



# **Northern Property**

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**Real Estate Investment Trust**

**2008 ANNUAL REPORT**

## Corporate Profile

Northern Property Real Estate Investment Trust owns and operates rental real estate in secondary markets in Canada. We have significant multi-family residential real estate investments in Alberta, a growing position in British Columbia and are the largest multi-family residential landlord in each of the NWT, Nunavut and the Province of Newfoundland and Labrador. NPR's income producing portfolio is primarily residential including multi-family apartment rental units, furnished executives and master leased seniors' buildings. We also have a portfolio of commercial buildings focused on government tenancies predominantly located in Canada's far north.

## Geographically Diversified

NPR works in five diverse regions of Canada: Nunavut, the Northwest Territories, Newfoundland, Alberta and British Columbia. We focus on acquiring property in regions that are naturally wealthy or have the potential of becoming so. We are engaged in northern areas where growth rates are generally higher and competition more restrained than in the metropolitan areas.

## Mainly Residential/Government Focus

Our primary business is providing rental residential property to Canadians in these carefully selected communities. Our definition of housing is broad. We own and operate rental apartments and town homes. We are a significant provider of housing to government and corporations, which sublet our units to their staff. We provide furnished executive-suite accommodation in selected locations. The REIT also owns and leases residential buildings and lands to companies which are in the business of providing accommodation and care services to seniors.

In addition NPR has a portfolio of commercial properties primarily located in its northern communities. Our commercial property most often involves government or corporate covenants and longer-term leases.

## Exposure to Canada's Natural Resource Economy

NPR's cities and towns are multi-faceted economically and often have an important natural resource component. Our properties are in communities which have leadership positions in oil, natural gas, diamonds, forestry products or agriculture. The communities in which we invest are filled with people who produce the commodities for which Canada is famous. NPR embraces the great Canadian resource economy.

## Conservatively Managed

The Trust operates on a financially prudent basis. The debt to gross book value ratio was 57.7 percent at year-end 2008. The 2008 payout ratio was 71.0 percent of distributable income.

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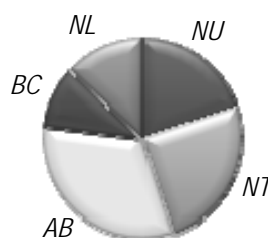
# Our Results

|   | 2008    | 2007    |
|---|---------|---------|
| Total revenue (\$000s)                      | 127,759 | 104,418 |
| Net operating income                        | 84,305  | 68,666  |
| Assets (\$000s)                             | 872,922 | 799,110 |
| Distributable income*                       | 52,139  | 41,050  |
| Distributable income per unit*              | \$2.08  | \$1.82  |
| Distributions per unit                      | \$1.48  | \$1.40  |
| Payout ratio                                | 71.0%   | 77.2%   |
| Number of residential units at December 31  | 7,807   | 6,973   |
| Total commercial square feet at December 31 | 907,509 | 863,083 |

\*Please refer to non-GAAP Financial Measures on page 14.

## REVENUES BY AREA

|                 |     |
|-----------------|-----|
| ■ Nunavut ..... | 20% |
| ■ NWT .....     | 25% |
| ■ AB .....      | 32% |
| ■ BC .....      | 10% |
| ■ Nfld .....    | 13% |

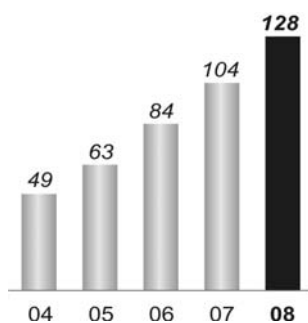


## REVENUE BY PROPERTY TYPE

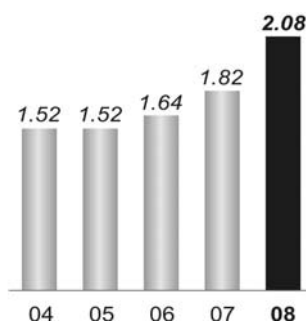
|                     |     |
|---------------------|-----|
| ■ Residential ..... | 83% |
| ■ Commercial .....  | 17% |



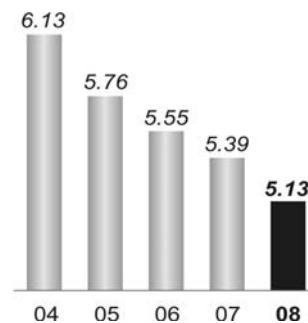
## REVENUES (\$mm)



## DISTRIBUTABLE INCOME PER UNIT (\$)



## AVERAGE INTEREST RATE (%)



# Letter to Unitholders

Dear Fellow Unitholders:

I am pleased to provide these comments respecting NPR's 2008 operating year and some thoughts about what lies ahead.

## 2008 IN REVIEW

Notwithstanding the devastating performance of the world economy in 2008, Northern Property had a very strong year in terms of its internal financial performance. We were able to materially exceed virtually all of our approved business plan targets. NPR achieved a record level of 2008 Distributable Income per Unit of \$2.08, some 14% higher than the previous year.

Rental market conditions were positive in 2008. Occupancy levels in our 6,100 unit multi-family rental portfolio were generally firm as our most formidable 'competitor', home ownership, became far less attractive for Canadians. Markets such as Fort McMurray and Yellowknife seemed to benefit from the trend away from home ownership.

NPR's apartment markets in Newfoundland and Nunavut strengthened as the economies of those places seemed more attractive to workers than the parts of the country which were coming off the boom of previous years.

Rental apartment market weakness was experienced in natural gas industry oriented places such as Grande Prairie and Inuvik. However, apartment rentals in Dawson Creek and Fort Nelson, where there is also important natural gas industry exposure, actually improved as new and promising low cost gas fields were discovered and exploited.

NPR's 320 unit, furnished executive properties performed well especially in St. John's and Iqaluit. Our master leased seniors' buildings consisting of 1,389 units in Newfoundland, southern Alberta and in Burnaby all performed in accordance with lease expectations.

75% of the Northern Property's commercial spaces are in Canada's 'far north'. They had a great year in 2008 in part due to the reality that they are largely tenanted by government.

Among the challenges that management had to deal with was the rapid rise in the cost of utilities, especially heating oil costs early in the year. This was a serious factor for us in the Northwest Territories and Nunavut. Escalating labour and material costs also were prevalent for much of the year. The sharp drop in fuel prices as the year went on and more recently in labour costs, while helpful to our 2008 bottom line, is expected to have a greater impact on 2009 results.

We believe that energy costs are likely to trend higher when commodity prices recover. We have a major initiative underway in Yellowknife to convert the primary source of apartment building heat from fuel oil to 'carbon neutral' wood pellet heating. NPR was a recipient of the Arctic Energy Alliance 2008 Energy Action Award recognizing the important improvements in our carbon footprint due to an extensive 'green' retrofit of four of our Yellowknife commercial buildings. The retrofit resulted in annual energy cost savings of \$370,000 for our tenants and reduces greenhouse gas emissions by 502 tonnes annually.

The credit crunch and meltdown of the equity markets caused NPR to constrain its acquisition activity for much of the year. We still were able to buy or build 724 multi-family units, 94 seniors' units and 40,233 square feet of commercial space. The availability of low cost CMHC insured mortgages facilitated our expansion. A lot of hard work on financings resulted in the weighted average cost of our debt decreasing to its lowest level ever – 5.13%.

2008 became a strong growth year for Northern Property. This was a particular achievement in the face of the chaos around us.

In a year in which the Toronto Stock Exchange lost 33% of its value and the Canadian REIT index 43%, Northern Property held up much better with an aggregate return of -21%. The REIT's conservative management style, at times criticized by market players in the past, seemed virtuous in a declining economy. Our low debt and low payout ratios leave us in better condition, relative to many, to deal with a prolonged and deep recession.

## LOOKING AHEAD

Business is affected by the performance of the general economy and in this Northern Property is little different than others. The decline in commodity prices, rising unemployment, diminished credit and constrained consumer spending must also result in challenges for us.

The level of same door growth that Northern Property enjoyed in 2007 and 2008 as a result of decreasing vacancy and strong rental rate increases are not expected to happen again in 2009. Early in 2009 we are seeing modest upticks in the vacancy rate in some markets. It is difficult to raise rents in recessionary times. Bad debt levels inevitably increase as tenants lose their jobs or are forced to take lower paid situations.

After 3 or 4 years of commodity driven expansion, there are new realities for NPR multi-family managers. We must and shall work exceptionally hard to retain our tenants. We will continue to invest in our buildings to keep them in excellent condition and make them more competitive than the offerings of our competitors. We will market aggressively and price appropriately.

Our furnished executive business, while having some of the characteristics of the hospitality industry, will decline somewhat due to economic conditions but is likely to fare much better than hotels. Putting up two or more employees in a furnished short stay apartment is a good strategy for recession afflicted companies. In early 2009, we are finding a bit of weakness in our two NWT properties which are levered to natural resources but business continues to be strong in our Nunavut and Newfoundland locations.

While NPR has no direct tenant risk in its master leased seniors' buildings, we will continue to monitor the margins of our operator-lessors to the degree that we are able. We take some comfort from the reality that our buildings house, what are to some degree, "essential service" operations. The leases to the operators typically include 1% annual rent increases. In 2009, organic growth of this kind seems pretty positive.

The long term leases and government tenancies which characterize our commercial properties should perform well for us in 2009 and we have very few commercial financings to deal with in the near term.

We do not expect much in the way of acquisition activity to take place on our part in 2009. Unlike other classes of real estate, apartment sale prices have not declined a great deal because owners can achieve respectable yields with the continued availability of low interest CMHC insured mortgages. Moreover, a significant expansion would require an equity offering which seems inadvisable in current stock market conditions.

While organic growth and accretive acquisition activity seem unlikely in 2009, NPR has some important advantages.

- We have low debt and some opportunity to refinance on exceptionally good terms in this environment.
- Utility costs are likely to be lower in 2009 than in the previous year.
- We have one of the lowest payout ratios among Canadian REIT's, 83% of AFFO. The current level of cash distributions is protected by a significant EBITDA buffer.
- Government spending is growing at a large rate. NPR is strongly levered to government activity in its staff housing leases, rent supplemented tenancies, subsidized seniors' operations and commercial leases.
- Our low cost base in communities with economies with a resource component will help us to reap the benefits when the economy finally begins to recover.

Playing defense is not as much fun. But doing it well is an essential "part of the game".

Respectfully submitted,



B. James Britton  
*President and Chief Executive Officer*

March 25, 2009

# Management's Discussion and Analysis

Management's Discussion and Analysis of financial conditions and results of operations should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2008 and 2007.

Certain information contained in Management's Discussion and Analysis contains forward looking statements relating to the business and financial outlook of Northern Property Real Estate Investment Trust ("NPR" or the "REIT"). These forward looking statements are subject to risks, uncertainties and other factors which could cause actual results to differ materially from future results expressed, projected or implied by such forward looking statements. These forward looking statements are made as of March 3, 2009 and NPR assumes no obligation to update or revise them to reflect new events or circumstances that may arise after March 3, 2009, except as required by law.

## Portfolio Summary

|              | Multi-family | Execusuites | Seniors      | Total Residential (units) | Commercial (sq ft) |
|--------------|--------------|-------------|--------------|---------------------------|--------------------|
| Alberta      | 1,598        | -           | 746          | 2,344                     | 77,755             |
| BC           | 1,372        | -           | 214          | 1,586                     | 124,417            |
| Newfoundland | 1,228        | 140         | 429          | 1,797                     | 17,030             |
| NWT          | 1,155        | 141         | -            | 1,296                     | 542,769            |
| Nunavut      | 745          | 39          | -            | 784                       | 145,538            |
| <b>Total</b> | <b>6,098</b> | <b>320</b>  | <b>1,389</b> | <b>7,807</b>              | <b>907,509</b>     |

## Financial Performance at a Glance

| Earnings Comparison<br>In \$000's except per unit amounts | Three Months<br>Ended December 31 |         | Year Ended<br>December 31 |         |
|---|-----------------------------------|---------|---------------------------|---------|
|   | 2008                              | 2007    | 2008                      | 2007    |
| Total revenue   | 32,515                            | 28,974  | 127,759                   | 104,418 |
| Net operating income ("NOI")                              | 21,424                            | 18,952  | 84,305                    | 68,666  |
| Net earnings  | 6,427                             | 7,733   | 22,702                    | 7,690   |
| Distributable Income ("DI")*                              | 13,560                            | 11,276  | 52,139                    | 41,050  |
| DI per unit*  | \$0.542                           | \$0.451 | \$2.083                   | \$1.820 |
| Distribution to unitholders                               | 9,260                             | 9,037   | 37,037                    | 31,691  |
| Distributions per unit                                    | \$0.370                           | \$0.362 | \$1.480                   | \$1.397 |
| Payout ratio  | 68.3%                             | 80.2%   | 71.0%                     | 77.2%   |
| Funds from Operations ("FFO") *                           | 13,758                            | 11,620  | 53,079                    | 42,251  |
| FFO per unit*   | \$0.550                           | \$0.465 | \$2.121                   | \$1.873 |

\*Please refer to non-GAAP Financial Measures on page 14.

## 1. OVERVIEW

NPR is primarily a multi-family residential real estate investment trust, providing a broad spectrum of rental accommodations and ancillary commercial space in Canadian secondary markets with strong economic fundamentals. Geographically, NPR operates in British Columbia, the Northwest Territories, Alberta, Nunavut and Newfoundland.

The REIT's residential portfolio is comprised of three segments: apartments, townhomes and single family rental units; executive apartment rental units, where the rental periods range from a few days to several months; and seniors' properties where the properties are leased on a long term basis to qualified operators who provide services to individual tenants.

NPR's commercial properties are located primarily in areas where NPR has residential operations. A significant portion of these properties are leased to federal and territorial governments and high quality commercial tenants under long term leases.

2008 was a strong year for NPR. Financial highlights for the three months and year ended December 31, 2008 include:

- DI per unit for the fourth quarter increased by 20.2% to \$0.542 compared to \$0.451 in 2007. DI per unit for the year ended December 31, 2008 increased by 14.5% to \$2.083 compared to \$1.820 in 2007.
- FFO per unit for the fourth quarter increased by 18.3% to \$0.550 compared to \$0.465 in 2007. FFO per unit for the year ended December 31, 2008 increased by 13.2% to \$2.121 compared to \$1.873 in 2007.
- Same door NOI growth was 6.1% in the fourth quarter and 6.1% year to date. Same door NOI growth was driven by the continued improved occupancy in Newfoundland and the Northwest Territories.
- Future income tax expense of \$3.3 million resulting from amendments to prior year's tax filings, additional temporary differences arising from acquisitions and deferred financing cost and refinements to the calculation of temporary differences between tax and accounting values of the REIT's assets.

The strong financial results for 2008 were driven by continued same door growth throughout the portfolio, especially in Fort McMurray, AB, Yellowknife, NWT and St. John's, NF and acquisitions completed in 2007 and 2008. In addition, lower interest rates on mortgage debt and the operating facility and decreasing utility costs in the fourth quarter contributed to the strong financial performance.

Other highlights for 2008 include:

- Completion of three development projects during the year; a 48 unit multi-family rental development in Dawson Creek, BC completed in July, 2008, a new Shoppers Drug Mart commercial property in Yellowknife, NWT completed in September, 2008 and a 79 unit residential rental development in Fort St. John, BC completed in November, 2008. These projects were completed within budget costs and timelines at a total cost of \$18.1 million.
- The lease up of the 48 units in Dawson Creek, BC, was completed quickly with occupancy rising to 94% in just 4 months. The Shoppers Drug Mart property was pre-leased prior to construction, with occupancy in mid-September. The lease up of the 79 unit development in Fort St. John, BC, completed on November 1, has also progressed quickly with occupancy of 62% at December 31, 2008.
- Mortgage financings and refinancings totaling \$144.6 million were completed during 2008, proceeds of which were used to repay existing mortgages and the completion of acquisitions and developments.
- The weighted average cost of debt continued to decline to 5.13% at December 31, 2008 from 5.39% at December 31, 2007.

## 1. OVERVIEW (continued)

### Acquisitions and Developments

While acquisition activity was curtailed during 2008, NPR completed acquisitions and developments totaling \$80.4 million during the year. NPR had entered into agreements to complete the majority of these transactions prior to the instability in the capital markets that was experienced in the latter half of 2008. These acquisitions and developments were financed through a combination of new mortgage financings, refinancing of underleveraged properties in the portfolio and the use of the operating facility. The acquisitions and developments are summarized below:

|                     | Units / Sq Ft | \$000's       |
|---------------------|---------------|---------------|
| Residential – units |               |               |
| Multi-family        | 724           | 64,580        |
| Seniors'            | 94            | 9,001         |
|                     | <b>818</b>    | <b>73,581</b> |
| Commercial – sq ft  | <b>40,233</b> | <b>6,810</b>  |

Acquisitions and developments completed in 2008 included entrance into two strong new markets, Lloydminster, AB and surrounding area and Nanaimo, BC, infill for the commercial portfolio in downtown Yellowknife and multi-family properties to round out the portfolios in Fort St. John and Dawson Creek, BC. Acquisition highlights include:

- 463 residential rental units were acquired in Lloydminster, AB and surrounding area, including 312 units in the fourth quarter.
- 121 residential rental units in Nanaimo, BC.
- Seniors' properties in Newfoundland totaling 94 units.
- Commercial properties totaling 40,233 square ft, including the development of a new Shoppers Drug Mart in Yellowknife, NWT.
- The development of two residential rental properties in Dawson Creek and Fort St. John, BC totaling 127 units.

### Current Economic Environment

The extremely troubled conditions in the capital markets throughout 2008 and in early 2009 have certainly had an effect on NPR. In 2008 Canadian REITs, on average, had a negative 38.5% total return. NPR unitholders fared better than most, posting a negative total return of 20.9%.

As a result of the meltdown in the capital markets, the REIT decelerated its acquisition program. The increased cost of capital caused some potential property transactions to be discarded because concluding them would have been dilutive. Moreover, management was concerned that replacing equity invested in additional property could be overly expensive or perhaps not even possible to raise in the difficult stock market conditions. In late 2008 and early 2009, the REIT closed only on those properties which it had agreed to purchase earlier in the year.

Notwithstanding the REIT's low payout ratio, a decision was made in November 2008 not to increase the level of monthly distributions. This was to preserve balance sheet liquidity and also provide additional protection to distributions should a prolonged recession negatively affect occupancy and rental rates.

The slowdown in the economy generally had very little impact on NPR's financial results in 2008. In the face of diminished business activity in the forestry, oil and gas and mining industries, the REIT maintained stable levels of occupancy overall and delivered solid same door growth. The loss of tenants to home ownership declined in most markets. The fall in commodity prices, while slowing up the pace of rent increases, also resulted in lower utility costs in many locations. Declining interest rates on CMHC insured mortgages also contributed to the growth in NPR's bottom line.

Overall rent market conditions remain sound early in 2009 for NPR. However, inevitably we expect additional residential vacancy in those markets which are levered to the oil and gas industry and to mining. Execusuite revenues can be expected to decline in those markets as well. Rent increases will be far more difficult to capture during a recession. Government activity is a major contributor to the economies of the NWT, Nunavut and Newfoundland. NPR expects these regions to be less effected by low commodity prices and the recession than other areas.



## 2. YEAR-TO-DATE RESULTS AND COMPARISONS

The following section provides a comparison of the financial results for the three months and year ended December 31, 2008 compared to the three months and year ended December 31, 2007.

### Earnings from Continuing Operations

| In \$000's   | Three Months<br>Ended December 31 |               | Year Ended<br>December 31 |               |
|--|-----------------------------------|---------------|---------------------------|---------------|
|  | 2008                              | 2007          | 2008                      | 2007          |
| Rental revenue   | 31,644                            | 28,407        | 124,626                   | 102,223       |
| Other property income  | 871                               | 567           | 3,133                     | 2,195         |
|  | 32,515                            | 28,974        | 127,759                   | 104,418       |
| Operating expenses   | (11,091)                          | (10,022)      | (43,454)                  | (35,752)      |
| <b>Net operating income</b>  | <b>21,424</b>                     | <b>18,952</b> | <b>84,305</b>             | <b>68,666</b> |
| Interest on mortgages  | (6,239)                           | (5,671)       | (24,499)                  | (20,380)      |
| Amortization   | (6,867)                           | (6,261)       | (26,447)                  | (22,012)      |
| <b>Earnings from continuing operations<br/>before other items and income taxes</b> | <b>8,318</b>                      | <b>7,020</b>  | <b>33,359</b>             | <b>26,274</b> |

### Rental Properties Revenue

| In \$000's   | Three Months<br>Ended December 31 |               | Year Ended<br>December 31 |                |
|--------------|-----------------------------------|---------------|---------------------------|----------------|
|              | 2008                              | 2007          | 2008                      | 2007           |
| Residential  |                                   |               |                           |                |
| Multi-family | 20,818                            | 18,394        | 79,839                    | 67,776         |
| Execusuites  | 1,797                             | 1,925         | 8,497                     | 8,038          |
| Seniors'     | 4,202                             | 3,870         | 16,494                    | 14,159         |
|              | 26,817                            | 24,189        | 104,830                   | 89,973         |
| Commercial   | 5,698                             | 4,785         | 22,929                    | 14,445         |
| <b>Total</b> | <b>32,515</b>                     | <b>28,974</b> | <b>127,759</b>            | <b>104,418</b> |

Total revenue for the three months ended December 31, 2008 was \$32.5 million, 12.2% higher than the same period of 2007 (\$29.0 million). Total revenue for the year ended December 31, 2008 was \$127.8 million, 22.4% higher than the same period of 2007 (\$104.4 million). The increase in revenue is primarily due to the significant acquisitions completed during 2007 and 2008, which contributed \$29.3 million to revenue in 2008. Same door revenue growth of 4.7% in the fourth quarter and of 5.2% in the year ended December 31, 2008 also contributed to the increase.

Rental revenue to be received from leases with rental rates varying over the term of the lease is recorded on a straight line basis over the terms of the associated leases. Rental revenue recorded on a straight line basis is generated from the commercial and seniors' properties portfolios. Rental revenue for the three months ended December 31, 2008 includes straight line rental revenue of \$297,000 (2007 – \$345,000). Rental revenue for the year ended December 31, 2008 includes straight line rental revenue of \$1.2 million (2007 – \$1.2 million).

### Residential Revenue

Residential rental revenue for the three months ended December 31, 2008 was \$26.8 million, 10.9% higher than the same period of 2007 (\$24.2 million). Residential rental revenue for the year ended December 31, 2008 was \$104.8 million, 16.5% higher than the same period of 2007 (\$90.0 million). The increase is primarily the result of the significant acquisitions completed during 2007 and 2008. Same door revenue growth of 6.4% in the fourth quarter and 5.3% for the year ended December 31, 2008 also contributed to the increase.

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

### Residential Rental Vacancy Loss – Year Ended December 31

|                       | Market Vacancy Loss |       | Renovation Vacancy Loss |      |
|-----------------------|---------------------|-------|-------------------------|------|
|                       | 2008                | 2007  | 2008                    | 2007 |
| Northwest Territories | 2.0%                | 6.0%  | 1.5%                    | 0.4% |
| Nunavut               | 0.7%                | 1.1%  | 0.2%                    | 0.1% |
| British Columbia      | 12.6%               | 10.8% | 5.0%                    | 5.9% |
| Alberta               | 2.8%                | 1.3%  | 0.1%                    | -    |
| Newfoundland          | 1.7%                | 2.7%  | 0.1%                    | 0.1% |
| Overall               | 3.5%                | 3.8%  | 1.2%                    | 0.9% |

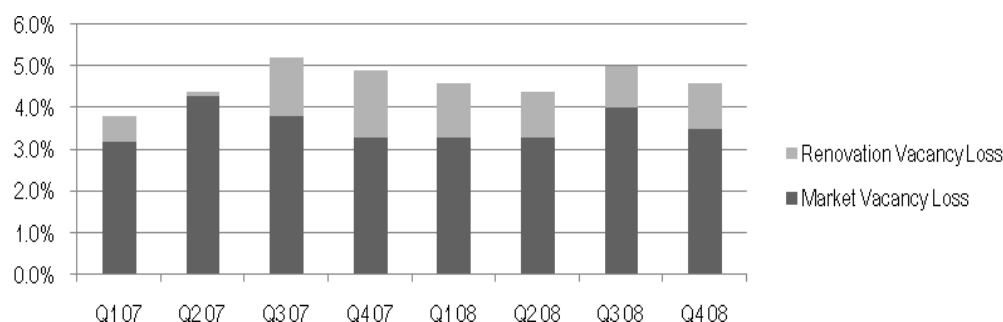
Vacancy loss is calculated as rental revenue from vacant units divided by gross potential rental revenue.

Market vacancy loss excludes recently developed properties that are in the lease up phase. Market vacancy loss relating to residential rental properties for the year ended December 31, 2008 decreased slightly to 3.5% compared to 3.8% for the year ended December 31, 2007. The decreased market vacancy loss is driven by the improvement in both the Northwest Territories and Newfoundland. The decrease was partially offset by a higher level of vacancy in north eastern BC and Grande Prairie, AB.

Market vacancy in Chetwynd and Fort Nelson in north eastern BC continue to be higher than the remainder of the portfolio. Rental markets in north eastern BC traditionally operate at higher levels of vacancy (10% to 15%) as a result of the seasonal forestry and natural gas industries. The portfolios in both communities were acquired with high vacancy levels built into the acquisition assumptions. The financial performance of these two portfolios is consistent with long term projections completed at the time of acquisition. With the recent significant natural gas discovery in the Horn River Basin, management expects that the Fort Nelson portfolio's financial performance will improve in the long term when the economic conditions exist for the development of this gas discovery. Vacancy levels in Dawson Creek and Fort St. John continue to operate within normal vacancy levels.

Renovation vacancy in the Northwest Territories is largely the result of fires in Yellowknife and Inuvik that destroyed 12 rental units. Reconstruction of the fire damaged units in Yellowknife was completed in January, 2009. The renovation loss in BC continues to decrease as the renovation project in Fort Nelson comes to a close. In Alberta, the renovation loss is primarily due to the improvements underway in the portfolio acquired in Lloydminster during the year.

### Quarterly Residential Rental Vacancy Loss



Total vacancy loss for the fourth quarter of 2008 decreased by approximately 0.4%, primarily due to improved occupancy in north eastern BC and St. John's, Newfoundland.

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

Execusuites rental revenue for the three months ended December 31, 2008 was \$1.8 million, 6.6% lower than the same period of 2007 (\$1.9 million). Execusuites rental revenue for the year ended December 31, 2008 was \$8.5 million, 5.7% higher than the same period of 2007 (\$8.0 million). The nature of the execusuite business is that Q4 is traditionally the weakest quarter due to lower occupancy. 2008 continued this trend, especially in Yellowknife and Inuvik, NWT where occupancy decreased more sharply than in previous years.

Rental income from seniors' properties represents rental payments made to NPR by the operators of the facilities under long-term triple net leases ranging from 15 to 20 years, with regularly scheduled increases, generally 1% per annum. For these properties, NPR is responsible for the physical facilities and has no direct business relationship with the individual tenant. As a result, NPR does not have exposure to vacancy for these properties. Rental revenue for the three months ended December 31, 2008 was \$4.2 million, 8.6% higher than the same period of 2007 (\$3.9 million). Seniors' rental revenue for the year ended December 31, 2008 was \$16.5 million, 16.5% higher than the same period of 2007 (\$14.2 million). The increase in revenue is the result of the acquisition of the Newfoundland portfolio in 2007 and 2008 and scheduled rent increases.

### Commercial Revenue

Commercial rental revenue for the three months ended December 31, 2008 was \$5.7 million, 19.1% higher than the same period of 2007 (\$4.8 million). Commercial rental revenue for the year ended December 31, 2008 was \$22.9 million, 58.7% higher than the same period of 2007 (\$14.4 million). The increase is primarily due to the acquisition of properties totaling approximately 427,000 square feet since January 1, 2007.

Vacancy increased to 43,000 square feet or 4.7% at December 31, 2008 compared to 14,000 square feet or 1.6% at December 31, 2007. The increase is primarily the result of the planned repositioning of YK Centre East in Yellowknife from a retail to an office focused property. In September, Shoppers Drug Mart relocated to its newly constructed property adjacent to YK Centre East, creating a significant portion of the vacancy. In September, NPR won the tender for a long term lease with the Government of the Northwest Territories for approximately 20,000 square feet in YK Centre East for a consolidated medical clinic commencing January 1, 2010. This will successfully complete the repositioning of the property and stabilize its tenancies in the market for the foreseeable future.

### Operating Expenses

| In \$000's          | Three Months<br>Ended December 31 |        | Year Ended<br>December 31 |        |
|---------------------|-----------------------------------|--------|---------------------------|--------|
|                     | 2008                              | 2007   | 2008                      | 2007   |
| Operating expenses: |                                   |        |                           |        |
| Utilities           | 3,743                             | 3,145  | 13,493                    | 10,005 |
| Property taxes      | 1,692                             | 1,343  | 6,420                     | 5,004  |
| Other expenses      | 5,656                             | 5,534  | 23,541                    | 20,743 |
|                     | 11,091                            | 10,022 | 43,454                    | 35,752 |

Utilities, expressed as a percentage of rental revenue, increased to 11.8% for the three months ended December 31, 2008 from 11.1% for the same period of 2007. Utilities, expressed as a percentage of rental revenue, increased to 10.8% for the year ended December 31, 2008 from 9.8% for the same period of 2007. The increase is the result of two main factors. First, utilities represent a greater portion of operating costs compared to the existing portfolio for the significant acquisitions completed in 2007, specifically the commercial portfolio in Yellowknife. These higher utility costs are ultimately recovered from commercial tenants. Second, during 2008, utility prices in northern Canada and BC experienced rapid increases as underlying commodity prices increased through the first half of the year. During the fourth quarter of 2008, utility costs decreased as underlying commodity prices declined, though not at the same pace or to the same extent. An exception was in Nunavut where the Government was forced to purchase its new supply of fuel oil at high mid-summer price levels. In the multi-family portfolio, the REIT can recover these costs over time through rental increases. There is a time lag between the increase in expenses and obtaining the rental rate increases due to statutory limitations on the timing and frequency of rental increases.

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

### Net Operating Income

| In \$000's   | Three Months<br>Ended December 31 |               | Year Ended<br>December 31 |               |
|--------------|-----------------------------------|---------------|---------------------------|---------------|
|              | 2008                              | 2007          | 2008                      | 2007          |
| Residential  |                                   |               |                           |               |
| Multi-family | 12,961                            | 11,444        | 49,450                    | 41,040        |
| Execusuites  | 826                               | 873           | 4,227                     | 4,211         |
| Seniors'     | 4,197                             | 3,865         | 16,471                    | 14,140        |
|              | 17,984                            | 16,182        | 70,148                    | 59,391        |
| Commercial   | 3,440                             | 2,770         | 14,157                    | 9,275         |
| <b>Total</b> | <b>21,424</b>                     | <b>18,952</b> | <b>84,305</b>             | <b>68,666</b> |

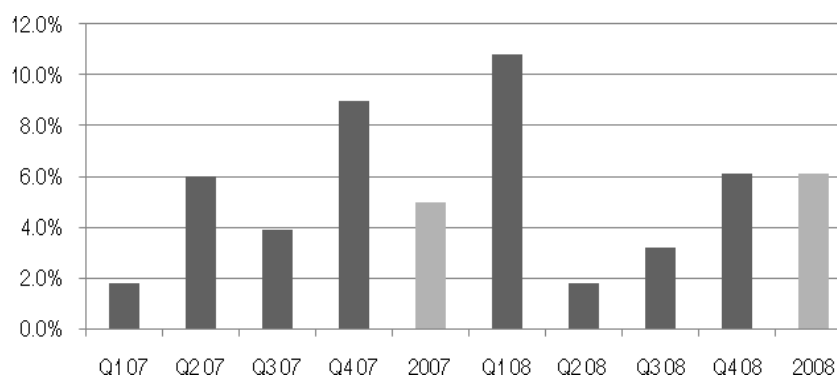
NOI derived from residential properties was 83.9% of total NOI for the three months ended December 31, 2008 compared to 85.4% for the same period of 2007. NOI derived from residential properties was 83.2% of total NOI for the year ended December 31, 2008 compared to 86.5% for the same period of 2007. The decrease is primarily a result of the significant acquisition of commercial properties located in Yellowknife, NWT in the third quarter of 2007. The acquisition of the commercial and seniors' properties, which are subject to net leases where the lessee is responsible for the operating costs, have reduced NPR's exposure to increases in operating costs.

The seniors' and commercial properties provide stability to the REIT's portfolio, reducing overall exposure to volatile utility prices and severe winter temperatures in Nunavut and the Northwest Territories. In these business segments, tenants pay the operating costs directly or the majority of the operating costs are recoverable from the tenants. For the year ended December 31, 2008, approximately 36.3% of NOI was derived from commercial and senior's properties where tenants are primarily responsible for operating costs.

### Same Door NOI

NPR defines same door NOI growth as the annual change in net operating income from properties that have been owned by the REIT for both the current and previous reporting periods, which for the purposes of this discussion include properties that were owned by NPR on or before January 1, 2007. Same door NOI growth for the three months ended December 31, 2008 compared to the same period of 2007 was 6.1%. Same door NOI growth for the year ended December 31, 2008 compared to the same period of 2007 was 6.1%. The strong same door growth for the year ended December 31, 2008 was fuelled by lower vacancy in Newfoundland, Yellowknife and Inuvik and normal rental increases throughout the other regions.

### Quarterly Same Door Net Operating Income Growth



## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

### Interest on Mortgages

Interest on mortgages for the three months ended December 31, 2008 increased to \$6.2 million compared to \$5.7 million for the same period of 2007. Interest on mortgages for the year ended December 31, 2008 increased to \$24.5 million compared to \$20.4 million for the same period of 2007. The increase is primarily the result of mortgage debt on acquisitions completed in 2007. The increased interest expense was partially offset by the continued decline in the weighted average interest rates of mortgages, which decreased to 5.13% at December 31, 2008 from 5.39% at December 31, 2007.

### Amortization

Amortization for the three months ended December 31, 2008 increased to \$6.9 million compared to \$6.3 million for the same period of 2007. Amortization for the year ended December 31, 2008 increased to \$26.4 million compared to \$22.0 million for the same period of 2007. The increase in amortization is the result of significant acquisition activity in 2007.

### Net Earnings

| In \$000's except per unit amounts         | Three Months<br>Ended December 31 |               | Year Ended<br>December 31 |               |
|--|-----------------------------------|---------------|---------------------------|---------------|
|  | 2008                              | 2007          | 2008                      | 2007          |
| <b>Earnings from continuing operations</b> |                                   |               |                           |               |
| <b>before the undernoted</b>               | <b>8,318</b>                      | <b>7,020</b>  | <b>33,359</b>             | <b>26,274</b> |
| Trust administration                       | (1,317)                           | (1,473)       | (6,796)                   | (5,542)       |
| Interest on operating facility             | (260)                             | (407)         | (1,286)                   | (1,565)       |
| Interest and other income                  | 96                                | 200           | 509                       | 817           |
| Gain (loss) on settlement of debt          | (29)                              | 104           | 558                       | 1,454         |
| Gain on sale of rental properties          | -                                 | 3,245         | 136                       | 3,321         |
| Non-controlling interest                   | (5)                               | -             | (63)                      | -             |
| <b>Earnings from continuing operations</b> |                                   |               |                           |               |
| <b>before income taxes</b>                 | <b>6,803</b>                      | <b>8,689</b>  | <b>26,417</b>             | <b>24,759</b> |
| Current taxes                              | (103)                             | (194)         | (409)                     | (541)         |
| Future taxes                               | (273)                             | (762)         | (3,306)                   | (16,523)      |
| <b>Earnings from continuing operations</b> | <b>6,427</b>                      | <b>7,733</b>  | <b>22,702</b>             | <b>7,695</b>  |
| <b>Loss from discontinued operations</b>   | <b>-</b>                          | <b>-</b>      | <b>-</b>                  | <b>(5)</b>    |
| <b>Net earnings</b>                        | <b>6,427</b>                      | <b>7,733</b>  | <b>22,702</b>             | <b>7,690</b>  |
| Other comprehensive earnings               | 118                               | 133           | 68                        | 55            |
| <b>Comprehensive earnings</b>              | <b>6,545</b>                      | <b>7,866</b>  | <b>22,770</b>             | <b>7,745</b>  |
| <b>Net earnings per unit</b>               |                                   |               |                           |               |
| <b>Basic:</b>                              |                                   |               |                           |               |
| Continuing operations                      | \$0.26                            | \$0.31        | \$0.91                    | \$0.34        |
| Discontinued operations                    | -                                 | -             | -                         | -             |
|  | <b>\$0.26</b>                     | <b>\$0.31</b> | <b>\$0.91</b>             | <b>\$0.34</b> |
| <b>Diluted:</b>                            |                                   |               |                           |               |
| Continuing operations                      | \$0.26                            | \$0.31        | \$0.91                    | \$0.34        |
| Discontinued operations                    | -                                 | -             | -                         | -             |
|  | <b>\$0.26</b>                     | <b>\$0.31</b> | <b>\$0.91</b>             | <b>\$0.34</b> |
| <b>Weighted average number of units</b>    |                                   |               |                           |               |
| <b>outstanding – basic (000's)</b>         | <b>25,034</b>                     | <b>24,993</b> | <b>25,028</b>             | <b>22,557</b> |
| <b>Weighted average number of units</b>    |                                   |               |                           |               |
| <b>outstanding – diluted (000's)</b>       | <b>25,081</b>                     | <b>25,002</b> | <b>25,061</b>             | <b>22,575</b> |

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

### Interest on Operating Facility

Interest on the operating facility for the three months ended December 31, 2008 was \$260,000 compared to \$407,000 for the same period of 2007. Interest on the operating facility for the year ended December 31, 2008 was \$1.3 million compared to \$1.6 million for the same period of 2007. The operating facility loan balance was \$26.6 million at December 31, 2008 compared to \$25.2 million at December 31, 2007. Interest on the operating facility decreased as a result of lower average balances throughout the year and a decrease in the prime rate from 6.0% at December 31, 2007 to 3.5% at December 31, 2008.

### Trust Administration

Trust administration costs for the three months ended December 31, 2008 were \$1.3 million compared to \$1.5 million for the same period of 2007. The decrease in costs for the fourth quarter of 2008 compared to same period of 2007 is primarily due to lower executive performance pay, partially offset by one-time costs associated with contemplated acquisitions that were not completed.

Trust administration costs for the year ended December 31, 2008 were \$6.8 million compared to \$5.5 million for the same period of 2007. The increase in trust administration costs are the result of the following:

- A compassionate settlement made to a former employee who suffered a serious criminal assault while temporarily assigned to a remote community;
- One-time costs associated with the temporary increase in the operating facility in Q1.
- Costs related to contemplated acquisitions that were not completed in the second half of 2008.
- Unit-based compensation relating to unit options granted to management and trustees.

### Gain on Sale of Rental Properties

During the first quarter of 2008, NPR completed the sale of two non-core assets located in Gjoa Haven, NWT and Iqaluit, Nunavut for gross proceeds of \$395,000 and a gain on sale of \$136,000. The gain on sale of \$3.3 million realized in 2007 resulted from the sale of a commercial property located in Inuvik, NWT, a non-core residential unit in Nunavut and 40% interest in Vista Village Limited Partnership. The financial results from these properties have not been reclassified as discontinued operations as they are not material to the financial results of the REIT.

### Future Income Taxes

Under the current tax legislation and the proposed technical amendments relating to the proposed Specified Investment Flow Throughs ("SIFTs") income tax rules, NPR does not appear to qualify for the real estate investment trust (the "REIT Exemption"). This is a result of two items, first, revenues earned from the execusuite portfolio do not appear to qualify as eligible revenue. The legislation provides for a maximum of 5% of non-eligible revenue. For 2008 revenue earned from the execusuite portfolio represents approximately 6.7% of total revenue. The second item relates to the structure of the holdings of limited partnership units. Under the current legislation, it appears that the holdings of the Class B Exchangeable Limited Partnership units do not meet the requirements of the legislation. As a result, NPR recorded future income tax expense of \$3.7 million for the year ended December 31, 2008 compared to \$16.7 million for the same period of 2007. This non-cash charge arose from temporary differences between the estimated accounting values and tax values of the REIT's assets and liabilities at January 1, 2011 and has no impact on NPR's cash flows or its ability to make distributions to unitholders.

Future income tax expense for the three months ended December 31, 2008 was \$273,000 compared to \$762,000 for the same period of 2007. Future income tax expense for the year ended December 31, 2008 was \$3.3 million compared to \$16.5 million for the same period of 2007. The future income tax expense of \$3.3 million for 2008 arises from incremental temporary differences between the estimated accounting values and tax values of financing costs on mortgage financings and acquisitions completed during the year and revisions to the calculations of the provision as a result of amendments to prior years' tax filings and refinements to the methodology used.

Management expects to be able to make changes, if required, to the structure and operations in order to qualify for the REIT Exemption prior to 2011. Management continues to evaluate the alternatives available in making the required changes and will update unitholders as further progress is made.

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

### Other Comprehensive Earnings

As part of the acquisition of rental properties in Fort McMurray, AB in 2007, the REIT acquired financial instruments relating to fixed-price utility contracts. The remaining obligation under these contracts is recorded at the current market price. Currently, the fixed-price utility contract is "out-of-money" as a result of the decrease in natural gas prices since July 1, 2008. The adjustment to the financial liability is included in other comprehensive earnings. The REIT recorded other comprehensive earnings of \$118,000 (2007 – \$133,000) for the three months ended December 31, 2008 and \$68,000 (2007 – \$55,000) for the year ended December 31, 2008.

### Non-GAAP Financial Measures

NPR does not consider cash flows from operations as the most direct measure of the REIT's performance as it includes changes in non-cash working capital balances such as prepaid property taxes, differences in timing of collections of rents and payments of expenses incurred. Management considers Distributable Income and Funds from Operations to be key performance indicators of NPR's financial performance and its capacity to make cash distributions to unitholders. Both measures are widely accepted measures of performance for Canadian real estate investment trusts, however are not defined by Canadian generally accepted accounting principles ("GAAP").

### Distributable Income

DI is calculated in accordance with NPR's declaration of trust (the "Trust Declaration") and as such, may not be comparable to similar measures presented by other Canadian real estate investment trusts.

Cash retained by the REIT represents the difference between DI and distributions made to unitholders. Cash retained is used in part to fund capital improvements and sustaining CAPEX, leasing costs and tenant improvements in the commercial portfolio, capital acquisitions and a portion of the principal repayment on mortgages. Capital improvements and sustaining CAPEX are incurred by the REIT to maintain the productive capacity of its properties, or their potential to maximize returns. NPR's goal is to maintain distributions at sustainable levels. NPR's DI and DI per unit increased as a result of both internal growth and the completion of accretive acquisitions.

In accordance with CSA Staff Notice 52-306 (Revised) Non-GAAP Financial Measures, NPR is required to reconcile DI to cash flow from operating activities. The following table outlines this reconciliation:

| In \$000's except per unit amounts      | Three Months      |               | Year Ended    |               |
|---|-------------------|---------------|---------------|---------------|
|   | Ended December 31 |               | December 31   |               |
|   | 2008              | 2007          | 2008          | 2007          |
| Cash flows from operating activities    | 12,539            | 10,398        | 53,634        | 35,369        |
| Adjustments:                            |                   |               |               |               |
| Net change in operating working capital | 1,026             | 878           | (1,432)       | 5,681         |
| Non-controlling interest                | (5)               | -             | (63)          | -             |
| <b>Distributable income</b>             | <b>13,560</b>     | <b>11,276</b> | <b>52,139</b> | <b>41,050</b> |
| Cash retained                           | (4,300)           | (2,239)       | (15,102)      | (9,359)       |
| Distribution to unitholders             | 9,260             | 9,037         | 37,037        | 31,691        |
| Distribution to unitholders per unit    | \$0.370           | \$0.362       | \$1.480       | \$1.397       |
| DI per unit – basic                     | \$0.542           | \$0.451       | \$2.083       | \$1.820       |
| DI per unit – diluted                   | \$0.541           | \$0.451       | \$2.080       | \$1.818       |
| DI Payout ratio                         | 68.3%             | 80.2%         | 71.0%         | 77.2%         |

DI for the three months ended December 31, 2008 was \$13.6 million or \$0.542 per unit compared to \$11.3 million or \$0.451 per unit for the same period of 2007. DI for the year ended December 31, 2008 was \$52.1 million or \$2.083 per unit compared to \$41.1 million or \$1.820 per unit for the same period of 2007. The increase in DI and DI per unit is the result of strong same door NOI growth in the existing portfolio, accretive acquisitions completed during 2007 and 2008 and lower weighted average interest rates on mortgages and the operating facility.

## 2. YEAR-TO-DATE RESULTS AND COMPARISONS (continued)

Distributions to unitholders for the three months ended December 31, 2008 were \$9.3 million or \$0.37 per unit compared to \$9.0 million or \$0.36 per unit for the same period of 2007. Distributions to unitholders for the year ended December 31, 2008 were \$37.0 million or \$1.48 per unit compared to \$31.7 million or \$1.40 per unit for the same period of 2007. The REIT's payout ratio remains strong at 68.3% for the three months ended December 31, 2008 compared to 80.2% for the same period of 2007 and 71.0% for the year ended December 31, 2008 compared to 77.2% for the same period of 2007. The REIT continues to maintain a sustainable distribution level in comparison to DI and taking into consideration sustaining CAPEX requirements.

Monthly distributions to unitholders on an annual basis were \$1.48 per unit in 2008. Since inception, the Trustees of NPR have increased annual distributions in the fourth quarter of each year. In 2008, the Trustees opted to forego the distribution increase due to the uncertain economic climate.

### Funds from Operations

FFO is calculated in accordance with the Real Property Association of Canada White Paper on Funds from Operations as revised on February 1, 2007. FFO as presented may not be comparable to similar measures presented by other Canadian real estate investment trusts.

| In \$000's except per unit amounts         | Three Months      |               | Year Ended    |               |
|--|-------------------|---------------|---------------|---------------|
|  | Ended December 31 |               | December 31   |               |
|  | 2008              | 2007          | 2008          | 2007          |
| <b>Earnings from continuing operations</b> | <b>6,427</b>      | <b>7,733</b>  | <b>22,702</b> | <b>7,695</b>  |
| Adjustments:                               |                   |               |               |               |
| Amortization                               | 6,867             | 6,261         | 26,447        | 22,012        |
| Loss (gain) on settlement of debt          | 29                | (104)         | (558)         | (1,454)       |
| Gain on sale of rental properties          | -                 | (3,245)       | (136)         | (3,321)       |
| Future income tax                          | 273               | 762           | 3,306         | 16,523        |
| Unit-based compensation                    | 162               | 213           | 1,318         | 801           |
| Cash flows from discontinued operations    | -                 | -             | -             | (5)           |
| <b>Funds from operations</b>               | <b>13,758</b>     | <b>11,620</b> | <b>53,079</b> | <b>42,251</b> |
| Distribution to unitholders per unit       | \$0.370           | \$0.362       | \$1.480       | \$1.397       |
| FFO per unit - basic                       | \$0.550           | \$0.465       | \$2.121       | \$1.873       |
| FFO per unit - diluted                     | \$0.549           | \$0.465       | \$2.118       | \$1.872       |
| FFO Payout ratio                           | 67.3%             | 77.8%         | 69.8%         | 75.0%         |

FFO for the three months ended December 31, 2008 was \$13.8 million or \$0.550 per unit compared to \$11.6 million or \$0.465 per unit for the same period of 2007. FFO for the year ended December 31, 2008 was \$53.1 million or \$2.121 per unit compared to \$42.3 million or \$1.873 per unit for the same period of 2007.



### 3. SUMMARY OF QUARTERLY RESULTS

#### Statement of Earnings and Comprehensive Earnings

| In \$000's, except per unit amounts                              | 2007    |           |         |          | 2008     |          |          |          |
|--|---------|-----------|---------|----------|----------|----------|----------|----------|
|  | Q1      | Q2        | Q3      | Q4       | Q1       | Q2       | Q3       | Q4       |
| Rental revenue   | 22,345  | 23,706    | 27,765  | 28,407   | 29,852   | 31,211   | 31,919   | 31,644   |
| Other property income  | 444     | 524       | 660     | 567      | 658      | 845      | 759      | 871      |
|  | 22,789  | 24,230    | 28,425  | 28,974   | 30,510   | 32,056   | 32,678   | 32,515   |
| Operating expenses   | (8,605) | (8,186)   | (8,939) | (10,022) | (10,757) | (11,115) | (10,491) | (11,091) |
| <b>Net operating income</b>                                      | 14,184  | 16,044    | 19,486  | 18,952   | 19,753   | 20,941   | 22,187   | 21,424   |
| Interest on mortgages  | (4,638) | (4,720)   | (5,351) | (5,671)  | (5,944)  | (6,159)  | (6,157)  | (6,239)  |
| Amortization   | (4,725) | (4,978)   | (6,048) | (6,261)  | (6,487)  | (6,489)  | (6,604)  | (6,867)  |
| <b>Earnings from continuing operations before the undernoted</b> | 4,821   | 6,346     | 8,087   | 7,020    | 7,322    | 8,293    | 9,426    | 8,318    |
| Trust administration   | (1,190) | (1,436)   | (1,443) | (1,473)  | (1,869)  | (1,976)  | (1,634)  | (1,317)  |
| Interest on operating facility                                   | (340)   | (572)     | (246)   | (407)    | (450)    | (283)    | (293)    | (260)    |
| Interest and other income  | 154     | 266       | 197     | 200      | 186      | 116      | 111      | 96       |
| Gain (loss) on settlement of debt                                | 694     | 510       | 146     | 104      | 577      | (13)     | 23       | (29)     |
| Gain on sale of rental properties                                | 76      | -         | -       | 3,245    | 136      | -        | -        | -        |
| Non-controlling interest   | -       | -         | -       | -        | (15)     | (17)     | (26)     | (5)      |
| <b>Earnings from continuing operations before income taxes</b>   | 4,215   | 5,114     | 6,741   | 8,689    | 5,887    | 6,120    | 7,607    | 6,803    |
| Current taxes  | (117)   | (114)     | (116)   | (194)    | (86)     | (92)     | (128)    | (103)    |
| Future tax recovery (expense)                                    | 91      | (15,924)  | 72      | (762)    | 80       | (318)    | (2,795)  | (273)    |
| <b>Earnings (loss) from continuing operations</b>                | 4,189   | (10,924)  | 6,697   | 7,733    | 5,881    | 5,710    | 4,684    | 6,427    |
| <b>Loss from discontinued operations</b>                         | (5)     | -         | -       | -        | -        | -        | -        | -        |
| <b>Net earnings (loss)</b>                                       | 4,184   | (10,924)  | 6,697   | 7,733    | 5,881    | 5,710    | 4,684    | 6,427    |
| Other comprehensive Earnings (Loss)                              | -       | -         | (78)    | 133      | 182      | 242      | (474)    | 118      |
| <b>Comprehensive earnings (loss)</b>                             | 4,184   | (10,924)  | 6,619   | 7,866    | 6,063    | 5,952    | 4,210    | 6,545    |
| <b>Net earnings (loss) per unit:</b>                             |         |           |         |          |          |          |          |          |
| <b>Basic:</b>  |         |           |         |          |          |          |          |          |
| Continuing operations  | \$0.206 | \$(0.537) | \$0.274 | \$0.309  | \$0.235  | \$0.228  | \$0.187  | \$0.257  |
| Discontinued operations  | -       | -         | -       | -        | -        | -        | -        | -        |
|  | \$0.206 | \$(0.537) | \$0.274 | \$0.309  | \$0.235  | \$0.228  | \$0.187  | \$0.257  |
| <b>Diluted:</b>  |         |           |         |          |          |          |          |          |
| Continuing operations  | \$0.206 | \$(0.537) | \$0.273 | \$0.309  | \$0.235  | \$0.228  | \$0.187  | \$0.256  |
| Discontinued operations  | -       | -         | -       | -        | -        | -        | -        | -        |
|  | \$0.206 | \$(0.537) | \$0.273 | \$0.309  | \$0.235  | \$0.228  | \$0.187  | \$0.256  |

### 3. SUMMARY OF QUARTERLY RESULTS (continued)

| In \$000's except per unit amounts | 2007    |         |         |         | 2008    |         |         |         |
|------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
|                                    | Q1      | Q2      | Q3      | Q4      | Q1      | Q2      | Q3      | Q4      |
| Distribution to unitholders        | 7,004   | 7,034   | 8,616   | 9,037   | 9,254   | 9,259   | 9,264   | 9,260   |
| Distribution per unit              | \$0.345 | \$0.345 | \$0.345 | \$0.362 | \$0.370 | \$0.370 | \$0.370 | \$0.370 |
| DI                                 | 7,958   | 9,437   | 12,379  | 11,276  | 11,501  | 12,950  | 14,128  | 13,560  |
| DI per unit – basic                | \$0.392 | \$0.464 | \$0.506 | \$0.451 | \$0.460 | \$0.518 | \$0.565 | \$0.542 |
| DI per unit – diluted              | \$0.391 | \$0.463 | \$0.505 | \$0.451 | \$0.459 | \$0.517 | \$0.564 | \$0.541 |
| DI Payout ratio                    | 88.0%   | 74.5%   | 69.6%   | 80.2%   | 80.5%   | 71.5%   | 65.6%   | 68.3%   |
| FFO                                | 8,236   | 9,668   | 12,727  | 11,620  | 11,783  | 13,172  | 14,366  | 13,758  |
| FFO per unit – basic               | \$0.406 | \$0.475 | \$0.520 | \$0.465 | \$0.471 | \$0.526 | \$0.574 | \$0.550 |
| FFO per unit – diluted             | \$0.405 | \$0.475 | \$0.519 | \$0.465 | \$0.470 | \$0.525 | \$0.573 | \$0.549 |
| FFO Payout ratio                   | 85.5%   | 72.6%   | 66.3%   | 77.8%   | 78.6%   | 70.3%   | 64.6%   | 67.3%   |
| Closing trading price              | \$25.65 | \$23.06 | \$23.40 | \$22.35 | \$20.79 | \$22.52 | \$22.71 | \$16.21 |

### 4. RISK FACTORS

NPR operates under a strict set of guidelines as set out in its Trust Declaration, which covers areas such as the maximum debt leverage allowed, investment restrictions, management authorities and environmental risks.

#### Interest Rate Risk

The REIT is exposed to interest rate risk on mortgages and loans payable and does not hold any financial instruments to mitigate that risk. The REIT utilizes both fixed and floating rate debt. Interest rate risk related to floating interest rates is limited primarily to the utilization of the credit facility. Management mitigates interest rate risk by utilizing fixed rate mortgages, ensuring access to a number of sources of funding and staggering mortgage maturities with the objective of achieving relatively even annual debt maturities. To the extent possible, the REIT maximizes the amount of mortgages on residential rental properties where it is possible to lower interest rates through Canada Mortgage and Housing Corporation mortgage insurance.

A sensitivity analysis on floating rate debt has been completed based on the exposure to interest rates at the balance sheet date. Floating rate debt includes all mortgages and loans payable which are not subject to fixed interest rates and the revolving line of credit. If interest rates changed by 0.50% and all other variables remained constant, the REIT's net earnings for the year ended December 31, 2008 would have changed by \$172,000.

#### Property Tax Risk

Over the past few years, property tax expense has increased as a result of re-evaluations of properties by municipalities and the tax rates applied to the valuations. NPR, in conjunction with outside consultants, regularly reviews these re-evaluations and appeals where warranted.

## **4. RISK FACTORS (continued)**

### **Income Tax Risk**

The federal Minister of Finance announced on October 31, 2006, a "Distribution Tax" on publicly traded investment trusts and publicly listed partnerships. The announcement created a new tax regime for SIFTs, which include certain publicly listed income trusts and publicly listed partnerships. These entities will be taxed in effect as corporations (at a rate comparable to the general combined federal/provincial corporate income tax rate). Certain real estate investment trusts are excluded from the SIFT definition and therefore are not subject to the new regime.

On June 22, 2007, the Budget Implementation Act, 2007, Bill C-52 received Royal Assent. Bill C-52 will not apply to an entity that qualifies for the REIT Exemption. Where an entity does not qualify for the REIT Exemption certain distributions will not be deductible in computing income for tax purposes and will be subject to tax on such distributions at a rate comparable to the general corporate income tax rate. Bill C-52 provides for a transition period for publicly traded entities that existed prior to November 1, 2006 and is not expected to apply to NPR until 2011.

On July 15, 2008, the Government of Canada released draft legislation to enact the proposed changes to the SIFT income tax rules previously announced on December 21, 2007, which provided clarification to the rules relating to the REIT Exemption, among other clarifications. There are no substantial changes in the draft legislation from the previously announced amendments.

Under the current legislation and proposed technical amendments, NPR does not appear to qualify for the REIT Exemption. Management believes that it will be able to make changes to the REIT's structure and operations in order to qualify for the REIT Exemption prior to 2011.

### **Utility Cost Risk**

NPR is exposed to utility cost risk, which results from the fluctuation in utility prices for fuel oil, natural gas and electricity, the primary utilities used to heat the REIT's properties. The exposure to utility cost risk is restricted primarily to the REIT's residential rental and executives portfolio. The leases in the remainder of the NPR's portfolio generally provide for recovery of operating costs, including utilities. Because of the northern location of a portion of NPR's portfolio, the exposure to utility price fluctuations is more pronounced in the first and last fiscal quarter of the year.

NPR manages its exposure to utility risk through a number of preventative measures, including retrofitting properties with energy efficient appliances, fixtures and windows. With the exception of a fixed price utility contract in place on certain residential rental units in Alberta, NPR does not utilize hedges or forward contracts in the management of exposure to utility risk. Over the last two years, NPR has been converting the heating of certain properties in Yellowknife from fuel oil based boilers to wood pellet boilers. The investment in these environmentally friendly boilers continues to reduce NPR's exposure to volatile heating oil prices. Management continues to review the feasibility of converting more buildings in Yellowknife to wood pellet boilers.

Heating oil is the primary source of fuel for heating properties located in Nunavut and the Northwest Territories. Exposure to increases in the cost of heating oil is partially offset by the ability to recover these increases from a significant proportion of its commercial and some residential tenants.

Natural gas is the significant source of fuel for heating properties located in Alberta, BC and Inuvik. In Alberta, the provincial government has a natural gas rebate program for energy costs incurred from October through March. In addition, NPR has fixed price contracts for certain of its properties which account for approximately 38% of the REIT's usage in Alberta. Natural gas prices in Inuvik and BC are not subject to regulated price control and the REIT does not use financial instruments to manage the exposure to the price risk.

Electricity is the primary source of fuel for heating properties located in Newfoundland as well as parts of north eastern BC. In Newfoundland, electricity is purchased from the provincially regulated utility and is directly paid by the tenants for a significant portion of the REIT's multi-family rental units. As there is not a significant direct risk to NPR regarding the price of electricity, a sensitivity analysis has not been prepared.

Management prepared a sensitivity analysis on the impact of price changes in the cost of heating oil and natural gas for the year ended December 31, 2008. A 10% change over the average price of heating oil and natural gas for 2008 would impact NPR's net earnings by \$283,000.

## **4. RISK FACTORS (continued)**

### **Liquidity Risk**

Ultimate responsibility for liquidity risk management lies with management and the Board of Trustees. NPR manages liquidity risk by managing mortgage and loan maturities to ensure a relatively even amount of mortgage maturities in each year. At December 31, 2008 NPR has a revolving credit facility in the amount of \$50.0 million (December 31, 2007 - \$40.0 million). At December 31, 2008 NPR has utilized \$26.6 million on its operating facility compared to \$25.2 million at December 31, 2007. Cash flow projections are completed on a regular basis to ensure there will be adequate liquidity to maintain operating and investment activities in addition to making monthly distributions to unitholders. The Board of Trustees reviews the current financial results and the annual business plan in determining appropriate distribution levels.

The current economic environment has resulted in a decrease in the availability of mortgage financing and higher rates for non-residential properties. For residential properties, there continues to be an adequate supply of mortgage funds available to NPR. The decrease in interest rates throughout 2008 and into early 2009 has presented an opportunity for NPR to continue its mortgage financing program at lower interest rates than are currently in place. In the current uncertain economic environment, it's not possible to predict whether this low interest rate environment will continue.

### **Credit Risk**

Credit risk arises from the possibility that tenants may not be able to fulfill their lease commitments. NPR's credit risk is primarily attributable to tenant receivables. Tenant receivables are comprised of a large number of tenants spread across the geographic areas in which the REIT operates. There are no significant exposures to single tenants with the exception of AgeCare Investments Ltd. ("AgeCare"), which leases seniors' properties in Alberta and BC from the REIT, and the Governments of Canada, the Northwest Territories and Nunavut, which lease a large number of rental units in the Northwest Territories and Nunavut. NPR mitigates credit risk through conducting thorough credit checks on prospective tenants, requiring rental payments on the first of the month, obtaining security deposits approximating one month's rent from tenants where legislation permits, and geographic diversification in its portfolio. NPR records a specific bad debt provision on balances owed from past tenants and provides an allowance for receivables, net of security deposits, from current tenants where the expected amount to be collected is less than the actual accounts receivable.

## **5. LIQUIDITY AND CAPITAL RESOURCES**

### **Long-Term Debt**

During 2008, NPR completed \$144.6 million in mortgage financings, renewals and assumptions at a weighted average rate of 4.65% with a weighted average term to maturity of 5.8 years. This contributed to the reduction in the weighted average interest rate of NPR's mortgage debt at December 31, 2008 to 5.13% compared to 5.39% at December 31, 2007. The weighted average term to maturity decreased to 6.7 years compared to 7.2 years at December 31, 2007.

At December 31, 2008, the REIT has credit facilities totaling \$50.0 million, bearing interest at prime, for acquisition and operating purposes. The operating facility is secured by certain rental properties. At December 31, 2008, NPR has utilized \$26.6 million (December 31, 2007 - \$25.2 million).

During 2008, the REIT completed an assessment of its credit facilities with the intent to optimize the structure of these facilities. Following this assessment, the acquisition facility was cancelled in July, 2008 and the operating facility was expanded from \$40.0 million to \$50.0 million.

## 5. LIQUIDITY AND CAPITAL RESOURCES (continued)

The following table outlines NPR's mortgage and loans payable maturity schedule for the next ten years:

| <i>In \$000's</i> | Principal Repayments During the Year | Principal on Maturity | Total          | % of Total    | Weighted Average Interest Rate |
|-------------------|--------------------------------------|-----------------------|----------------|---------------|--------------------------------|
| 2009              | 14,552                               | 48,437                | 62,989         | 12.5%         | 5.47%                          |
| 2010              | 12,770                               | 15,635                | 28,405         | 5.7%          | 6.47%                          |
| 2011              | 12,734                               | 19,478                | 32,212         | 6.4%          | 6.51%                          |
| 2012              | 10,996                               | 33,228                | 44,224         | 8.8%          | 4.89%                          |
| 2013              | 10,064                               | 80,291                | 90,355         | 18.0%         | 4.52%                          |
| 2014              | 8,215                                | 33,833                | 42,048         | 8.4%          | 4.50%                          |
| 2015              | 7,987                                | 8,699                 | 16,686         | 3.3%          | 4.77%                          |
| 2016              | 6,028                                | 45,295                | 51,323         | 10.2%         | 5.21%                          |
| 2017              | 5,495                                | 10,771                | 16,266         | 3.2%          | 4.99%                          |
| 2018              | 4,488                                | 32,733                | 37,221         | 7.4%          | 4.79%                          |
| Thereafter        | 13,668                               | 66,880                | 80,548         | 16.1%         | 5.41%                          |
|                   | <b>106,997</b>                       | <b>395,280</b>        | <b>502,277</b> | <b>100.0%</b> | <b>5.13%</b>                   |

### Debt to Gross Book Value

NPR's Debt to Gross Book Value, as defined in the Trust Declaration, increased to 57.7% at December 31, 2008 compared to 53.8% at December 31, 2007. NPR's Trust Declaration permits total leverage up to 70%. The calculation of Debt to Gross Book Value is shown below:

| <i>In \$000's</i>                                       | December 31, 2008 | December 31, 2007 |
|---|-------------------|-------------------|
| Bank indebtedness, net of cash                          | (731)             | 104               |
| Operating facility                                      | 26,600            | 25,200            |
| Mortgages and loans payable                             | 502,277           | 416,334           |
| <b>Debt</b>   | <b>528,146</b>    | <b>441,638</b>    |
| Rental properties and other capital assets              | 833,967           | 765,447           |
| Capital assets improvements in progress                 | 3,773             | 1,957             |
| Capital assets under development                        | 8,996             | 1,257             |
| Refundable deposits and mortgage proceeds held in trust | 185               | 7,998             |
| Accumulated amortization                                | 90,758            | 65,761            |
| Future income taxes arising on acquisitions             | (21,625)          | (21,458)          |
| <b>Gross book value</b>                                 | <b>916,054</b>    | <b>820,962</b>    |
| <b>Debt to gross book value</b>                         | <b>57.7%</b>      | <b>53.8%</b>      |

## 5. LIQUIDITY AND CAPITAL RESOURCES (continued)

### Debt Service Coverage Ratio and Interest Service Coverage Ratio

NPR is subject to financial covenants in its mortgage and loans payable and operating facility. The significant financial covenants are defined as follows:

- Debt Service Coverage Ratio – calculated as Net earnings before interest, taxes and amortization divided by the debt service payments (interest expense and principal repayments);
- Interest Service Coverage Ratio – calculated as Net earnings before interest, taxes and amortization divided by the interest expense;

| In \$000's  | December 31, 2008 | December 31, 2007 |
|---|-------------------|-------------------|
| Earnings from continuing operations before taxes            | 26,417            | 24,759            |
| Amortization  | 26,447            | 22,012            |
| Interest on mortgages                                       | 24,499            | 20,380            |
| Interest on operating facility                              | 1,286             | 1,565             |
| <b>Net earnings before interest, taxes and amortization</b> | <b>78,649</b>     | <b>68,716</b>     |
| Interest on mortgages                                       | 24,499            | 20,380            |
| Interest on operating facility                              | 1,286             | 1,565             |
| Principal repayments  | 14,983            | 15,086            |
| <b>Debt service</b>   | <b>40,768</b>     | <b>37,031</b>     |
| <b>Interest service coverage ratio</b>                      | <b>3.05</b>       | <b>3.13</b>       |
| <b>Debt service coverage ratio</b>                          | <b>1.93</b>       | <b>1.86</b>       |

The Interest Service Coverage Ratio for the year ended December 31, 2008 remained healthy at 3.05 compared to 3.13 for the year ended December 31, 2007. The Debt Service Coverage Ratio for the year ended December 31, 2008 improved slightly to 1.93 compared to 1.86 for the year ended December 31, 2007. The change in both ratios is the result of higher debt levels at lower interest rates, which were used to fund \$80.4 million of acquisitions in 2008.

### Unitholders' Equity

Total unitholders' equity decreased from \$318.1 million at December 31, 2007 to \$305.1 million at December 31, 2008.

| In 000's                                       | Units         | \$             |
|--|---------------|----------------|
| Unitholders' equity – January 1, 2008          | 25,004        | 318,067        |
| Units issued under prior year LTIP grants      | 30            | -              |
| Issue costs                                    | -             | (8)            |
| Unit based compensation                        | -             | 631            |
| Long term incentive units granted              | -             | 687            |
| Comprehensive earnings                         | -             | 22,770         |
| Distributions to unitholders                   | -             | (37,037)       |
| <b>Unitholders' equity – December 31, 2008</b> | <b>25,034</b> | <b>305,110</b> |

## 5. LIQUIDITY AND CAPITAL RESOURCES (continued)

As of December 31, 2008, the authorized capital of the REIT consists of an unlimited number of trust units and special voting units (collectively, the "Units") of which 22,755,010 Units are issued and outstanding and 2,278,635 Units are reserved for issuance upon the exchange of the Class "B" limited partnership units ("Class B Units") of Northern Property Limited Partnership, a subsidiary partnership of the REIT. The Class B Units can be exchanged for trust units at any time at the option of the holder of the Class B Units. Each Class B Unit has a "Special Voting Unit" attached to it, which entitles the holder one vote, either in person or by proxy at the meeting of unitholders of the trust as if he or she were a unitholder.

On May 20, 2008, 735,000 options were granted to trustees and officers with an exercise price of \$23.12 with an expiration date of May 20, 2013. The options vest over a three year period with the first third vesting immediately and the remaining options vesting equally on May 20, 2009 and May 20, 2010. Non-cash unit-based compensation expense relating to these options included in trust administration was \$631,000 for the year ended December 31, 2008.

### Financial Obligations

NPR continued the development of 189 multi-family residential rental units located in Grande Prairie, AB on land previously acquired by the REIT. The estimated total cost of construction is approximately \$22.9 million. Costs incurred to date are \$11.8 million, including land. This project will be funded through a combination of the operating facility and construction financing, which was arranged in February, 2009. Throughout the year end of December 31, 2008, these expenditures have been funded through the operating facility.

### Working Capital Requirements

NPR requires sufficient working capital resources to fund day to day operating expenditures, sustaining CAPEX, distributions to unitholders and interest costs. NPR expects that funds generated from operations will be sufficient to cover these expenditures. Principal repayments on existing mortgages are funded in part through the funds generated from operations and through refinancing of mortgages maturing during the year.

### Capital Improvements and Sustaining CAPEX

| In \$000's           | Three Months      |       | Year Ended  |       |
|----------------------|-------------------|-------|-------------|-------|
|                      | Ended December 31 |       | December 31 |       |
|                      | 2008              | 2007  | 2008        | 2007  |
| Sustaining CAPEX     | 1,527             | 1,268 | 5,902       | 4,599 |
| Capital improvements | 1,676             | 1,875 | 6,881       | 4,800 |
|                      | 3,203             | 3,143 | 12,783      | 9,399 |

Capital improvements are expenditures made in the 18 months following the acquisition of a property to complete any deferred maintenance, capital repairs or additions and to improve the building to meet investment requirements. Capital improvements are generally funded from borrowings associated with the improvement projects.

Sustaining CAPEX represents ongoing expenditures required to maintain the productive capacity of the REIT's portfolio. These include capital expenditures to maintain common areas, HVAC systems, including the additional investment in wood pellet boilers, building envelopes and to refurbish units on tenant turnover. Sustaining CAPEX also includes expenditures to reduce energy consumption. Sustaining CAPEX is generally funded through cash flow from operations. Sustaining CAPEX for the year ended December 31, 2008 was incurred primarily in the residential rental portfolio and on a per door basis represents approximately \$960 per unit.

## 6. TRANSACTIONS WITH RELATED PARTIES

A company owned by a Trustee of NPR leases commercial space from NPR under normal commercial terms. NPR earned rental revenue from that arrangement of \$454,350 for the year ended December 31, 2008 (2007 – \$451,350). Amounts outstanding in accounts receivable pertaining to this lease were \$nil at December 31, 2008 (December 31, 2007 – \$nil).

A Trustee of NPR is a senior partner of a law firm that provides legal services to NPR in the ordinary course of business. Fees paid for the year ended December 31, 2008 were \$41,000 (2007 – \$214,000).

A Trustee of NPR is the Chairman of AgeCare, which leases six seniors' properties from NPR. For the year ended December 31, 2008, NPR earned rental income, including rental revenue earned on a straight-line basis over the term of the lease, totaling \$12.6 million (2007 – \$12.6 million) from AgeCare. Amounts outstanding in accounts receivable pertaining to this lease were \$nil at December 31, 2008 (December 31, 2007 – \$nil). In addition, AgeCare is paid an annual fee for advisory services provided to NPR respecting prospective acquisitions of seniors' properties. For the year ended December 31, 2008, NPR paid \$120,000 for these services (2007 – \$120,000).

In the second quarter of 2008, the REIT commenced renovations to a seniors' facility in BC which is leased to AgeCare. The renovations are being completed under the terms of existing lease agreements and will be recovered from AgeCare over a period not to exceed the remaining term of the lease agreement. The approved budget for the renovation project is \$2.2 million, with \$1.5 million incurred through December 31, 2008.

## 7. PROPOSED AND FUTURE TRANSACTIONS

In connection with the acquisition of certain seniors' properties in Newfoundland, the tenants have agreed to expand or renovate certain properties purchased by NPR. NPR has entered into agreements to purchase these capital improvements and expansions once completed. In total, NPR has commitments totalling \$6.2 million, which are expected to be completed in 2009.

Between January 1, 2009 and March 2, 2009, NPR completed the acquisition of 40 residential rental units and 52 units in seniors' properties, all located in Newfoundland. The combined purchase prices for these acquisitions was \$7.3 million and were financed through a combination of the operating facility, assumption of a mortgage and the issuance of Class B Limited Partnership units.

Between January 1, 2009 and March 2, 2009, NPR completed mortgage financings and renewals totalling \$8.9 million with interest rates from 3.06% to 3.96% and terms to maturity from 2 years to 9 years. Proceeds from the mortgage financings were used to repay existing mortgage debt and a portion of the operating facility.

## 8. CRITICAL ACCOUNTING ESTIMATES

Significant accounting policies for NPR are described in Note 2 to the Annual Consolidated Financial Statements for the year ended December 31, 2008. Management believes the policies which are most subject to estimation and management's judgment are those outlined below.

### Amortization

Amortization is recorded on buildings on a straight-line basis. A significant portion of the acquisition cost of each property is allocated to building. The allocation of the acquisition cost to building and the determination of the useful life are based upon estimates by management. In the event the allocation to building is inappropriate or the estimated useful life of buildings proves incorrect, the computation of amortization will not be appropriately reflected over future periods.

### Property Acquisitions

In accordance with the Canadian Institute of Chartered Accountants ("CICA") 1581 Business Combinations and CICA 3062 Impairment of Long-term Assets, Management is required to perform procedures to determine the fair value of the acquisition and the intangible value of above and below-market leases, as well as the identifiable direct benefits of tenant relationships on a discounted basis. The procedures associated with CICA 1581 and CICA 3062 are subject to estimation and management's judgment. Management allocates acquisition costs to land, building and intangible assets and liabilities based upon the best information available at the time of preparation of the financial statements. Any adjustments to these allocations will be reflected prospectively in subsequent financial statements.



## **8. CRITICAL ACCOUNTING ESTIMATES (continued)**

### **Future Income Taxes**

The calculation of the future income tax assets and liabilities is based on estimated temporary differences between the book value and tax value of NPR's assets and liabilities on January 1, 2011. NPR has recorded a future tax liability of \$39.5 million (December 31, 2007 – \$36.2 million) using expected income tax rates between 19.63% and 29.5%.

### **Impairment of Assets**

Under Canadian GAAP, Management is required to write down to fair value, any investments in income properties that are determined to have been permanently impaired. The fair value of investments in income properties is dependent upon anticipated future cash flows from operations over the anticipated holding period. No provision was recorded in 2007 or 2008.

### **Discontinued Operations**

The financial results of non-core rental properties sold in 2008 and 2007 have not been reclassified as discontinued operations as the results are not material to the financial results of NPR.

### **Unit-based Compensation**

The calculation of unit-based compensation is based on the fair value method, under which compensation expense is measured at the date the options are granted and recognized over the vesting period. The following assumptions were used in calculating the fair value of the options granted: expected annual dividend rate of 6.40%, expected volatility of 18%, risk-free rate of return of 3.10% and expected life of 5 years. Unit-based compensation expense for the three month period ended December 31, 2008 was \$98,000 (2007 - \$nil) and \$631,000 (2007 - \$nil) for the year ended December 31, 2008.

## **9. CHANGE IN ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS**

### **Change in Accounting Policy**

Effective January 1, 2008, NPR adopted CICA Handbook Section 1535, Capital Disclosures. This section requires the disclosure of (i) an entity's objectives, policies and process for managing capital; (ii) quantitative data about an entity's managed capital; (iii) whether an entity has complied with capital requirements; and (iv) if an entity has not complied with such capital requirements, the consequences of such non-compliance.

Effective January 1, 2008, NPR adopted CICA Handbook Section 3862, Financial Instruments – Disclosures and Section 3863 Financial Instruments - Presentation. These sections require incremental disclosures regarding the significance of financial instruments for the REIT's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the REIT is exposed.

Effective January 1, 2008, NPR adopted CICA Handbook Section 3031, Inventory. This section establishes standards for the measurement of inventories, allocation of overhead, accounting for write-downs and disclosures. The new standard has no material impact on the REIT's financial statements.

The new standards will have no impact on the REIT's consolidated financial statements beyond the additional disclosure in the notes to the financial statements.

### **Recent Accounting Pronouncements**

New accounting standards are anticipated regarding the accounting for business combinations. The proposed CICA Exposure draft regarding business combinations may result in a decrease in NPR's earnings during periods in which acquisitions are completed as the proposed accounting standards would require the expensing of acquisition costs (such as legal costs) in connection with a business combination in the period in which they are incurred. Currently, these costs are allocated to the cost of the assets acquired under the business combination and amortized over the expected useful life of the assets.

## **9. CHANGE IN ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS (continued)**

Section 3064, Goodwill and Intangible Assets, will replace the current Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the REIT will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. NPR is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. Management does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

Section 1582 – Business Combinations will replace the current Section 1581 – Business Combinations and Section 1601 – Consolidated Financial Statements and Section 1602 – Non-controlling Interests will replace the current section 1600 – Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. The new standards will require net assets, non-controlling interest and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded such that transactions currently accounted for as an asset acquisition may come within the scope of these Sections. Acquisition costs will no longer be accounted for as part of the consideration and will be expensed when incurred. Management expects that more acquisition transactions will be considered business combinations and acquisition costs will be expensed the statement of net earnings when this section is adopted.

### **International Financial Reporting Standards**

On February 13, 2008 the Accounting Standards Board ("AcSB") confirmed that the transition date to International Financial Reporting Standards ("IFRS") from Canadian GAAP would be January 1, 2011. In April 2008, the AcSB issued an exposure draft proposing to incorporate IFRS into the CICA Handbook as a replacement for current Canadian GAAP for most publicly accountable enterprises including the REIT. NPR will adopt IFRS as the basis for preparing its consolidated financial statements and will provide comparative financial information for the previous fiscal year using IFRS beginning with the quarter ending March 31, 2011. The impact of the adoption of IFRS on the consolidated financial statements of NPR will likely be significant and, as such, NPR has established and budgeted for an IFRS conversion project which began in the latter half of 2008. The project will consist of training and education of the project team; a scoping analysis of NPR's financial statements and the applicable IFRS; implementation and training of accounting and operations staff; the conversion of integrated systems and process changes if required; and a post implementation review.

NPR is currently training its implementation team and evaluating the impact of IFRS on the consolidated financial statements, including the assessment of IFRS 1, First-time Adoption of International Financial Reporting Standards, which provides guidance for the initial adoption of IFRS. The main differences between Canadian GAAP and IFRS identified to date include accounting for investment properties, accounting for joint ventures, impairment testing for assets, accounting for Trust and LP units and financial statement presentation. As part of the implementation, NPR will assess the impact of the IFRS conversion on information systems, Disclosure Controls and Procedures and Internal Controls over Financial Reporting. The International Accounting Standards Board ("IASB") has activities currently underway that may or will, change IFRS and such changes may or will, impact the REIT. NPR will assess any such changes as they occur. NPR is also developing a communication plan to ensure all stakeholders will be informed of the progress made throughout the project.

NPR's financial performance and financial position presented under current GAAP may be significantly different when presented in accordance with IFRS. Management has identified a number of areas that will require a significant amount of time and effort to address in order to meet the required timelines. These areas include potential amendments to the Trust Declaration, certain debt covenants in credit facilities and compensation arrangements.

## **10. DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Disclosure Controls and Procedures are designed and implemented by, or under the supervision of the issuer's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") to ensure that material information relating to the issuer is communicated to them by others in the organization as it becomes known and is appropriately disclosed as required under the continuous disclosure requirements of securities legislation. In essence, these types of controls are related to the quality and timeliness of financial and non-financial information in securities filings. During the year ended December 31, 2008, the effectiveness of the design and operation of our disclosure controls and procedures was evaluated. The evaluation was performed using the COSO control framework (Sponsoring Organizations of the Treadway Commission control framework) adopted by NPR. Based on this evaluation, the CEO and CFO have concluded that NPR's disclosure controls and procedures, as defined in Multilateral Instruments 52-109, Certification of Disclosure in Issuer's Annual and Interim Filings, are effective and ensure that information required to be disclosed in reports that we file or submit under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in those rules and forms.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. A control system, no matter how well designed, can provide only reasonable and not absolute assurance that the objectives of the control system are met. As a result of inherent limitation in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instances of fraud, if any, have been detected.

The CEO and CFO have completed an evaluation of the design and effectiveness of such internal controls over financial reporting as at December 31, 2008. Based on this evaluation, the CEO and CFO have concluded that internal controls over financial reporting were effective as at December 31, 2008. Management believes that the consolidated financial statements included in this report present fairly in all material respects the financial position, results of operations and cash flows for the periods presented.

## **11. ADDITIONAL INFORMATION**

Additional information relating to NPR, including the REIT's annual information return, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

# Management's Responsibility for Financial Statements

To the Unitholders of  
Northern Property Real Estate Investment Trust (the "Trust"):

The accompanying consolidated financial statements and information included in this Annual Report have been prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants. The Management of the Trust is responsible for their integrity and objectivity. To fulfill this responsibility, the Trust maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices and accounting and administrative procedures are of high quality. The financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Deloitte & Touche LLP, the auditors appointed by the unitholders, have examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the consolidated financial statements. Their report as auditors is set forth herein. The consolidated financial statements have been further reviewed and approved by the Board of Trustees and its Audit Committee. The Audit Committee, which is comprised of three trustees who are not officers of the Trust, reports to the Board of Trustees. The auditors have direct and full access to the Audit Committee.



B. James Britton  
*President and Chief Executive Officer*



Todd R. Cook  
*Chief Financial Officer*

## Auditors' Report

To the Unitholders of  
Northern Property Real Estate Investment Trust:

We have audited the consolidated balance sheets of Northern Property Real Estate Investment Trust (the "Trust") as at December 31, 2008 and 2007 and the consolidated statements of earnings and comprehensive earnings, unitholders' equity, and cash flows for the years ended December 31, 2008 and 2007. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years ended December 31, 2008 and 2007 in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta  
February 20, 2009



Chartered Accountants

## CONSOLIDATED BALANCE SHEETS

At December 31

(Thousands of dollars)

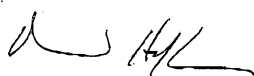
|   | 2008           | 2007           |
|---|----------------|----------------|
| <b>ASSETS</b>                                       |                |                |
| Cash  | 731            | -              |
| Rental properties and other capital assets (Note 4) | 833,967        | 765,447        |
| Capital improvements in progress                    | 3,773          | 1,957          |
| Capital assets under development                    | 8,996          | 1,257          |
| Prepaid expenses and other assets (Note 5)          | 5,664          | 12,893         |
| Accounts receivable (Note 17)                       | 5,085          | 5,059          |
| Tenant security deposits                            | 3,575          | 2,917          |
| Deferred rent receivable                            | 3,248          | 2,039          |
| Loans receivable                                    | 1,742          | 479            |
| Intangible assets (Note 6)                          | 6,141          | 7,062          |
|   | <b>872,922</b> | <b>799,110</b> |
| <b>LIABILITIES</b>                                  |                |                |
| Mortgages and loans payable (Note 7)                | 482,800        | 401,909        |
| Bank indebtedness                                   | -              | 104            |
| Operating facility (Note 8)                         | 26,600         | 25,200         |
| Accounts payable and accrued liabilities            | 15,111         | 13,993         |
| Distributions payable                               | 3,092          | 3,083          |
| Future income tax liability (Note 11)               | 39,489         | 36,183         |
| Intangible liabilities (Note 6)                     | 279            | 571            |
| Non-controlling interest                            | 441            | -              |
|   | <b>567,812</b> | <b>481,043</b> |
| <b>UNITHOLDERS' EQUITY</b>                          | <b>305,110</b> | <b>318,067</b> |
|   | <b>872,922</b> | <b>799,110</b> |

See accompanying notes to the consolidated financial statements.

Guarantees, commitments and contingencies (Note 14)

Subsequent events (Note 19)

APPROVED BY THE BOARD



Dennis J. Hoffman  
Trustee



Todd R. Cook  
Chief Financial Officer

## CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE EARNINGS

Year Ended December 31

(Thousands of dollars, except per unit amounts)

|  | 2008     | 2007     |
|--|----------|----------|
| <b>REVENUE</b>   |          |          |
| Rental revenue   | 124,626  | 102,223  |
| Other property income  | 3,133    | 2,195    |
|  | 127,759  | 104,418  |
| Operating expenses   | (43,454) | (35,752) |
|  | 84,305   | 68,666   |
| <b>EXPENSES</b>  |          |          |
| Interest on mortgages  | (24,499) | (20,380) |
| Amortization   | (26,447) | (22,012) |
|  | (50,946) | (42,392) |
| <b>EARNINGS FROM CONTINUING OPERATIONS BEFORE THE UNDERNOTED</b> | 33,359   | 26,274   |
| Trust administration   | (6,796)  | (5,542)  |
| Interest on operating facility                                   | (1,286)  | (1,565)  |
| Interest and other income  | 509      | 817      |
| Gain on settlement of debt                                       | 558      | 1,454    |
| Gain on sale of rental properties                                | 136      | 3,321    |
| Non-controlling interest   | (63)     | -        |
| <b>EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>   | 26,417   | 24,759   |
| Current taxes (Note 11)  | (409)    | (541)    |
| Future taxes (Note 11)   | (3,306)  | (16,523) |
| <b>EARNINGS FROM CONTINUING OPERATIONS</b>                       | 22,702   | 7,695    |
| <b>LOSS FROM DISCONTINUED OPERATIONS</b>                         | -        | (5)      |
| <b>NET EARNINGS</b>  | 22,702   | 7,690    |
| Other comprehensive earnings                                     | 68       | 55       |
| <b>COMPREHENSIVE EARNINGS</b>                                    | 22,770   | 7,745    |
| <b>Net Earnings per unit (Note 13)</b>                           |          |          |
| <b>Basic and Diluted:</b>  |          |          |
| Continuing operations  | \$0.91   | \$0.34   |
| Discontinued operations  | -        | -        |
|  | \$0.91   | \$0.34   |

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

Year Ended December 31

(Thousands of dollars, except per unit amounts)

|   | 2008             | 2007             |
|---|------------------|------------------|
| <b>TRUST UNITS (Note 12)</b>                    |                  |                  |
| Balance, beginning of year                      | 366,789          | 261,730          |
| Issuance of units                               | -                | 108,750          |
| Issue Costs                                     | (8)              | (4,718)          |
| Long term incentive plan units issued           | 665              | 1,027            |
| <b>Balance, end of year</b>                     | <b>367,446</b>   | <b>366,789</b>   |
| <b>CONTRIBUTED SURPLUS</b>                      |                  |                  |
| Balance, beginning of year                      | 1,023            | 1,249            |
| Unit-based compensation                         | 631              | -                |
| Long term incentive plan units granted          | 687              | 801              |
| Long term incentive plan units issued           | (665)            | (1,027)          |
| <b>Balance, end of year</b>                     | <b>1,676</b>     | <b>1,023</b>     |
| <b>CUMULATIVE DEFICIT</b>                       |                  |                  |
| <b>CUMULATIVE NET EARNINGS</b>                  |                  |                  |
| Balance, beginning of year                      | 63,354           | 55,664           |
| Net earnings                                    | 22,702           | 7,690            |
| <b>Balance, end of year</b>                     | <b>86,056</b>    | <b>63,354</b>    |
| <b>CUMULATIVE DISTRIBUTIONS TO UNITHOLDERS</b>  |                  |                  |
| Balance, beginning of year                      | (113,154)        | (81,463)         |
| Distributions declared to unitholders           | (37,037)         | (31,691)         |
| <b>Balance, end of year</b>                     | <b>(150,191)</b> | <b>(113,154)</b> |
| <b>CUMULATIVE DEFICIT, end of year</b>          | <b>(64,135)</b>  | <b>(49,800)</b>  |
| <b>ACCUMULATED OTHER COMPREHENSIVE EARNINGS</b> |                  |                  |
| Balance, beginning of year                      | 55               | -                |
| Net earnings                                    | 68               | 55               |
| <b>Balance, end of year</b>                     | <b>123</b>       | <b>55</b>        |
| <b>TOTAL UNITHOLDERS' EQUITY</b>                | <b>305,110</b>   | <b>318,067</b>   |

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31

(Thousands of dollars)

|  | 2008      | 2007      |
|--|-----------|-----------|
| <b>CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:</b> |           |           |
| <b>OPERATING</b>                                       |           |           |
| Net earnings from continuing operations                | 22,702    | 7,695     |
| Adjustments for:                                       |           |           |
| Deferred rental revenue                                | (1,209)   | (1,228)   |
| Amortization   | 26,447    | 22,012    |
| Amortization of fair value of debt                     | 560       | 322       |
| Amortization of above and below market leases          | (291)     | (295)     |
| Gain on settlement of debt                             | (558)     | (1,454)   |
| Gain on sale of rental properties                      | (136)     | (3,321)   |
| Non-controlling interest                               | 63        | -         |
| Unit-based compensation                                | 1,318     | 801       |
| Future income taxes                                    | 3,306     | 16,523    |
|  | 52,202    | 41,055    |
| Cash flows used in discontinued operations             | -         | (5)       |
| Changes in non-cash working capital                    | 1,432     | (5,681)   |
|  | 53,634    | 35,369    |
| <b>FINANCING</b>                                       |           |           |
| Proceeds from public offering (net of issue costs)     | (8)       | 100,276   |
| Proceeds from mortgages and loans                      | 144,603   | 73,844    |
| Proceeds from operating facility                       | 1,400     | 2,200     |
| Proceeds from acquisition facility                     | -         | 9,058     |
| Payments from non-controlling interest                 | 377       | -         |
| Repayment of mortgages and loans payable               | (58,659)  | (37,880)  |
| Repayment of acquisition facility                      | -         | (9,058)   |
| Distributions paid to unitholders                      | (37,029)  | (30,940)  |
|  | 50,684    | 107,500   |
| <b>INVESTING</b>                                       |           |           |
| Acquisition of rental properties and other assets      | (65,645)  | (135,152) |
| Proceeds from sale of rental properties                | 395       | 3,904     |
| Capital assets under development                       | (25,450)  | (3,019)   |
| Building capital maintenance                           | (5,902)   | (4,599)   |
| Capital improvements                                   | (6,881)   | (4,800)   |
|  | (103,483) | (143,666) |
| NET INCREASE (DECREASE) IN CASH<br>(BANK INDEBTEDNESS) | 835       | (797)     |
| CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR            | (104)     | 693       |
| CASH (BANK INDEBTEDNESS), END OF YEAR                  | 731       | (104)     |
| <b>SUPPLEMENTARY INFORMATION</b>                       |           |           |
| Interest paid  | 24,444    | 21,270    |
| Interest received                                      | 371       | 348       |
| Income taxes paid                                      | 727       | 415       |

See accompanying notes to the consolidated financial statements.



# Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

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## 1. DESCRIPTION OF THE TRUST

Northern Property Real Estate Investment Trust ("NPR" or the "REIT") is an unincorporated open-ended real estate investment trust that invests in and owns a portfolio of residential and commercial income producing properties.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Basis of presentation

NPR's consolidated financial statements are prepared in conformity with Canadian generally accepted accounting principles ("GAAP").

### Principles of consolidation

The consolidated financial statements include the accounts of NPR and its wholly-owned subsidiary, together with the proportionate share of the assets, liabilities, revenue and expenses of joint ventures.

### Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and to make disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenue and expenses for the consolidated reported period. Actual results could differ from those estimates. Estimates are used to determine amounts reported as allowance for doubtful accounts, estimated useful lives and values of income producing properties, intangible and other assets, accrued liabilities and capital adequacy. Actual amounts could differ from those estimates.

### Capital assets

Rental properties, capital improvements in progress and capital assets under development are stated at the lower of cost less accumulated amortization and net recoverable amount. Cost of the properties includes the original acquisition costs of the property and other acquisition related costs. Costs associated with upgrading the existing facilities, other than ordinary repairs and maintenance, are capitalized as project improvements. The net recoverable amount represents the undiscounted, estimated future net cash flow expected to be received from the ongoing use of the property plus its residual worth and is intended to determine recovery of an investment and is not an expression of a property's fair market value.

All capital assets are recorded at cost and are amortized using the following annual rates and methods:

|                                    |               |                     |
|------------------------------------|---------------|---------------------|
| Buildings                          | 30 - 40 years | straight-line basis |
| Furniture, fixtures and equipment  | 20% - 30%     | declining-balance   |
| Vehicles                           | 20% - 30%     | declining-balance   |
| Capital and leasehold improvements | 3 - 20 years  | straight-line basis |

Estimated useful lives of capital assets are periodically evaluated by management and any changes in these estimates are accounted for on a prospective basis.

NPR reviews its capital assets and, if it is determined that the carrying value of a building exceeds the undiscounted estimated future net cash flow expected to be received from the ongoing use and residual worth of the property, the carrying value of the building is reduced to its estimated fair value. Based on this review, a provision for impairment of \$nil has been recorded for the year ended December 31, 2008 (December 31, 2007 - \$nil).

### Disposal of long-lived assets

Amounts related to the disposal of long-lived assets are classified as held for sale, and the results of operations and cash flows associated with the assets disposed are reported separately as discontinued operations, less applicable income taxes. A long-lived asset is classified as an asset held for sale at the point in time when it is available for immediate sale, management has committed to a plan to sell the asset and are actively locating a buyer for the asset at a sales price that is reasonable in relation to the current fair value of the asset, and the sale is probable and is expected to be completed within a one-year period. For unsolicited interest in a long-lived asset, the asset is classified as held for sale only if all the conditions of the purchase and sale agreement have been met, a sufficient purchaser deposit has been received and the sale is probable and expected to be completed shortly after the end of the current period.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

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### 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Land equity leases

Prepaid land equity leases are amortized over the remaining lives of the related leases ranging from 15 to 30 years.

#### Deferred financing costs

Deferred financing costs are amortized using the effective interest method over the amortization period of the related loans.

#### Income taxes

NPR is taxed as a "mutual fund trust" for income tax purposes. Pursuant to the Declaration of Trust, the trustees of NPR will make distributions or designate all taxable income earned; including the taxable part of net realized capital gains by NPR, to unitholders and will deduct such distributions and designations for income tax purposes.

Income taxes are accounted for using the liability method. Under this method, future income taxes are recognized for the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. Future income taxes are computed using substantively enacted corporate income tax rates for the years in which tax and accounting basis differences are expected to reverse.

Future income tax liabilities of NPR are primarily in relation to tax and accounting base differences in corporate subsidiaries of the REIT.

#### Revenue recognition

Revenue from a rental property is recognized when a tenant commences occupancy of a property and rent is due. NPR retains all benefits and risk of ownership of its rental properties, and therefore, accounts for leases with its tenants as operating leases. Rental revenue includes rent and other sundry revenue recoveries. Rental revenue to be received from leases with rental rates varying over the term of the lease is recorded on a straight-line basis over the term of the associated lease. Accordingly, a receivable amount from the tenants for the difference between the rental revenue recorded on a straight line basis and the rent that is contractually due from the tenant has been recorded as deferred rent receivable for accounting purposes.

#### Intangible assets and liabilities

The REIT allocates the purchase price of real property to land, building, and intangible assets and liabilities, such as the value of above-market and below-market leases, in-place leases and lease origination costs, if any. Intangible assets and liabilities are recorded at cost and amortized over their estimated useful lives ranging from 1 year to 18 years.

The values of above-market and below-market leases for acquired properties are determined based on the present value of the difference between the contractual base rentals under the lease and fair market lease rates for similar in-place leases, measured from the date of acquisition to the end of the remaining lease term.

The values of in-place leases are calculated as the present value of the net operating income lost during a hypothetical expected lease-up period required to replace the existing leases at the date of purchase.

Intangible assets and liabilities associated with the acquisition of real property are amortized over the remaining term of the associated lease. Above and below market leases are amortized to rental revenue. The amortization of the remaining intangible assets are included in amortization expense.

#### Unit-based Compensation

Under the REIT's Long Term Incentive Plan, the fair value of the units granted to trustees, officers and employees is recognized as compensation expense with an offsetting amount to contributed surplus based on the closing price of the REIT's trust units on December 31 of the fiscal year. Upon issuance in accordance with the vesting policy, the units issued are credited to capital with an offsetting amount to contributed surplus based on the fair value of the units at the time of the grant.

Under the REIT's Unit Option Plan, options to acquire units are granted to trustees, officers and employees from time to time at exercise prices not less than the market value of the shares at the date of the grant. Options granted by the REIT are accounted for in accordance with the fair-value method of accounting for stock-based compensation, and as such, the calculated fair value of the option is recognized as compensation expense with an offsetting amount recorded to contributed surplus, based on an estimate of the fair value using a Black-Scholes option-pricing model. Compensation expense is recognized over the vesting period of the related options.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

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### 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Upon exercise of the options, consideration paid, which approximates the market value of the shares on grant date, is credited to capital. In addition, contributed surplus, representing the calculated fair value of the options exercised, is reclassified to capital. Forfeitures of options are accounted for as they occur.

### 3. CHANGE IN ACCOUNTING POLICY AND RECENT ACCOUNTING PRONOUNCEMENTS

#### Change in accounting policy

Effective January 1, 2008, NPR adopted CICA Handbook Section 1535, Capital Disclosures. This section requires the disclosure of (i) an entity's objectives, policies and process for managing capital; (ii) quantitative data about an entity's managed capital; (iii) whether an entity has complied with capital requirements; and (iv) if an entity has not complied with such capital requirements, the consequences of such non-compliance. This information has been presented in Note 18.

Effective January 1, 2008, NPR adopted CICA Handbook Section 3862, Financial Instruments - Disclosures and Section 3863 Financial Instruments - Presentation. These sections require incremental disclosures regarding the significance of financial instruments for the REIT's financial position and performance; and the nature, extent and management of risks arising from financial instruments to which the REIT is exposed. This information has been presented in Note 17.

Effective January 1, 2008, NPR adopted CICA Handbook Section 3031, Inventory. This section establishes standards for the measurement of inventories, allocation of overhead, accounting for write-downs and disclosures.

These new standards have no material impact on the REIT's consolidated financial statements beyond additional disclosure in the notes to the financial statements.

#### Recent accounting pronouncements

New accounting standards are anticipated regarding the accounting for business combinations. The proposed CICA Exposure draft regarding business combinations may result in a decrease in NPR's earnings during periods in which acquisitions are completed as the proposed accounting standards would require the expensing of acquisition costs (such as legal costs) in connection with a business combination in the period in which they are incurred. Currently these costs are allocated to the cost of the assets acquired under the business combination and amortized over the expected useful life of the assets.

Section 3064, Goodwill and Intangible Assets, will replace the current Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the REIT will adopt the new standards for its fiscal year beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. NPR is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements. Management does not expect that the adoption of this new Section will have a material impact on its consolidated financial statements.

Section 1582 – Business Combinations will replace the current Section 1581 – Business Combinations and Section 1601 – Consolidated Financial Statements and Section 1602 – Non-controlling Interests will replace the current section 1600 – Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. The new standards will require net assets, non-controlling interest and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded such that transactions currently accounted for as an asset acquisition may come within the scope of these Sections. Acquisition costs will no longer be accounted for as part of the consideration and will be expensed when incurred. Management expects that more acquisition transactions will be considered business combinations and acquisition costs will be expensed the statement of net earnings when this section is adopted.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

### 3. CHANGE IN ACCOUNTING POLICY AND RECENT ACCOUNTING PRONOUNCEMENTS (continued)

The adoption of International Financial Reporting Standards ("IFRS") will be effective for the interim and annual reporting periods beginning on or after January 1, 2011 for Canadian publicly accountable profit oriented enterprises. IFRS will replace current Canadian GAAP for these enterprises requiring the preparation of financial statements in accordance with IFRS for financial years beginning on or after January 1, 2011. NPR will adopt IFRS as the basis for preparing its consolidated financial statements and will provide comparative financial information for the previous fiscal year using IFRS beginning with the quarter ending March 31, 2011. NPR will also provide an opening balance sheet as at January 1, 2010. NPR has established and budgeted for an IFRS conversion project which began during the year ended December 31, 2008. The project will consist of training and education of the project team; a scoping analysis of NPR's financial statements and the applicable IFRS; implementation and training of accounting and operations staff; the conversion of integrated systems and process changes if required; and a post implementation review. NPR is currently in the scoping analysis phase of evaluating the impact of IFRS to the consolidated financial statements. Any changes to integrated systems or process changes may require changes to NPR's Disclosure Controls and Procedures and Internal Controls over Financial Reporting. The REIT's financial performance and financial position presented under current GAAP may be significantly different when presented in accordance with IFRS. The Canadian Securities Administrators issued Staff Notice 52-321, Early Adoption of International Financial Reporting Standards, which provides issuers with the option to early adopt IFRS effective January 1, 2009. NPR does not intend to early adopt these standards on January 1, 2009.

### 4. RENTAL PROPERTIES AND OTHER CAPITAL ASSETS

|                                    | December 31, 2008 |                          |                | December 31, 2007 |                          |                |
|------------------------------------|-------------------|--------------------------|----------------|-------------------|--------------------------|----------------|
|                                    | Cost              | Accumulated Amortization | Net Book Value | Cost              | Accumulated Amortization | Net Book Value |
| Land                               | 90,676            | -                        | 90,676         | 82,332            | -                        | 82,332         |
| Buildings                          | 800,612           | (76,187)                 | 724,425        | 724,355           | (55,525)                 | 668,830        |
| Furniture, fixtures and equipment  | 9,006             | (3,757)                  | 5,249          | 6,942             | (2,767)                  | 4,175          |
| Vehicles                           | 1,193             | (732)                    | 461            | 1,050             | (561)                    | 489            |
| Capital and leasehold improvements | 23,026            | (9,870)                  | 13,156         | 16,317            | (6,758)                  | 9,559          |
| Equipment under capital lease      | 212               | (212)                    | -              | 212               | (150)                    | 62             |
|                                    | 924,725           | (90,758)                 | 833,967        | 831,208           | (65,761)                 | 765,447        |

NPR periodically reviews the carrying value of its rental properties and, if it is determined that the carrying value of a building exceeds the undiscounted estimated future net cash flow expected to be received from the ongoing use and residual worth of the property, the carrying value of the building is reduced to its estimated fair value. No provision was recorded in 2007 or 2008.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

### 4. RENTAL PROPERTIES AND OTHER CAPITAL ASSETS (continued)

NPR acquired properties and completed development projects in the year ended December 31, 2008 for a total purchase price of \$80.4 million (2007 – \$189.7 million). The acquisitions and development projects were financed as follows:

|  | 2008   | 2007    |
|--|--------|---------|
| Mortgages and debt assumed                                     | -      | 51,788  |
| Class B LP Units issued  | -      | 3,728   |
| Cash paid  | 80,391 | 134,185 |
|  | 80,391 | 189,701 |
| Fair value adjustment to debt                                  | -      | 331     |
| Future tax liability recognized on acquisition                 | -      | 9,475   |
| Total purchase price of property acquisitions and developments | 80,391 | 199,507 |
| Residential units  | 724    | 683     |
| Seniors' units   | 94     | 332     |
|  | 818    | 1,015   |
| Commercial square feet   | 40,233 | 386,449 |

During the year ended December 31, 2008, NPR disposed of two properties for gross proceeds of \$395,000 and a gain on sale of \$136,000.

### 5. PREPAID EXPENSES AND OTHER ASSETS

|   | 2008  | 2007   |
|---|-------|--------|
| Refundable deposits and mortgage proceeds held in trust | 185   | 7,998  |
| Prepaid equity leases                                   | 2,167 | 2,339  |
| Prepaid expenses  | 2,812 | 2,047  |
| Other   | 500   | 509    |
|   | 5,664 | 12,893 |

### 6. INTANGIBLE ASSETS AND LIABILITIES

|                         | 2008  |                          |                | 2007  |                          |                |
|-------------------------|-------|--------------------------|----------------|-------|--------------------------|----------------|
|                         | Cost  | Accumulated Amortization | Net Book Value | Cost  | Accumulated Amortization | Net Book Value |
| Above-market leases     | 173   | (114)                    | 59             | 313   | (97)                     | 216            |
| In-place leases         | 6,565 | (1,588)                  | 4,977          | 6,134 | (672)                    | 5,462          |
| Lease origination costs | 1,669 | (564)                    | 1,105          | 1,570 | (186)                    | 1,384          |
|                         | 8,407 | (2,266)                  | 6,141          | 8,017 | (955)                    | 7,062          |
| Below-market leases     | 1,220 | (941)                    | 279            | 1,203 | (632)                    | 571            |

Intangible assets are comprised of the value of above-market leases, in-place leases and lease origination costs for rental property acquisitions completed. Intangible liabilities are comprised of the value of below-market leases for rental property acquisitions completed.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

### 7. MORTGAGES AND LOANS PAYABLE

|                             | 2008           | 2007           |
|-----------------------------|----------------|----------------|
| Mortgages and loans payable | 502,277        | 416,334        |
| Fair value adjustment       | (8,574)        | (8,379)        |
| Deferred financing costs    | (10,903)       | (6,046)        |
|                             | <b>482,800</b> | <b>401,909</b> |

Mortgages and loans payable bear interest at rates ranging from 3.62% to 12.13% and have a weighted average rate of 5.13% as at December 31, 2008 (December 31, 2007 – 5.39%). Mortgages and loans are payable in monthly installments of blended principal and interest of approximately \$3.4 million. The mortgages mature between 2009 and 2025 and are secured by charges against specific properties. Land and buildings with a carrying value of \$686.3 million have been pledged to secure mortgages and loans payable of the REIT. The fair value of mortgages payable at December 31, 2008 is approximately \$517.7 million (December 31, 2007 – \$408.9 million).

Minimum future principal payments required are as follows:

|            |                |
|------------|----------------|
| 2009       | 62,989         |
| 2010       | 28,405         |
| 2011       | 32,212         |
| 2012       | 44,224         |
| 2013       | 90,355         |
| Subsequent | 244,092        |
|            | <b>502,277</b> |

### 8. OPERATING FACILITY

NPR has a revolving line of credit in the amount of \$50.0 million (December 31, 2007 - \$40.0 million) for acquisition and operating purposes, bearing interest at prime or bankers' acceptance rate with a maturity of May 31, 2009. Specific properties with a carrying value of \$86.5 million have been pledged as collateral security for the line of credit. At December 31, 2008, NPR had utilized \$26.6 million (December 31, 2007 – \$25.2 million).

### 9. LONG-TERM INCENTIVE PLAN AND UNIT OPTION PLAN

NPR has a Long-Term Incentive Plan ("LTIP") for the executives of NPR, based on the results of each fiscal year. Units granted and issued under the LTIP are as follows:

|  | Number of Units |
|--|-----------------|
| Balance – December 31, 2007              | 43,586          |
| Units vested and issued – January, 2008  | (6,033)         |
| Units vested and issued – February, 2008 | (11,592)        |
| Units vested and issued – May, 2008      | (11,931)        |
| Units granted – December 31, 2008        | 42,410          |
| <b>Balance – December 31, 2008</b>       | <b>56,440</b>   |

The total amount of LTIP awards are determined at the end of each fiscal year by the Board of Trustees based on an assessment of the performance of the REIT and the individual performance of the executives. The number of units issued is based on the trading price on December 31 of each year. Pursuant to the policy, rights to units generally vest in 1/3 tranches: immediately upon award, then 12 and 24 months following. As at December 31, 2008, a total of 155,219 LTIP units had vested and been issued (December 31, 2007 – 125,663).

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

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### 9. LONG-TERM INCENTIVE PLAN AND UNIT OPTION PLAN (continued)

The REIT has a Unit Option Plan (the "Option Plan"), which is subject to the rules of the Toronto Stock Exchange ("TSX"). In accordance with the Option Plan, the REIT may grant options to acquire units up to a total of 1,830,429 units. All options to acquire units expire after 5 years and vest as determined by the Governance and Compensation Committee of the REIT. The exercise price is determined using the weighted average trading price of the units on the five days prior to the options being granted.

On May 20, 2008, 735,000 options with an exercise price of \$23.12 and expiring on May 20, 2013 were granted to trustees and officers. 245,002 options vested immediately, 245,001 options will vest on May 20, 2009 and 244,997 will vest on May 20, 2010. All options remain outstanding at December 31, 2008.

The REIT accounts for its Option Plan using the fair value method, under which compensation expense is measured at the date the options are granted and recognized over the vesting period. The following assumptions were used in calculating the fair value of the options granted: expected annual dividend rate of 6.40%, expected volatility of 18%, risk-free rate of return of 3.10% and expected life of 5 years. Compensation expense for the year ended December 31, 2008 relating to options granted was \$631,000 (2007 – \$nil).

### 10. EMPLOYEE UNIT PURCHASE PLAN

Under the terms of the Employee Unit Purchase Plan (the "EUPP"), employees may invest a maximum of 5% of their salary in NPR trust units and the REIT will contribute one unit for every three units acquired by an employee. The units are purchased on the TSX at market prices. During the year ended December 31, 2008, employees invested a total of \$115,562 (2007 – \$94,221) and the REIT contributed \$38,555 (2007 – \$32,644). During the year ended December 31, 2008, 7,974 units (2007 – 5,749 units) were purchased at an average cost of \$20.65 per unit (2007 – \$23.77 per unit).

### 11. INCOME TAXES

NPR has certain corporate subsidiaries which are subject to income tax on their respective taxable income at the applicable legislated tax rates.

On June 22, 2007, the Budget Implementation Act, 2007, Bill C-52 ("Bill C-52") received Royal Assent. Bill C-52 will not apply to an entity that qualifies for the real estate investment trust exemption (the "REIT Exemption"). Where an entity does not qualify for the REIT Exemption certain distributions will not be deductible in computing income for tax purposes and will be subject to tax on such distributions at a rate comparable to the general corporate income tax rate. Bill C-52 provides for a transition period for publicly traded entities that existed prior to November 1, 2006 and is not expected to apply to NPR until 2011.

GAAP requires NPR to recognize future income tax assets and liabilities based on estimated temporary differences expected as at January 1, 2011. Under the current legislation, NPR does not appear to qualify for the REIT Exemption. The future income tax provision arises from temporary differences between the estimated accounting and tax values of NPR's assets and liabilities at January 1, 2011 and has been calculated using the expected tax rates of 19.63% to 29.5%.

NPR has certain capital assets which have a lower tax value than their applicable accounting value. NPR has therefore recorded a future tax liability of \$39.5 million (December 31, 2007 – \$36.2 million) using an expected income tax rate ranging from 19.63% to 29.5% (2007 – 19.63% to 29.5%).

## Notes to the Consolidated Financial Statements

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(Columnar amounts expressed in thousands of dollars except where indicated)

### 11. INCOME TAXES (continued)

The future tax liabilities arise from the temporary differences summarized below:

|  | 2008          | 2007          |
|--|---------------|---------------|
| Future tax liabilities arising from temporary differences between accounting and tax basis of: |               |               |
| Rental property assets in corporate subsidiaries   | 9,614         | 10,007        |
| Acquisition of rental property assets in a business combination                                | 9,476         | 9,476         |
| Rental properties  | 15,487        | 14,702        |
| Prepaid mortgages  | 981           | 617           |
| Other assets   | 3,931         | 1,381         |
|  | <b>39,489</b> | <b>36,183</b> |

The provision for income taxes differs from the results which would be obtained by applying the combined federal and provincial income tax rate to net income before taxes. The difference results from the following:

|  | 2008         | 2007          |
|--|--------------|---------------|
| Earnings from continuing operations before income taxes          | 26,417       | 24,759        |
| Loss from discontinued operations                                | -            | (5)           |
|  | 26,417       | 24,754        |
| Less income attributable to NPR not subject to future income tax | (24,529)     | (23,417)      |
| Income in corporate subsidiaries                                 | 1,888        | 1,337         |
| Income tax rate based on basic and weighted average rates        | 19.63%       | 20.75%        |
| Expected income tax expense from statutory income tax rate       | 371          | 277           |
| Increase (decrease) in current taxes resulting from:             |              |               |
| Non-deductible expenses  | (88)         | (3)           |
| Sale of rental properties  | 9            | 325           |
| Other  | 117          | (58)          |
| Current income tax expense                                       | 409          | 541           |
| Increase (decrease) in future taxes resulting from:              |              |               |
| Future income taxes - corporate subsidiaries                     | (394)        | (172)         |
| Decrease in future income tax rates                              | -            | (567)         |
| Future income taxes relating to Bill-C52                         | 3,700        | 16,700        |
| Adjustment to future income tax liabilities, and other           | -            | 562           |
| Future income tax expense  | 3,306        | 16,523        |
| Total income tax expense   | <b>3,715</b> | <b>17,064</b> |



## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

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### 12. UNITHOLDERS' CAPITAL

Total NPR Trust units and Class B units issued, as the result of an exchange of Class B limited partnership units of Northern Property Limited Partnership (the "Class B LP Units"), outstanding and eligible for distributions at December 31, 2008 is 25,033,645 (December 31, 2007 – 25,004,089), representing net proceeds of \$367.5 million, net of issue costs of \$19.6 million (December 31, 2007 - \$366.8 million, net of issue costs of \$19.6 million). The number of units issued and outstanding is as follows:

| Date                       | Description          | Trust Units | Issue Price | Class B LP Units | Issue Price | Units      | Total \$(000's) |
|----------------------------|----------------------|-------------|-------------|------------------|-------------|------------|-----------------|
| December 31, 2006          |                      | 17,852,667  |             | 2,423,623        |             | 20,276,290 | 261,730         |
| January 04, 2007           | LTIP units issued    | 19,858      | \$17.70     | -                | -           | 19,858     | 353             |
| February 16, 2007          | LTIP units issued    | 8,139       | \$27.95     | -                | -           | 8,139      | 227             |
| May 01, 2007               | Property acquisition | -           | -           | 78,033           | \$25.63     | 78,033     | 2,000           |
| May 08, 2007               | Property acquisition | -           | -           | 38,986           | \$25.65     | 38,986     | 1,000           |
| May 08, 2007               | Issue costs          | -           | -           | -                | -           | -          | (13)            |
| May 16, 2007               | LTIP units issued    | 1,597       | \$27.95     | -                | -           | 1,597      | 45              |
| June 21, 2007              | LTIP units issued    | 16,317      | \$24.00     | -                | -           | 16,317     | 393             |
| July 7, 2007               | LTIP units issued    | 750         | \$11.99     | -                | -           | 750        | 9               |
| July 11, 2007              | Public offering      | 4,532,000   | \$23.17     | -                | -           | 4,532,000  | 105,006         |
| July 11, 2007              | Issue costs          | -           | -           | -                | -           | -          | (4,587)         |
| November 1, 2007           | Property acquisition | -           | -           | 32,119           | \$23.17     | 32,119     | 744             |
| November 1, 2007           | Issue costs          | -           | -           | -                | -           | -          | (118)           |
| Class B LP units exchanged |                      | 105,660     | -           | (105,660)        | -           | -          | -               |
| December 31, 2007          |                      | 22,536,988  |             | 2,467,101        |             | 25,004,089 | 366,789         |
| January 02, 2008           | LTIP units issued    | 6,033       | \$23.12     | -                | -           | 6,033      | 139             |
| February 16, 2008          | LTIP units issued    | 11,592      | \$22.35     | -                | -           | 11,592     | 259             |
| May 26, 2008               | LTIP units issued    | 11,931      | \$22.35     | -                | -           | 11,931     | 267             |
|                            | Issue costs          | -           | -           | -                | -           | -          | (8)             |
| Class B LP units exchanged |                      | 188,466     | -           | (188,466)        | -           | -          | -               |
| December 31, 2008          |                      | 22,755,010  |             | 2,278,635        |             | 25,033,645 | 367,446         |

#### Trust units

The total authorized number of trust units is unlimited. The total number of trust units of the REIT outstanding as at December 31, 2008 is 22,755,010 (December 31, 2007 – 22,536,988) representing a net book value of \$338.3 million (December 31, 2007 - \$334.5 million), net of issue costs.

#### Class B Exchangeable Limited Partnership Units and Special Voting Units

The Class B Units can be exchanged for trust units at any time at the option of the holder of the Class B units. Each Class B units has a "Special Voting Unit" attached to it, which entitles the holder to one vote, either in person or by proxy at the meeting of unitholders of the trust as if he or she was a unitholders of the trust. Total number of Class B LP Units and special voting units of Northern Property Limited Partnership, a controlled limited partnership, outstanding as at December 31, 2008, is 2,278,635 (December 31, 2007 – 2,467,101) representing a net book value of \$29.1 million (December 31, 2007 – \$32.3 million).

#### Distributions to unitholders

Pursuant to the Trust Declaration, holders of Trust units and Class B units are entitled to receive distributions made on each Distribution Date as approved by the Trustees. Distributions for the year are required to be at least equal to the Net Income as determined in accordance with the Income Tax Act.

## Notes to the Consolidated Financial Statements

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(Columnar amounts expressed in thousands of dollars except where indicated)

### 13. NET EARNINGS PER UNIT

|  | 2008       | 2007       |
|--|------------|------------|
| Earnings from continuing operations                          | 22,702     | 7,695      |
| Loss from discontinued operations                            | -          | (5)        |
| Net earnings   | 22,702     | 7,690      |
| Weighted average units for basic earnings per unit           | 25,027,697 | 22,556,774 |
| Effect of dilutive units to be issued in respect of the LTIP | 19,978     | 18,619     |
| Dilutive effect of Option Plan                               | 13,270     | -          |
| Weighted average units for diluted Earnings per unit         | 25,060,945 | 22,575,393 |
| Net earnings per unit:                                       |            |            |
| <b>Basic:</b>  |            |            |
| Continuing operations  | \$0.91     | \$0.34     |
| Discontinued operations                                      | -          | -          |
|  | \$0.91     | \$0.34     |
| <b>Diluted:</b>  |            |            |
| Continuing operations  | \$0.91     | \$0.34     |
| Discontinued operations                                      | -          | -          |
|  | \$0.91     | \$0.34     |

### 14. GUARANTEES, COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, NPR may provide indemnification commitments to counterparties in transactions such as credit facilities, leasing transactions, service arrangements, director and officer indemnification agreements and sales of assets. These indemnification agreements may require NPR to compensate the counterparties for costs incurred as a result of changes in laws and regulations (including tax legislation) or as a result of litigation claims or statutory sanctions that may be suffered by counterparties as a consequence of the transaction. The terms of these indemnification agreements may vary based on the contract and do not provide any limit on the maximum potential liability. To date, NPR has not made any significant payments under such indemnifications and no amount has been accrued in the financial statements with respect to these indemnification commitments. In the normal course of operations, NPR becomes subject to various legal and other claims. Management and its legal counsel evaluate these claims and where required, accrue the best estimate of costs relating to these claims. Management believes the outcome of claims of this nature at December 31, 2008 will not have a material impact on NPR.

During the normal course of operations, NPR provided guarantees for mortgages and loans payable relating to investments in corporations and joint ventures where NPR owns less than 100%. The mortgages and loans payable are secured by specific charges against the properties owned by the corporations and joint ventures. In the event of a default of the corporation or joint venture, NPR may be liable for 100% of the outstanding balances of these mortgages and loans payable. At December 31, 2008, NPR has provided guarantees totaling \$10.4 million (December 31, 2007 – \$14.4 million). Of this amount, \$5.2 million has been included in mortgages and loans payable (December 31, 2007 – \$7.2 million). The mortgages bear interest at rates ranging from 4.54% to 7.9% and mature June 2009 to December 2013 (December 2007 – 4.54% to 7.50% and mature June 2008 to January 2012). As at December 31, 2008, land and buildings with a carrying value of \$6.5 million have been pledged to secure these mortgage and loans payable.

NPR commenced the development of 189 multi-family residential rental units located in Grande Prairie, Alberta on land previously acquired by NPR. The estimated total cost of construction, including the original cost of land, is approximately \$22.9 million. Costs incurred to December 31, 2008 are \$11.8 million, including the original cost of the land.

In connection with the acquisition of certain seniors' properties in Newfoundland, the tenants have agreed to expand or renovate certain properties purchased by NPR. NPR has entered into agreements to purchase these capital improvements and expansions once completed. In total, NPR has commitments totalling \$6.2 million, which are expected to be completed in 2009.

## Notes to the Consolidated Financial Statements

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### 15. SEGMENTED INFORMATION

NPR considers residential multi-family, executives, seniors' and commercial income producing properties to be separate segments operating in five provinces and territories in Canada. The accounting policies of the segments are as described in Note 2. Discontinued operations are not allocated to individual segments. All items, except gain on sale of rental properties and gain on settlement of debt, included in the Consolidated Statement of Earnings are related only to the REIT and are not allocated to the defined segments. As such, NPR has not provided a reconciliation of Earnings from Continuing Operations Before Other Items to Net Earnings. In 2007 and 2008, gain on sale of rental properties was earned in the residential rental and commercial business segments in Nunavut and the Northwest Territories, respectively. Gain (loss) on settlement of debt was earned in the residential business segments in all geographic segments. Segmented information for NPR is provided below:

| <b>Total Assets</b>      |                |                |                |                |                |                |
|--------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>December 31, 2008</b> | Alberta        | BC             | Nfld           | NWT            | Nunavut        | Total          |
| Residential              |                |                |                |                |                |                |
| Multi-family             | 161,176        | 90,384         | 56,109         | 86,323         | 115,131        | 509,123        |
| Execusuites              | -              | -              | 9,495          | 8,019          | 9,853          | 27,367         |
| Seniors'                 | 123,794        | 15,710         | 40,965         | -              | -              | 180,469        |
|                          | 284,970        | 106,094        | 106,569        | 94,342         | 124,984        | 716,959        |
| Commercial               | 8,912          | 21,409         | 1,222          | 97,868         | 20,992         | 150,403        |
| Trust                    | 5,560          | -              | -              | -              | -              | 5,560          |
| <b>TOTAL ASSETS</b>      | <b>299,442</b> | <b>127,503</b> | <b>107,791</b> | <b>192,210</b> | <b>145,976</b> | <b>872,922</b> |

| <b>Total Assets</b>      |                |               |                |                |                |                |
|--------------------------|----------------|---------------|----------------|----------------|----------------|----------------|
| <b>December 31, 2007</b> | Alberta        | BC            | Nfld           | NWT            | Nunavut        | Total          |
| Residential              |                |               |                |                |                |                |
| Multi-family             | 119,189        | 60,875        | 55,963         | 88,633         | 122,730        | 447,390        |
| Execusuites              | -              | -             | 9,921          | 7,438          | 10,015         | 27,374         |
| Seniors'                 | 126,006        | 14,238        | 32,923         | -              | -              | 173,167        |
|                          | 245,195        | 75,113        | 98,807         | 96,071         | 132,745        | 647,931        |
| Commercial               | 11,423         | 21,872        | 1,273          | 87,980         | 23,281         | 145,829        |
| Trust                    | 5,350          | -             | -              | -              | -              | 5,350          |
| <b>TOTAL ASSETS</b>      | <b>261,968</b> | <b>96,985</b> | <b>100,080</b> | <b>184,051</b> | <b>156,026</b> | <b>799,110</b> |

| <b>Geographic Segments</b>                                    |              |              |              |              |              |               |
|---|--------------|--------------|--------------|--------------|--------------|---------------|
| <b>2008</b>   | Alberta      | BC           | Nfld         | NWT          | Nunavut      | Total         |
| Rental revenue  | 32,875       | 14,082       | 16,252       | 36,556       | 24,861       | 124,626       |
| Other income  | 830          | 427          | 432          | 1,097        | 347          | 3,133         |
| Operating expenses  | (6,960)      | (6,145)      | (5,901)      | (16,851)     | (7,597)      | (43,454)      |
| Net operating income  | 26,745       | 8,364        | 10,783       | 20,802       | 17,611       | 84,305        |
| Interest on mortgages   | (9,814)      | (2,452)      | (2,372)      | (5,464)      | (4,397)      | (24,499)      |
| Amortization  | (6,940)      | (3,254)      | (3,210)      | (7,246)      | (5,797)      | (26,447)      |
| <b>EARNINGS FROM CONTINUING OPERATIONS BEFORE OTHER ITEMS</b> | <b>9,991</b> | <b>2,658</b> | <b>5,201</b> | <b>8,092</b> | <b>7,417</b> | <b>33,359</b> |

## Notes to the Consolidated Financial Statements

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(Columnar amounts expressed in thousands of dollars except where indicated)

### 15. SEGMENTED INFORMATION (continued)

#### Geographic Segments

| 2007   | Alberta | BC      | Nfld    | NWT      | Nunavut | Total    |
|--|---------|---------|---------|----------|---------|----------|
| Rental revenue   | 27,337  | 10,080  | 12,479  | 28,082   | 24,245  | 102,223  |
| Other income   | 562     | 293     | 381     | 727      | 232     | 2,195    |
| Operating expenses                                     | (5,205) | (4,642) | (5,725) | (13,302) | (6,878) | (35,752) |
| Net operating income                                   | 22,694  | 5,731   | 7,135   | 15,507   | 17,599  | 68,666   |
| Interest on mortgages                                  | (8,026) | (1,584) | (1,969) | (4,301)  | (4,500) | (20,380) |
| Amortization   | (5,934) | (2,088) | (2,301) | (5,702)  | (5,987) | (22,012) |
| EARNINGS FROM CONTINUING OPERATIONS BEFORE OTHER ITEMS | 8,734   | 2,059   | 2,865   | 5,504    | 7,112   | 26,274   |

#### Business Segments

| 2008   | Multi-family | Execusuites | Seniors' | Total Residential | Commercial | Total    |
|--|--------------|-------------|----------|-------------------|------------|----------|
| Rental revenue   | 77,162       | 8,369       | 16,494   | 102,025           | 22,601     | 124,626  |
| Other income   | 2,677        | 128         | -        | 2,805             | 328        | 3,133    |
| Operating expenses                                     | (30,389)     | (4,270)     | (23)     | (34,682)          | (8,772)    | (43,454) |
| Net operating income                                   | 49,450       | 4,227       | 16,471   | 70,148            | 14,157     | 84,305   |
| Interest on mortgages                                  | (14,631)     | (872)       | (6,286)  | (21,789)          | (2,710)    | (24,499) |
| Amortization   | (16,374)     | (1,035)     | (4,217)  | (21,626)          | (4,821)    | (26,447) |
| EARNINGS FROM CONTINUING OPERATIONS BEFORE OTHER ITEMS | 18,445       | 2,320       | 5,968    | 26,733            | 6,626      | 33,359   |

#### Business Segments

| 2007   | Multi-family | Execusuites | Seniors' | Total Residential | Commercial | Total    |
|--|--------------|-------------|----------|-------------------|------------|----------|
| Rental revenue   | 65,834       | 7,920       | 14,159   | 87,913            | 14,310     | 102,223  |
| Other income   | 1,942        | 118         | -        | 2,060             | 135        | 2,195    |
| Operating expenses                                     | (26,736)     | (3,827)     | (19)     | (30,582)          | (5,170)    | (35,752) |
| Net operating income                                   | 41,040       | 4,211       | 14,140   | 59,391            | 9,275      | 68,666   |
| Interest on mortgages                                  | (11,623)     | (795)       | (6,198)  | (18,616)          | (1,764)    | (20,380) |
| Amortization   | (13,732)     | (1,146)     | (3,673)  | (18,551)          | (3,461)    | (22,012) |
| EARNINGS FROM CONTINUING OPERATIONS BEFORE OTHER ITEMS | 15,685       | 2,270       | 4,269    | 22,224            | 4,050      | 26,274   |

### 16. RELATED PARTY TRANSACTIONS

A Trustee of NPR leases space from NPR under normal commercial terms. NPR earned rental revenue of \$454,350 from that arrangement for the year ended December 31, 2008 (2007 – \$451,350). Amounts outstanding in accounts receivable pertaining to this lease were \$nil at December 31, 2008 (December 31, 2007 – \$nil).

A Trustee of NPR is a senior partner of a law firm that provides legal services to NPR in the ordinary course of business. Fees paid for the year ended December 31, 2008 were \$41,000 (2007 – \$214,000).

## Notes to the Consolidated Financial Statements

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### 16. RELATED PARTY TRANSACTIONS (continued)

A Trustee of NPR is the Chairman of AgeCare Investments Ltd. ("AgeCare"), which leases six seniors' properties from NPR. For the year ended December 31, 2008, NPR earned rental income, including rental revenue earned on a straight-line basis over the term of the lease, totaling \$12.6 million (2007 – \$12.6 million) from AgeCare. Amounts outstanding in accounts receivable pertaining to this lease were \$nil at December 31, 2008 (December 31, 2007 – \$nil). In addition, AgeCare is paid an annual fee of \$120,000 for advisory services provided to NPR respecting prospective acquisitions of seniors' properties. For the Year ended December 31, 2008, NPR paid \$120,000 for these services (2007 – \$120,000).

In the second quarter of 2008, the REIT commenced renovations to a seniors' facility in BC which is leased to AgeCare. The renovations are being completed under the terms of existing lease agreements and costs will be recovered from AgeCare over the remaining term of the lease agreement. The approved budget for the renovation project is \$2.2 million, with \$1.5 million incurred through December 31, 2008.

### 17. FINANCIAL INSTRUMENTS

Management has determined that the majority of the NPR's financial assets are designated as loans and receivables, as defined by Section 3855 of the CICA Handbook, and are carried at amortized cost. Management has also determined that all of its financial liabilities have been designated as other financial liabilities and are carried at amortized cost utilizing the effective interest method. Financial instruments include loans receivable, accounts receivable, tenant security deposits, mortgages payable, loans payable, accounts payable and accrued liabilities and bank indebtedness. Unless otherwise specified, the fair value of these instruments approximates their carrying values.

#### Utility cost risk

The REIT is exposed to utility cost risk, which results from the fluctuation in utility prices for fuel oil, natural gas and electricity, the primary utilities used to heat the REIT's properties. The exposure to utility cost risk is restricted primarily to the REIT's residential rental and executives portfolio. The leases in the remainder of the REIT's portfolio generally provide for recovery of operating costs, including utilities. Because of the northern location of a portion of the REIT's portfolio, the exposure to utility price fluctuations is more pronounced in the first and last fiscal quarter of the year.

NPR manages its exposure to utility risk through a number of preventative measures, including retrofitting properties with energy efficient appliances, fixtures and windows. With the exception of a fixed price utility contract in place on certain residential rental units in Alberta, NPR does not utilize hedges or forward contracts in the management of exposure to utility risk.

Heating oil is the primary source of fuel for heating properties located in Nunavut and the Northwest Territories. Exposure to increases in the cost of heating oil is partially offset by the ability to recover these increases from a significant proportion of its commercial and some residential tenants.

Natural gas is the significant source of fuel for heating properties located in Alberta, BC and Inuvik. In Alberta, the provincial government has a natural gas rebate program for energy costs incurred from October through March. In addition, the REIT has fixed price contracts for certain of its properties which account for approximately 38% of the REIT's usage in Alberta. Natural gas prices in Inuvik and BC are not subject to regulated price control and the REIT does not use financial instruments to manage the exposure to the price risk.

Electricity is the primary source of fuel for heating properties located in Newfoundland as well as parts of north eastern BC. In Newfoundland, electricity is purchased from the provincially regulated utility and is directly paid by the tenants for a significant portion of the REIT's residential rental units. As there is not a significant direct risk to NPR regarding the price of electricity, a sensitivity analysis has not been prepared.

Management prepared a sensitivity analysis on the impact of price changes in the cost of utilities, specifically heating oil and natural gas, for the year ended December 31, 2008. A 10% change over the average price of utilities for 2008 would impact NPR's net earnings by \$283,000.

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### 17. FINANCIAL INSTRUMENTS (continued)

#### Liquidity risk

Ultimate responsibility for liquidity risk management lies with management and the Board of Trustees of the REIT. The REIT manages liquidity risk by managing mortgage and loan maturities to ensure a relatively even amount of mortgage maturities in each year. At December 31, 2008 the REIT has a revolving line of credit in the amount of \$50.0 million (2007 - \$40.0 million). At December 31, 2008, \$26.6 million of the revolving line of credit was utilized (2007 - \$25.2 million). Cash flow projections are completed on a regular basis to ensure there will be adequate liquidity to maintain operating and investment activities in addition to making monthly distributions to unitholders. The Board of Trustees reviews the current financial results and the annual business plan in determining appropriate distribution levels.

#### Credit risk

Credit risk arises from the possibility that tenants may not be able to fulfill their lease commitments. The REIT's credit risk is primarily attributable to tenant receivables. Tenant receivables are comprised of a large number of tenants spread across the geographic areas in which the REIT operates. There are no significant exposures to single tenants with the exception of AgeCare Investments Ltd, which leases seniors' properties in Alberta and BC from the REIT, and the Governments of Canada, the Northwest Territories and Nunavut, which leases a large number of rental units in the Northwest Territories and Nunavut.

NPR mitigates this risk through conducting thorough credit checks on prospective tenants, requiring rental payments on the first of the month, obtaining security deposits approximating one month's rent from tenants where legislation permits, and geographic diversification in its portfolio. Tenants are required to pay rent on the first of each month, with the exception of certain government leases where rent is due at the end of the month and certain commercial tenants where operating cost recoveries are billed in arrears. As such, the majority of tenant receivables are past due at the balance sheet date.

The following is an aging of current tenant and other receivables:

|                                 | December 31, 2008 | December 31, 2007 |
|---------------------------------|-------------------|-------------------|
| 0-30 days                       | 987               | 835               |
| 31-60 days                      | 267               | 40                |
| 61-90 days                      | 130               | 23                |
| Over 90 days                    | 722               | 396               |
| Tenant receivables              | 2,106             | 1,294             |
| Other receivables               | 3,329             | 4,015             |
| Allowance for doubtful accounts | (350)             | (250)             |
|                                 | 5,085             | 5,059             |

NPR classifies tenants as past tenants on the date of their move out from a residential unit. Effective January 1, 2008 NPR recorded a specific bad debt provision on all balances owed by past tenants. Any subsequent recovery of balances owed from past tenants is recorded as a reduction in the bad debt provision for the period. In addition, NPR records an allowance for bad debt from current tenants and other receivables where the expected amount to be collected is less than the actual accounts receivable. The amounts disclosed on the balance sheet are net of allowances for uncollectible accounts from current tenants and other receivables, estimated by Management based on prior experience and current economic conditions.

The reconciliation of changes in allowance for doubtful accounts is as follows:

|                                 | Total |
|---------------------------------|-------|
| Balance, December 31, 2007      | 250   |
| Accounts receivable written off | (690) |
| Accounts recovered              | 355   |
| Additional allowance            | 435   |
| Balance, December 31, 2008      | 350   |

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

### 17. FINANCIAL INSTRUMENTS (continued)

The following is an aging of accounts payable and accrued liabilities:

|                          | December 31, 2008 | December 31, 2007 |
|--------------------------|-------------------|-------------------|
| 0-6 months               | 9,916             | 8,877             |
| 6 months to 1 year       | 1,251             | 322               |
| Over 1 year              | 51                | 130               |
|                          | 11,218            | 9,329             |
| Tenant security deposits | 3,893             | 4,664             |
|                          | 15,111            | 13,993            |

NPR has an operating facility to ensure it has sufficient available funds to meet current and foreseeable financial requirements. Management believes that future cash flows from operations and availability under the current credit facility will be adequate to support these financial liabilities.

#### Interest rate risk

The REIT is exposed to interest rate risk on mortgages and loans payable and does not hold any financial instruments to mitigate that risk. The REIT utilizes both fixed and floating rate debt. Interest rate risk related to floating interest rates is limited primarily to the utilization of the credit facility. Management mitigates interest rate risk by utilizing fixed rate mortgages, ensuring access to a number of sources of funding and staggering mortgage maturities with the objective of achieving relatively even annual debt maturities. To the extent possible, the REIT maximizes the amount of mortgages on residential rental properties where it is possible to lower interest rates through Canada Mortgage and Housing Corporation mortgage insurance.

The sensitivity analysis for floating rate debt has been completed based on the exposure to interest rates at the balance sheet date. Floating rate debt includes all mortgage and loans payable which are not subject to fixed interest rates and the revolving line of credit. If interest rates changed by 0.50% and all other variables remained constant, the REIT's net earnings for the Year ended December 31, 2008 would have changed by \$172,000.

### 18. CAPITAL MANAGEMENT

The REIT's objective when managing its capital is to safeguard its assets while maximizing the growth of its business, returns to unitholders and maintaining the sustainability of cash distributions. The REIT's capital consists of mortgages and loans payable, operating and acquisition facilities, Trust Units and Class B LP Units.

Management monitors the REIT's capital structure on an ongoing basis to determine the appropriate level of mortgage debt and loans payable to be placed on specific properties at the time of acquisition or when existing debt matures. The REIT follows conservative guidelines which are set out in the Trust Declaration. In determining the most appropriate debt, consideration is given to strength of cash flow generated from the specific property, interest rate, amortization period, maturity of the debt in relation to the existing debt of the REIT, interest and debt service ratios, and limits on the amount of floating rate debt. The REIT has an operating facility which is used to fund acquisitions and capital expenditures until specific mortgage debt is placed or additional equity is raised.

## Notes to the Consolidated Financial Statements

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

### 18. CAPITAL MANAGEMENT (continued)

Consistent with others in the industry, the REIT monitors capital on the basis of debt to gross book value ratio. The Declaration of Trust provides for a maximum debt to gross book value ratio of 70%. The REIT does not anticipate operating above a debt to gross book value ratio of 60%. The REIT's debt to gross book value is as follows:

|   | December 31, 2008 | December 31, 2007 |
|---|-------------------|-------------------|
| Bank indebtedness, net of cash                          | (731)             | 104               |
| Operating facility                                      | 26,600            | 25,200            |
| Mortgages and loans payable                             | 502,277           | 416,334           |
| <b>Debt</b>   | <b>528,146</b>    | <b>441,638</b>    |
| Rental properties and other capital assets              | 833,967           | 765,447           |
| Capital assets improvements in progress                 | 3,773             | 1,957             |
| Capital assets under development                        | 8,996             | 1,257             |
| Refundable deposits and mortgage proceeds held in trust | 185               | 7,998             |
| Accumulated amortization                                | 90,758            | 65,761            |
| Future income taxes on acquisitions                     | (21,625)          | (21,458)          |
| <b>Gross book value</b>                                 | <b>916,054</b>    | <b>820,962</b>    |
| <b>Debt to gross book value</b>                         | <b>57.7%</b>      | <b>53.8%</b>      |

NPR is subject to three principal financial covenants in its mortgage and loans payable and operating facility. The financial covenants are described as follows:

- Debt Service Coverage Ratio – calculated as Net earnings before interest, taxes and amortization divided by the debt service payments (interest expense and principal repayments);
- Interest Service Coverage Ratio – calculated as Net earnings before interest, taxes and amortization divided by the interest expense;
- Debt to Gross Book value as calculated above.

|   | December 31, 2008 | December 31, 2007 |
|---|-------------------|-------------------|
| Earnings from continuing operations before taxes            | 26,417            | 24,759            |
| Amortization  | 26,447            | 22,012            |
| Interest on mortgages                                       | 24,499            | 20,380            |
| Interest on operating facility                              | 1,286             | 1,565             |
| <b>Net earnings before interest, taxes and amortization</b> | <b>78,649</b>     | <b>68,716</b>     |
| Interest on mortgages                                       | 24,499            | 20,380            |
| Interest on operating facility                              | 1,286             | 1,565             |
| Principal repayments  | 14,983            | 15,086            |
| <b>Debt service</b>   | <b>40,768</b>     | <b>37,031</b>     |
| <b>Interest service coverage ratio</b>                      | <b>3.05</b>       | <b>3.13</b>       |
| <b>Debt service coverage ratio</b>                          | <b>1.93</b>       | <b>1.86</b>       |

As at and during the year ended December 31, 2008, the REIT complied with all externally imposed capital requirements and all covenants relating to its debt facilities.



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

Years ended December 31, 2008 and 2007

(Columnar amounts expressed in thousands of dollars except where indicated)

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### **19. SUBSEQUENT EVENTS**

Between January 1, 2009 and March 2, 2009, NPR completed the acquisition of 40 residential rental units and 52 units in seniors' properties, all located in Newfoundland. The combined purchase prices for these properties was \$7.3 million and were financed through a combination of the operating facility, assumption of a mortgage and the issuance of Class B Limited Partnership units.

Between January 1, 2009 and March 2, 2009, NPR completed mortgage financings and renewals totalling \$8.9 million with interest rates from 3.06% to 3.96% and terms to maturity from 2 years to 9 years. Proceeds from the mortgage financings were used to repay existing mortgage debt and a portion of the operating facility.

# Management Team

## TRUSTEES



Douglas H. Mitchell, Q.C.  
*Chair of the Trust*



B. James Britton  
*President, Chief Executive Officer  
and Trustee*



John C. Charles, CA  
*Trustee*



Kenn Harper  
*Trustee*



Dennis J. Hoffman, CA  
*Trustee*



Kabir Jivraj, MBBS  
*Trustee*



Dennis G. Patterson, LLB  
*Trustee*



C. Donald Wilson  
*Trustee*

## OFFICERS



B. James Britton  
*President and  
Chief Executive Officer*



Todd R. Cook, CA  
*Chief Financial  
Officer*



Alan V. Vaughan  
*Vice President,  
Business Development*



Richard Anda  
*Vice President,  
Operations*



Barbara Lavery  
*Corporate Secretary*

# Corporate Information

## ANNUAL GENERAL MEETING

Tuesday, May 12, 2009, 1:30 pm  
Calgary TELUS Convention Centre  
Telus 101, 102  
120 Ninth Avenue SE  
Calgary, AB T2G 0P3

## STOCK EXCHANGE

Toronto Stock Exchange (TSX)  
Trading Symbol: NPR.UN

## LEGAL COUNSEL

Borden Ladner Gervais LLP

## AUDITORS

Deloitte & Touche LLP

## REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada  
Valiant Trust Company

## CORPORATE OFFICE

110, 6131 – 6th Street SE  
Calgary, AB T2H 1L9  
Tel: 403.531.0720  
Fax: 403.531.0727  
Email: [info@npreit.com](mailto:info@npreit.com)  
[www.npreit.com](http://www.npreit.com)



Northern Property Real Estate Investment Trust owns and operates rental real estate in secondary markets in Canada. We have significant multi-family residential real estate investments in Alberta, a growing position in British Columbia and are the largest multi-family residential landlord in each of the NWT, Nunavut and the Province of Newfoundland and Labrador. NPR's income producing portfolio is primarily residential including multi-family apartment rental units, furnished executives and master leased seniors' buildings. We also have a portfolio of commercial buildings focused on government tenancies predominantly located in Canada's far north.



## **Northern Property**

Real Estate Investment Trust

110, 6131 – 6th Street SE  
Calgary, AB T2H 1L9  
Tel: 403.531.0720  
Fax: 403.531.0727  
Email: [info@npreit.com](mailto:info@npreit.com)  
[www.npreit.com](http://www.npreit.com)