Senior Debentures	February 3, 2017	5.90%	6.06%	n/a	\$115.0	<b>114.1</b>	-
Series C Senior Debentures	December 1, 2018	5.00%	5.30%	n/a	\$125.0	<b>122.5</b>	-
Non-Convertible Debentures	-	11.50%	12.90%	n/a	-	-	\$188.8
					<b>\$894.5</b>	<b>\$823.0</b>	\$565.7

Debentures payable increased by \$257.3 million to \$823.0 million at September 30, 2010 from \$565.7 million at December 31, 2009. During the nine months ended September 30, 2010, the REIT issued Series A, Series B and Series C Senior Debentures with a carrying value of \$350.7 million in aggregate, issued 2020 Convertible Debentures with a carrying value of \$89.0 million, and repaid in full the Non-Convertible Debentures which had a carrying value of \$188.8 million at December 31, 2009.

*2020 Convertible Debentures*

In July 2010, the REIT completed a public offering of \$100 million Series D convertible unsecured subordinated debentures (the "2020 Convertible Debentures"), bearing interest at the annual contractual rate of 5.90% and an effective interest rate of 7.53%. The 2020 Convertible Debentures mature on June 30, 2020, and interest is payable semi-annually on June 30 and December 31. Each 2020 Convertible Debenture is now convertible into freely tradeable Stapled Units at the holder's option 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, at a conversion price of \$23.50 per Stapled Unit, being a conversion rate of approximately 42.5532 Stapled Units per \$1 principal amount, subject to adjustment upon the occurrence of certain events in accordance with the Indenture governing the 2020 Convertible Debentures.

On redemption or maturity of the 2020 Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the 2020 Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing it be issued) a variable number of Stapled Units equal to the principal amount of the 2020 Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units. The 2020 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2014. Thereafter, but prior to June 30, 2016, the 2020 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2016 and prior to

the maturity date, the 2020 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest.

The REIT accounted for the 2020 Convertible Debentures by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability and classifying such value as debt. The remaining value of the 2020 Convertible Debentures is classified as equity.

On issuance, the REIT recorded a liability of \$88.9 million, net of issue costs of \$4.2 million, and equity, which represents the holders' option to convert the 2020 Convertible Debentures into Stapled Units, of \$6.6 million, net of issue costs of \$0.3 million. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the 2020 Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding 2020 Convertible Debentures.

*Series A Senior Debentures, Series B Senior Debentures and Series C 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.

In September 2010, the REIT issued \$125 million Series C unsecured senior debentures (the "Series C Senior Debentures"), bearing interest at the annual contractual rate of 5.00% and an effective interest rate of 5.30%. The Series C Senior Debentures mature December 1, 2018, and interest is paid semi-annually on June 1 and December 1. On issuance, the REIT recorded a liability of \$122.5 million, net of issue costs of \$2.5 million.

At its option, the REIT may redeem any of the Series A, Series B or Series C 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 \$23.4 million from \$167.0 million at December 31, 2009 to \$190.4 million at September 30, 2010. The change is mainly due to an increase in accruals relating to properties under development and tenant inducements. These accruals at September 30, 2010 totalled \$86.7 million as compared to \$74.5 million at December 31, 2009. Other payables and accruals increased as a result of transactions occurring in the normal course of business operations including an increase of \$10.3 million due to increased interest accrued on all of the debentures. Also included in accrued liabilities is the total interest accrued to date on the non-recourse mortgages under default of \$7.2 million (December 31, 2009 - \$11.7 million). This amount has decreased as the lenders have now taken title to five of the properties.

### ***Future Income Tax Liability***

As at September 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 \$96.7 million between December 31, 2009 and September 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**

<b>(in thousands of dollars except per unit amounts)</b>	Three months ended September 30		Nine months ended September 30	
	<b>2010</b>	2009	<b>2010</b>	2009
<b>Net earnings</b>	<b>\$34,354</b>	\$15,656	<b>\$161,759</b>	\$56,655
Add (deduct)				
Depreciation and amortization	<b>31,466</b>	30,694	<b>94,182</b>	93,779
Impairment (gain) loss on income properties	-	(496)	-	14,496
Gain on sale of income properties	<b>(7)</b>	(6,902)	<b>(3,616)</b>	(13,767)
Future income tax (recovery) expense	-	1,808	<b>(123,303)</b>	7,867
Net earnings attributable to non-controlling interest	<b>1,371</b>	727	<b>5,818</b>	2,424
Operating income from discontinued operations	<b>(151)</b>	(1,419)	<b>(81)</b>	(4,762)
Funds from operations – continuing operations	<b>67,033</b>	40,068	<b>134,759</b>	156,692
Funds from operations – discontinued operations	<b>151</b>	1,588	<b>122</b>	6,382
<b>Funds from operations</b>	<b>67,184</b>	41,656	<b>134,881</b>	163,074
Add (deduct)				
Net loss on derivative instruments and foreign exchange	<b>4,638</b>	12,278	<b>10,491</b>	13,708
Mortgage interest accruals on non-recourse mortgage defaults	<b>969</b>	2,668	<b>5,592</b>	7,633
Additional recoveries for capital expenditures in excess of items expensed in property operating costs	<b>(2,043)</b>	(1,157)	<b>(7,613)</b>	(4,903)
Gain on extinguishment of debt	<b>(15,973)</b>	-	<b>(17,628)</b>	-
Lease terminations and other non-recurring items	-	-	<b>(2,311)</b>	-
Loss on repayment of debentures	-	-	<b>38,834</b>	-
<b>Normalized funds from operations</b>	<b>\$54,775</b>	\$55,445	<b>\$162,246</b>	\$179,512
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	<b>149,729</b>	147,991	<b>149,504</b>	147,759
Diluted weighted average number of units (in thousands of units) for the calculation of FFO <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup> <sup>(4)</sup>	<b>173,412</b>	160,900	<b>150,074</b>	161,547
Funds from operations per unit (basic – adjusted for conversion of non-controlling interest)	<b>\$0.45</b>	\$0.28	<b>\$0.90</b>	\$1.10
Funds from operations per unit (diluted)	<b>\$0.44</b>	\$0.26	<b>\$0.90</b>	\$1.02
Diluted weighted average number of units (in thousands of units) for the calculation of NFFO <sup>(1)</sup> <sup>(2)</sup> <sup>(5)</sup> <sup>(6)</sup>	<b>170,360</b>	168,237	<b>169,994</b>	161,547
Normalized funds from operations per unit (basic - adjusted for conversion of non-controlling interest)	<b>\$0.37</b>	\$0.37	<b>\$1.09</b>	\$1.21
Normalized funds from operations - diluted	<b>\$0.36</b>	\$0.34	<b>\$1.08</b>	\$1.13

<sup>(1)</sup> For the three and nine months ended September 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 nine months ended September 30, 2009, the number of units were 12,909,722 and 11,315,173 respectively. The warrants were redeemed in December 2009.

<sup>(2)</sup> For the three and nine months ended September 30, 2010, 721,608 and 569,720 units respectively are included in the determination of diluted FFO and NFFO with respect to the unit option plan.

- (3) The 2014, 2017 and 2020 convertible debentures are dilutive for the three months ended September 30, 2010. Debenture interest for the three months ended September 30, 2010 of \$8.3 million is added to FFO and 22,961,586 units are included in the diluted weighted average number of units outstanding for that period.
- (4) The 2014 convertible debentures are dilutive for the nine months ended September 30, 2009. Debenture interest for the nine months ended September 30, 2009 of \$2.5 million is added to FFO and 2,472,528 units are included in the diluted weighted average number of units outstanding for that period.
- (5) The 2014 convertible debentures are dilutive for the three and nine months ended September 30, 2010 and 2009. Debenture interest of \$3.8 million and \$11.0 million is added to NFFO and 10,698,331 units and 10,708,506 units are included in the diluted weighted average number of units outstanding for the respective 2010 periods. For the 2009 three and nine month periods, debenture interest of \$2.5 million is added to NFFO for both respective periods and 7,336,957 units and 2,472,528 units are included in the diluted weighted average number of units outstanding for the respective periods.
- (6) The 2017 convertible debentures are dilutive for the three and nine months ended September 30, 2010. Debenture interest of \$3.3 million and \$9.6 million is added to NFFO for the respective periods and 9,210,526 units are included in the diluted weighted average number of units outstanding for both periods.

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 \$0.7 million in normalized funds from operations between Q3 2010 and Q3 2009 are:

- A decrease of \$0.6 million in property operating income primarily due to the average U.S./Canadian dollar foreign exchange rate of \$1.06 for Q3 2010 as compared to \$1.09 during Q3 2009;
- A decrease of \$1.4 million from properties sold between July 1, 2009 and September 30, 2010;
- A decrease of \$1.6 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 \$1.6 million in property operating income due to acquisitions during 2010;
- An increase of \$1.6 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 \$17.3 million in normalized funds from operations between the nine months ended September 30, 2010 as compared to the same period in 2009 are:

- A decrease of \$7.3 million in property operating income primarily due to the average U.S./Canadian dollar foreign exchange rate of \$1.04 as compared to \$1.17 for the nine months ended September 30, 2009;
- A decrease of \$6.3 million from properties sold between January 1, 2009 and September 30, 2010;
- A decrease of \$3.6 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$1.9 million due to higher property management fees;
- A decrease of \$0.3 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 0.9 million due to higher interest expense; and
- An increase of \$3.0 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 September 30		Nine months ended September 30	
	2010	2009	2010	2009
<b>Funds from operations</b>	<b>\$67,184</b>	\$41,656	<b>\$134,881</b>	\$163,074
Add (deduct)				
Straight-lining of contractual rent	(1,975)	(3,422)	(6,157)	(10,193)
Rent amortization	972	842	3,064	2,880
Effective interest rate accretion	3,001	1,973	8,207	3,458
Mortgage interest accruals on non-recourse mortgage defaults	969	2,668	5,592	7,633
Gain on extinguishment of debt	(15,973)	-	(17,628)	-
Additions to tenant expenditures	(1,523)	(1,643)	(4,270)	(3,925)
Capital expenditures	(2,452)	(2,000)	(11,943)	(4,653)
Net loss on derivative instruments and foreign exchange	4,638	12,278	10,491	13,708
Unit-based compensation	311	177	915	358
<b>Adjusted funds from operations</b>	<b>\$55,152</b>	\$52,529	<b>\$123,152</b>	\$172,340
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	149,729	147,991	149,504	147,759
Diluted weighted average number of units (in thousands of units) for the calculation of AFFO <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup> <sup>(4)</sup> <sup>(5)</sup>	173,412	168,237	169,993	166,523
Adjusted funds from operations per unit (basic - adjusted for conversion of non-controlling interest)	\$0.37	\$0.35	\$0.82	\$1.17
Adjusted funds from operations per unit (diluted)	\$0.35	\$0.32	\$0.81	\$1.08
Cash distributions paid per unit	\$0.21	\$0.18	\$0.57	\$0.54
Payout ratio	56.8%	51.4%	69.5%	46.2%

(1) For the three and nine months ended September 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 nine months ended September 30, 2009, the number of units were 12,909,722 and 11,315,173 respectively. The warrants were redeemed in December 2009.

(2) For the three and nine months ended September 30, 2010, 721,608 and 569,720 units respectively are included in the determination of diluted AFFO with respect to the unit option plan.

(3) The 2013 convertible debentures are dilutive for the nine months ended September 30, 2009. Contractual interest for the nine months of \$5.7 million is added to AFFO and 4,976,201 units are included in the diluted weighted average number of units outstanding for that period.

(4) The 2014 convertible debentures are dilutive for the three and nine months ended September 30, 2010. Contractual interest for the three months of \$2.5 million and \$7.6 million for the nine months ended September 30, 2010 is added to AFFO and 10,698,331 units and 10,708,506 units respectively are included in the diluted weighted average number of units outstanding for both periods.

(5) The 2014 convertible debentures are dilutive for the three and nine months ended September 30, 2009. Contractual interest for the three and nine months of \$1.7 million is added to AFFO and 7,336,957 and 2,472,528 units are included in the diluted weighted average number of units outstanding for each respective period.

(6) The 2017 convertible debentures are dilutive for the three and nine months ended September 30, 2010. Contractual interest of \$2.6 million and \$7.6 million is added to AFFO for the respective periods and 9,210,526 units are included in the diluted weighted average number of units outstanding for both periods.

(7) The 2020 convertible debentures are dilutive for the three months ended September 30, 2010. Contractual interest of \$1.1 million is added to AFFO and 3,052,729 units are included in the diluted weighted average number of units for that period.



Excluding the non-recurring charge to redeem the Non-Convertible Debentures and the lease terminations and other non-recurring items, basic AFFO would have been \$159.7 million for the nine months ended September 30, 2010 (\$1.07 per unit).

The primary reasons for the increase of \$2.6 million in AFFO for the three months ended September 30, 2010 as compared to the same periods last year are:

- A decrease of \$0.6 million in property operating income primarily due to the average U.S./Canadian dollar foreign exchange rate of \$1.06 for Q3 2010 as compared to \$1.09 during Q3 2009;
- A decrease of \$0.3 million due to higher capital and tenant expenditures;
- A decrease of \$1.2 million from properties sold between July 1, 2009 and September 30, 2010;
- An decrease of \$1.6 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 \$0.9 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 expensed in property operating costs;
- An increase of \$0.6 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 \$2.7 million due to lower interest expense;
- An increase of \$1.5 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 \$49.2 million in AFFO for the nine months ended September 30, 2010 as compared to the same period last year are:

- A decrease of \$38.8 million due to the one-time loss on the repayment of the Non-Convertible Debentures;
- A decrease of \$7.6 million due to higher capital and tenant expenditures;
- A decrease of \$7.3 million in property operating income primarily due to the average U.S./Canadian dollar foreign exchange rate of \$1.04 for the nine months ended September 30, 2010 as compared to \$1.17 during the nine months ended September 30, 2009;
- A decrease of \$5.5 million from properties sold between January 1, 2009 and September 30, 2010;
- A decrease of \$1.3 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 \$3.6 million due to lower interest income, higher trust expenses and higher current income taxes;
- A decrease of \$1.9 million due to higher property management fees;
- An increase of \$3.8 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 \$4.1 million due to lower interest expense;
- An increase of \$2.7 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 expensed in property operating costs; and

- An increase of \$2.9 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 September 30		Nine months ended September 30	
	2010	2009	2010	2009
<b>Adjusted funds from operations</b>	<b>\$55,152</b>	\$52,529	<b>\$123,152</b>	\$172,340
Straight-lining of contractual rent	1,975	3,422	6,157	10,193
Additions to tenant expenditures	1,523	1,643	4,270	3,925
Capital expenditures	2,452	2,000	11,943	4,653
Change in other non-cash operating items	(8,578)	(5,102)	(15,294)	(11,111)
Mortgage interest accruals on non-recourse mortgage defaults	(969)	(2,668)	(5,592)	(7,633)
Loss on repayment of debentures	-	-	38,834	-
Realized loss on foreign exchange	-	(2)	(2)	(22)
<b>Cash provided by operations</b>	<b>\$51,555</b>	\$51,822	<b>\$163,468</b>	\$172,345

### 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	Nine months ended	Year ended	Year ended
	September 30, 2010	September 30, 2010	December 31, 2009	December 31, 2008
Cash provided by operating activities	\$51,555	\$163,468	\$238,941	\$233,200
Net earnings	\$34,354	\$161,759	\$86,525	\$97,706
Actual cash distributions paid or payable relating to the period	27,084	75,233	97,726	161,839
Excess of cash provided by operating activities over cash distributions paid	24,471	88,235	141,215	71,361
Excess (shortfall) of net earnings over cash distributions paid	7,270	86,526	(11,201)	(64,133)

For the three and nine months ended September 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 nine months ended September 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 September 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 three 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 three 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 September 30, 2010, approximately \$242.0 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 September 30, 2010 for the next 4.25 years and thereafter:

Payments Due by Period					
<b>Contractual Obligations (in thousands of dollars)</b>	2010 *	2011- 2012	2013- 2014	2015 and thereafter	Total
Mortgages payable	\$28,799	\$538,687	\$476,679	\$1,617,549	\$2,661,714
2013 Convertible debentures	-	-	115,000	-	115,000
2014 Convertible debentures	-	-	149,447	-	149,447
2017 Convertible debentures	-	-	-	175,000	175,000
2020 Convertible debentures	-	-	-	100,000	100,000
Series A Senior Debentures	-	-	-	115,000	115,000
Series B Senior Debentures	-	-	-	115,000	115,000
Series C Senior Debentures	-	-	-	125,000	125,000
<b>Total Contractual Obligations</b>	<b>\$28,799</b>	<b>\$538,687</b>	<b>\$741,126</b>	<b>\$2,247,549</b>	<b>\$3,556,161</b>

\* 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 September 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.

<b>(in thousands of dollars)</b>	Costs incurred to date	Remaining Costs	Budget
Land	\$60,804	-	\$60,804
Financing costs	18,268	22,940	41,208
Capitalized interest on the REIT's costs as incurred	105,982	109,740	215,722
Soft costs	129,179	55,233	184,412
Hard costs	781,573	325,941	1,107,514
Recoveries and other income	(35,266)	(67,822)	(103,088)
Contingency	-	40,150	40,150
Cost incurred to date/remaining costs/budget	1,060,540	486,182	1,546,722
Less capitalized interest on the REIT's costs incurred	(105,982)	(109,740)	(215,722)
<b>Total costs incurred to date/ remaining costs/budget less capitalized interest</b>	<b>\$954,558</b>	<b>\$376,442</b>	<b>\$1,331,000</b>

Both the REIT and Altus Group Cost Consulting believe the remaining contingencies to be sufficient at this stage of the project. The decrease in the financing costs from last quarter is due to the amendments made to the Bow construction financing facility (see "Subsequent Events"). Based on the current anticipated tranche completion dates, there is a possibility that there could be a slight delay in delivery. A penalty of \$20 per square foot per annum of free base minimum rent is payable for each tranche that is delayed beyond the contracted tranche completion dates. This penalty based on the possible delay, would be estimated to be approximately \$4.7 million if it materializes. This negative impact was offset by the reduction in the interest and standby fee of \$13.7 million. If these delays do materialize, the contractors expect that certain subcontractors may look for additional billings for cost overruns, which should be covered by the contingency.

The REIT believes that as at September 30, 2010, through the undrawn construction facility of \$425 million and the available cash and undrawn credit facility of \$284 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 \$2.5 billion as at September 30, 2010. This represents the amount by which the REIT can increase its debt, subject to market availability, before the REIT reaches 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	2011 Estimated Property Operating Income (\$000's) <sup>(1)</sup>	Loan to Value <sup>(2)</sup>
2010 *	\$ 3,951	2	\$ 1,033	29%
2011	70,246	11	17,437	30%
2012	267,093	21	48,658	41%
2013	101,326	10	22,100	34%
2014	182,632	8	26,910	51%
2015	216,071	22	27,714	59%
	\$841,319	74	\$143,851	44%

\* For the balance of the year

<sup>(1)</sup> Converting U.S. dollars to Canadian dollars at an exchange rate of 1.03

<sup>(2)</sup> 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 September 30, 2010, such guarantees amounted to \$41.8 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 September 30, 2010, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$117.1 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 to 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 September 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 U.S. 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 net earnings. See Subsequent Events for change in rate on the Bow credit facility.

**SECTION III**

**SUMMARY OF QUARTERLY RESULTS**

(unaudited) (in thousands of dollars except per unit amounts)	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009 <sup>(1)</sup>
Rentals from income properties	<b>\$152,743</b>	\$151,344	\$151,223	\$151,668
Mortgage interest and other income	<b>248</b>	802	1,274	1,621
Net property operating income	<b>26,705</b>	28,122	24,965	21,606
Net earnings (loss) from continuing operations	<b>34,201</b>	144,655	(20,660)	31,488
Net earnings (loss) per unit from continuing operations				
(basic)	<b>0.24</b>	1.00	(0.14)	0.22
(diluted)	<b>0.24</b>	0.91	(0.14)	0.20
Net earnings (loss)	<b>\$34,354</b>	\$144,665	(\$17,260)	\$29,870
Net earnings (loss) per unit				
(basic)	<b>0.24</b>	1.00	(0.12)	0.21
(diluted)	<b>0.24</b>	0.91	(0.12)	0.19

	September 30, 2009 <sup>(1)</sup>	June 30, 2009 <sup>(1)</sup>	March 31, 2009 <sup>(1)</sup>	December 31, 2008 <sup>(1)</sup>
Rentals from income properties	\$148,206	\$148,999	\$156,292	\$151,257
Mortgage interest and other income	1,602	1,504	1,495	1,045
Net property operating income	23,896	28,415	30,540	26,507
Net earnings (loss) from continuing operations	7,641	10,754	20,413	5,140
Net earnings (loss) per unit from continuing operations				
(basic)	0.05	0.07	0.15	0.04
(diluted)	0.05	0.07	0.14	0.03
Net earnings	\$15,656	\$18,901	\$22,098	\$45,826
Net earnings per unit				
(basic)	0.11	0.13	0.16	0.33
(diluted)	0.10	0.13	0.15	0.32

<sup>(1)</sup> 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. 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.

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.

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**

The discussion in this section should be read in conjunction with the Trusts' annual MD&A for the 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 combined 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.

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 Trusts' 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	Complete
	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	Complete
Internal Control 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:

- 1) 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.
- 2) IFRS defines investment property as property held by the REIT to earn rental income, capital appreciation or both. Assets classified as income properties on the balance sheet of the REIT 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.



The REIT has completed its analysis and has elected to use the cost model to account for its investment property. In addition, the REIT will also elect under IFRS 1 to use the fair value as the deemed cost for certain income properties (currently the REIT has identified approximately 15 properties, but the number of assets may change) upon the initial implementation of IFRS. At conversion, the adjustments resulting from this election are recorded directly to unitholders' equity.

For the fair value disclosure, management has hired external appraisers to provide a valuation of each property as at January 1, 2010. These valuations are now complete and are in the process of being reviewed. For subsequent reporting of the fair value of income properties, the REIT will prepare these valuations internally 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. The REIT will use market data provided by valuation firms.

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 will be completed by the end of Q4 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).

- 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. The REIT is currently finalizing its assessment of potential impairments.
- 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.
- 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 has completed the testing of these modifications. The December 31, 2009 accrued rent receivable balance of \$125.2 million is expected to change to approximately \$147 million once IFRS is adopted. 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 will 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 will result in a reduction of non-controlling interest of approximately \$77.9 million (based on September 30, 2010 figures) and a corresponding liability being recorded. Distributions on the Class B units will then be reflected as a component of interest expense in earnings.
- 7) Included in the budget for the Bow is approximately \$37 million of rental income expected to be received from EnCana Corporation prior to substantial completion of the building which is currently recorded in the current budget in the line item "recoveries and other income". Under IFRS, income earned during the construction of the property will not reduce the cost to

construct the Bow, but will rather be included in rentals from income properties which will cause a corresponding increase to the cost of the project. These figures assume all occupancies occur on time.

### ***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", under IFRS1 the REIT will choose to adopt the fair value model for certain income properties prospectively. At conversion the resulting adjustments of this election are recorded directly to unitholders' equity. The REIT will finalize its decision on which income properties will be recorded at deemed fair value in Q4 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 September 30, 2010, the debt to GBV ratio in accordance with the Declaration of Trust is 49.5%. Given the change for the increase in income properties as mentioned above, the debt to GBV ratio will decrease.

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 accumulated net earnings 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 has concluded that it will elect to capitalize amounts on qualifying assets which had not been previously capitalized using the provisions of IAS 23. 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 with no impact for the nine months ended September 30, 2010. This adjustment may change depending on which income properties are deemed fair value on initial adoption.

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 REIT's 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 nine months ended September 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 September 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 September 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 88% of the hard cost budget. Together with costs incurred to date, the REIT has effectively locked in approximately 94% 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%. See Subsequent Events for a change to the rate.

The REIT secured a \$425 million construction facility during April 2009. There were amendments to the construction facility in the first nine 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 September 30, 2010 nor has any amount been drawn upon the credit facility. Please see note 24 of the September 30, 2010 unaudited combined financial statements for further information. See Subsequent Events for further amendments to the Bow construction facility.

### **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. Once the Bow is completed, EnCana Corporation is expected to also account for more than 5% of the rentals from income properties. EnCana Corporation's current public debt rating is A (low).

### **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 September 30, 2010, U.S. Holdco owed \$131.7 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, the 2020 Convertible Debentures and the Series A, B and C 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, the 2017 Convertible Debentures and the 2020 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 October 2010, the REIT completed the acquisition of a property under development comprising approximately 92 acres located in Caledon, Ontario for a purchase price of approximately \$31.5 million and a vendor take-back mortgage of \$18.0 million bearing interest at 4.0% per annum and maturing in October 2015.

In October 2010, the REIT amended the Bow construction financing facility. The amendments included the following:

- (1) the expected annual effective interest rate, including the cost of the swap, was reduced from 6.90% to 4.65%;
- (2) there is no longer a limit on annual distributions; and
- (3) the execution of an acceptable management agreement for the project is no longer a condition precedent for borrowing, but must be satisfied prior to first occupancy.

### **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](http://www.sedar.com).

## Corporate Information

### H&R REIT Board of Trustees

Thomas J. Hofstedter<sup>1</sup>, President and Chief Executive Officer, H&R Real Estate Investment Trust  
Robert Dickson<sup>2,4</sup>, Managing Director, MDC Partners  
Edward Gilbert<sup>1,2,3,4</sup>, Chief Operating Officer, Firm Capital Mortgage Investment Trust  
The Honourable Robert P. Kaplan, P.C., Q.C.<sup>4</sup>, Business Consultant, Former Member of Parliament  
Laurence A. Lebovic<sup>1,3,4</sup>, Chief Executive Officer, Runnymede Development Corporation Ltd.  
Ronald C. Rutman<sup>2,3,4</sup>, Partner, Zeifman & Company, Chartered Accountants

### H&R Finance Trust Board of Trustees

Thomas J. Hofstedter, President and Chief Executive Officer, H&R Real Estate Investment Trust  
Shimshon (Stephen) Gross<sup>2</sup>, President, LRG Holdings Inc.  
Marvin Rubner<sup>2</sup>, Manager and Founder, Yad Investments Limited.  
Neil Sigler<sup>2</sup>, Vice President, Gold Seal Management Inc.

### Officers

Thomas J. Hofstedter, President and Chief Executive Officer  
Larry Froom, Chief Financial Officer  
Nathan Uhr, Vice-President, Acquisitions (H&R REIT)  
Shawn Goldberg, Vice-President, Finance (H&R REIT)

### Auditors

KPMG LLP

### Legal Counsel

Blake, Cassels & Graydon LLP

### Taxability of Distributions

11% of the distributions made by the H&R REIT and 5% of the distributions made by H&R Finance Trust to Unitholders during 2009 were tax deferred.

### Plan Eligibility

RRSP, RRIF, DPSP

### Stock Exchange Listing

Units and debentures of H&R are listed on the Toronto Stock Exchange under the trading symbols HR.UN, HR.DB, HR.DB.B, HR.DB.C and HR.DB.D.

### Unitholder Distribution Reinvestment Plan and Direct Unit Purchase Plan

Since January 1, 2000, H&R REIT has offered registered holders of its units resident in Canada the opportunity to participate in its Unitholder Distribution Reinvestment Plan (the "DRIP") and Direct Unit Purchase Plan. The DRIP allows participants to have their monthly cash distributions of H&R REIT reinvested in additional stapled units of H&R at a 3% discount to the weighted average price of the stapled units on the *TSX* for the five trading days (the "Average Market Price") immediately preceding the cash distribution date. The Direct Unit Purchase Plan allows participants to purchase additional stapled units on a monthly basis at the Average Market Price subject to a minimum purchase of \$250 per month (up to a maximum of \$13,500 per year) for each participant. For more information on the DRIP and/or the Direct Unit Purchase Plan, please contact us by email through the "Contact Us" webpage of our website, or contact our Registrar and Transfer Agent.

### Registrar and Transfer Agent

CIBC Mellon Trust Company, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario, Canada M5C 2W9  
Telephone: 416-643-5500 within the Toronto area or 1-800-387-0825, Fax: 416 643 5501, E-mail: [inquiries@cibcmellon.com](mailto:inquiries@cibcmellon.com),  
Website: [www.cibcmellon.com](http://www.cibcmellon.com)

### Contact Information

Investors, investment analysts and others seeking financial information should go to our website at [www.hr-reit.com](http://www.hr-reit.com), or e-mail [info@hr-reit.com](mailto:info@hr-reit.com), or call 416-635-7520 and ask for Larry Froom, Chief Financial Officer, or fax 416-398-0040, or write to H&R Real Estate Investment Trust, 3625 Dufferin Street, Suite 500, Downsview, Ontario, Canada, M3K 1N4

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1 Investment Committee

2 Audit Committee

3 Compensation and Governance Committee

4 Nomination Committee



H&R Real Estate Investment Trust  
H&R Finance Trust

[www.hr-reit.com](http://www.hr-reit.com)

