



2009 Fourth Quarter and Annual Report to Unitholders

Since 1996, H&R REIT has ensured financial stability through a disciplined strategy based on long-term commercial property leasing and financing, accretive acquisitions and conservative balance sheet management.

Financial Results

The following table includes non-GAAP (Generally Accepted Accounting Principles) information that should not be construed as an alternative to net earnings or cash provided by operations and may not be comparable to similar measures presented by other issuers as there is no standardized meaning of funds from operations ("FFO") and adjusted funds from operations ("AFFO") under GAAP. Financial information for the period ending after October 1, 2008 is presented herein on a combined and/or stapled basis. Financial information for the period ended prior to October 1, 2008 is presented for H&R REIT.

	3 months ended Dec.31		12 months ended Dec.31	
	2009	2008	2009	2008
FFO (millions) *	\$54.5	\$46.9	\$225.2	\$228.3
FFO per stapled unit (basic)	\$0.37	\$0.32	\$1.52	\$1.61
AFFO (millions) *	\$51.1	\$54.8	\$223.4	\$214.3
AFFO per stapled unit (basic)	\$0.34	\$0.37	\$1.51	\$1.51
Cash distributions paid (millions)(net of DRIP)	\$24.4	\$44.0	\$97.7	\$161.8
Cash distributions per stapled unit	\$0.18	\$0.36	\$0.72	\$1.44

* Reconciliations of net earnings to FFO, and AFFO to cash provided by operations are included in H&R's MD&A.

The following table includes results reported in accordance with Canadian GAAP.

	3 months ended Dec.31		12 months ended Dec.31	
	2009	2008	2009	2008
Rentals from income properties (millions)	\$151.7	\$151.3	\$605.2	\$592.0
Net earnings (millions) *	\$29.9	\$45.8	\$86.5	\$97.7
Net earnings per stapled unit (basic)	\$0.21	\$0.33	\$0.61	\$0.73
Cash provided by operations (millions) *	\$66.6	\$73.4	\$238.9	\$233.2

As at year end 2009, H&R's debt to gross book value (calculated in accordance with the Declaration of Trust) was 52.5% compared to 54.8% as at December 31, 2008, and non-recourse debt to total debt was 44.9% (51.4% at year end 2008).

Development Highlights

H&R REIT is currently building *The Bow*, a two million square foot office building in Calgary's downtown financial district. EnCana Corporation has head-leased the entire office tower and all underground parking spaces on a triple-net basis for an initial term of 25 years. As at December 31, 2009, H&R REIT had incurred approximately \$652 million of the \$1.33-billion budget (excluding capitalized interest costs for accounting purposes). H&R has effectively locked in approximately 87% of total budgeted costs before contingencies, and secured all of the funds required for completion of this trophy office development. The annualized net rent from *The Bow* is expected to be \$94 million.

Capital Transaction Highlights

During the fourth quarter 2009, H&R issued \$175 million of 6.00% convertible unsecured subordinated debentures, sold an industrial property for gross proceeds of \$140 million, and redeemed 28.6 million warrants issued to Fairfax Financial Holdings Limited for approximately \$186 million. During 2009, the REIT did not acquire any properties, sold seven properties for gross proceeds of \$217 million, and raised \$525 million from three debentures.

Tom Hofstedter

President and Chief Executive Officer
February 25, 2010

Combined Financial Statements of

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

Years ended December 31, 2009 and 2008



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AUDITORS' REPORT TO THE UNITHOLDERS

We have audited the combined balance sheets of H&R Real Estate Investment Trust and H&R Finance Trust as at December 31, 2009 and 2008 and the combined statements of earnings, unitholders' equity and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Trusts' 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 combined financial statements present fairly, in all material respects, the financial position of the Trusts as at December 31, 2009 and 2008 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

Toronto, Canada

February 25, 2010

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

Combined Balance Sheets
(In thousands of dollars)
December 31, 2009 and 2008

	2009	2008
		(note 2(a))
Assets		
Income properties (note 3)	\$ 4,124,856	\$ 4,516,830
Properties under development (note 4)	794,534	590,196
Accrued rent receivable	125,212	117,253
Other assets (note 5)	114,473	80,642
Cash and cash equivalents (note 6)	109,224	17,212
Mortgages and amount receivable (note 7)	63,789	90,071
Assets held for sale and discontinued operations (note 25)	19,035	29,870
	<u>\$ 5,351,123</u>	<u>\$ 5,442,074</u>

Liabilities and Unitholders' Equity

Liabilities:

Mortgages payable (note 8)	\$ 2,818,476	\$ 3,151,511
Debentures payable (note 9)	565,758	104,820
Accounts payable and accrued liabilities	166,971	129,314
Future income tax liability (note 24)	138,122	144,007
Intangible liabilities	57,237	64,302
Bank indebtedness (note 10)	13,556	112,934
Liabilities related to discontinued operations (note 25)	2,215	8,151
	<u>3,762,335</u>	<u>3,715,039</u>
Non-controlling interest (note 11)	75,122	75,367
Unitholders' equity (notes 12 and 13)	1,513,666	1,651,668
Commitments and contingencies (note 26)		
Subsequent events (notes 12(a), 12(d) and 28)		
	<u>\$ 5,351,123</u>	<u>\$ 5,442,074</u>

See accompanying notes to combined financial statements.

Approved by the Trustees:

"Robert Dickson" Trustee

"Thomas J. Hofstedter" Trustee

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

Combined Statements of Earnings
(In thousands of dollars, except per unit amounts)
Years ended December 31, 2009 and 2008

	2009	2008 (note 2(a))
Operating revenue:		
Rentals from income properties (note 14)	\$ 605,165	\$ 591,954
Interest income	6,222	3,294
	<u>611,387</u>	<u>595,248</u>
Operating expenses:		
Property operating costs	195,615	196,040
Interest (note 15)	182,671	169,940
Depreciation and amortization (note 16)	128,643	122,005
	<u>506,929</u>	<u>487,985</u>
Net property operating income (note 23)	104,458	107,263
Impairment loss on income properties (note 3)	(14,764)	(53,237)
Unrealized gain on swap derivatives (note 10(b))	3,463	-
Net loss on foreign exchange	(20,509)	(7,090)
Trust expenses	(8,551)	(10,494)
Net earnings before income taxes, non-controlling interest and discontinued operations	64,097	36,442
Income tax recovery (expense) (note 24)	9,249	(17,226)
Net earnings before non-controlling interest and discontinued operations	73,346	19,216
Non-controlling interest (note 11)	(3,049)	34
Net earnings from continuing operations	70,297	19,250
Net earnings from discontinued operations (note 25)	16,228	78,456
Net earnings	\$ 86,525	\$ 97,706
Basic net earnings per unit (note 17):		
Continuing operations	\$ 0.50	\$ 0.15
Discontinued operations	0.11	0.58
	<u>\$ 0.61</u>	<u>\$ 0.73</u>
Diluted net earnings per unit (note 17):		
Continuing operations	\$ 0.46	\$ 0.14
Discontinued operations	0.10	0.58
	<u>\$ 0.56</u>	<u>\$ 0.72</u>

See accompanying notes to combined financial statements.

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

Combined Statements of Unitholders' Equity and Comprehensive Income

(In thousands of dollars)

Years ended December 31, 2009 and 2008

Unitholders' Equity

	Value of units	Accumulated net earnings (note 2(a))	Accumulated distributions	Contributed surplus	Equity component of warrants and debentures	Accumulated other comprehensive loss (note 13)	Total
Unitholders' equity, December 31, 2007	\$ 1,829,111	\$ 654,348	\$ (941,613)	\$ -	\$ -	\$ (85,210)	\$ 1,456,636
Adjustment to unitholders' equity to comply with new accounting standard (note 2(a))	-	(7,277)	-	-	-	-	(7,277)
Unitholders' equity, January 1, 2008	1,829,111	647,071	(941,613)	-	-	(85,210)	1,449,359
Proceeds from issuance of units (note 12)	344,903	-	-	-	-	-	344,903
Issue costs	(7,781)	-	-	-	-	-	(7,781)
Equity component from issuance of convertible debentures, net of costs (note 9(a))	-	-	-	-	6,767	-	6,767
Exchange of Class B units of HRLP (note 11)	21,745	-	-	-	-	-	21,745
Net earnings	-	97,706	-	-	-	-	97,706
Distributions to unitholders (note 12(b))	-	-	(327,110)	-	-	-	(327,110)
Unit-based compensation (note 12(a))	74	-	-	-	-	-	74
Other comprehensive income	-	-	-	-	-	66,005	66,005
Unitholders' equity, December 31, 2008	2,188,052	744,777	(1,268,723)	-	6,767	(19,205)	1,651,668
Proceeds from issuance of units (note 12)	23,441	-	-	-	-	-	23,441
Issue costs	(866)	-	-	-	-	-	(866)
Issuance of warrants, net of costs (note 9(b))	-	-	-	-	8,533	-	8,533
Equity component from issuance of convertible debentures, net of costs (notes 9(c) and 9(d))	-	-	-	-	43,326	-	43,326
Net earnings	-	86,525	-	-	-	-	86,525
Distributions to unitholders (note 12(b))	-	-	(102,605)	-	-	-	(102,605)
Redemption of units (note 11)	(28,873)	-	-	28,873	-	-	-
Redemption of warrants (note 9(b))	-	(148,308)	-	(28,873)	(8,533)	-	(185,714)
Unit-based compensation (note 12(a))	535	-	-	-	-	-	535
Other comprehensive loss	-	-	-	-	-	(11,177)	(11,177)
Unitholders' equity, December 31, 2009	\$ 2,182,289	\$ 682,994	\$ (1,371,328)	\$ -	\$ 50,093	\$ (30,382)	\$ 1,513,666

Comprehensive Income

	2009	2008 (note 2(a))
Net earnings	\$ 86,525	\$ 97,706
Unrealized gain (loss) on translation of self-sustaining foreign operations	(16,605)	40,515
Transfer of derivative designated as cash flow hedge to net earnings	4,282	-
Transfer of realized loss on foreign exchange	-	27,341
Loss on derivatives designated as cash flow hedges	-	(1,777)
Transfer of realized loss on cash flow hedges to net earnings	162	538
Future income tax (note 24)	984	(612)
Other comprehensive income (loss)	(11,177)	66,005
Comprehensive income	\$ 75,348	\$ 163,711

See accompanying notes to combined financial statements.

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

Combined Statements of Cash Flows

(In thousands of dollars)

Years ended December 31, 2009 and 2008

	2009	2008 (note 2(a))
Cash provided by (used in):		
Operations:		
Net earnings	\$ 86,525	\$ 97,706
Items not affecting cash:		
Rent amortization (notes 14 and 25)	3,931	4,813
Depreciation and amortization (notes 16 and 25)	130,409	126,393
Gain on sale of income properties (note 25)	(10,649)	(71,420)
Impairment loss on income properties (notes 3 and 25)	14,764	53,665
Future income taxes (recovery) (note 24)	(9,613)	15,628
Unrealized gain on swap derivatives (note 10(b))	(3,463)	-
Net loss on foreign exchange	20,487	7,341
Effective interest rate accretion (notes 15 and 25)	5,844	1,236
Unit-based compensation (note 12(a))	535	74
Net earnings attributable to non-controlling interest (note 11)	3,670	3,829
Change in other non-cash operating items (note 18)	(3,499)	(6,065)
	238,941	233,200
Financing:		
Bank indebtedness	(99,374)	(78,191)
Mortgages payable:		
New mortgages payable	82,134	101,854
Principal repayments	(143,553)	(141,500)
Proceeds from issuance of debentures payable (note 9)	510,352	110,484
Redemption of warrants (note 9(b))	(185,714)	-
Proceeds from issuance of units, net	13,781	162,353
Distributions to unitholders (note 12(b))	(93,811)	(152,341)
Distributions to non-controlling interest (note 11)	(3,915)	(9,498)
	79,900	(6,839)
Investments:		
Properties under development	(313,511)	(336,659)
Income properties:		
Net proceeds on disposition of income properties	96,258	147,347
Acquisitions and capital expenditures	(10,090)	(36,262)
Mortgages and amounts receivable	15,821	(3,295)
Restricted cash (note 5)	(15,497)	7,654
	(227,019)	(221,215)
Increase in cash and cash equivalents	91,822	5,146
Cash and cash equivalents, beginning of year (notes 6 and 25)	17,683	12,537
Cash and cash equivalents, end of year (notes 6 and 25)	\$ 109,505	\$ 17,683
Supplemental cash flow information:		
Interest paid	\$ 207,277	\$ 200,369
Supplemental disclosure of non-cash financing and investing activities:		
Acquisitions of income properties through assumption of mortgages payable	-	56,182
Release of mortgage obligation upon lender consent	(10,424)	-
Non-cash mortgages and amounts receivable granted to purchasers on disposition of income properties	-	71,461
Non-cash release of mortgages payable on disposition of income properties	117,849	91,172
Non-cash issuance of warrants (note 9(b))	8,533	-
Non-cash transfer of property from properties under development to income properties	117,007	-
Non-cash release of property to lender	6,672	-
Non-cash distributions to unitholders (note 12(b))	8,794	42,269

See accompanying notes to combined financial statements.

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

Notes to Combined Financial Statements

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

Years ended December 31, 2009 and 2008

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

The REIT is an unincorporated open-ended trust and Finance Trust is an unincorporated investment trust (note 12). Unitholders of the Trusts participate pro rata in distributions of income and, in the event of termination of the Trusts, participate pro rata in the net assets remaining after satisfaction of all liabilities.

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

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

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

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

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

1. Significant accounting policies:

These combined financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and reflect the following policies:

(a) Principles of combination:

The principles used to prepare combined financial statements are similar to those used to prepare consolidated financial statements. The combined financial statements include the assets, liabilities, unitholders' equity, comprehensive income and operating results of the Trusts, after elimination of the following:

- (i) the REIT's notes payable to Finance Trust; and
- (ii) the REIT's interest expense and Finance Trust's interest income from the notes payable to Finance Trust.

The foreign exchange gain or loss recorded in net earnings as a result of exchanging Finance Trust's U.S. dollar note receivable from U.S. Holdco is not eliminated on combination as U.S. Holdco is a self-sustaining operation of the REIT, which results in the foreign exchange on the note payable being reported in accumulated other comprehensive income (loss).

The combination of the Trusts does not result in the elimination of the equity of Finance Trust as neither of the Trusts hold any interest in the other. The equity of the Trusts will be presented by way of combining the two together. As a result, the creation of Finance Trust will result in an increase to equity for the issuance of such Finance Trust units, similar to the reporting of the distribution of Finance Trust units to unitholders by the REIT.

(b) Principles of consolidation:

The combined financial statements include the accounts of all entities in which the REIT holds a controlling interest. Finance Trust does not hold a controlling interest in any entity.

The REIT carries out a portion of its activities through co-ownership agreements and records its proportionate share of assets, liabilities, revenue, expenses and cash flows of all co-ownerships in which it participates.

All material intercompany transactions and balances have been eliminated upon consolidation.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

1. Significant accounting policies (continued):

(c) Income properties:

Income properties are recorded at cost less accumulated depreciation. The REIT reviews whether the income properties are impaired whenever events or changes in circumstances affect the ultimate value of the income property and indicate that the carrying amount may not be recoverable. An impairment is recognized if the sum of the estimated undiscounted future cash flows from operations and expected residual value is less than the carrying value of a particular asset. The impairment recognized is measured at the amount by which the carrying amount of the asset exceeds its fair value. Buildings are depreciated on a straight-line basis over their useful lives for a period of approximately 40 years. Building improvements are amortized over their useful lives, which typically vary between 5 and 20 years. Improvements that do not meet the capitalization criteria are expensed in full in the period incurred. Paving and equipment are depreciated on a straight-line basis over their useful lives, which is typically 10 years. Intangibles resulting from in-place leases are amortized over the related lease terms.

Upon acquisition of income properties, the REIT allocates the purchase price to the fair value of assets and liabilities including land, building and intangibles such as above- and below-market leases, in-place operating leases and customer relationship value.

(d) Deferred leasing expenses:

Leasing costs, such as commissions and tenant improvements, are deferred and amortized on a straight-line basis over the terms of the related leases.

(e) Revenue recognition:

The REIT retains substantially all of the benefits and risks of ownership of its income properties and therefore, accounts for its leases with tenants as operating leases. Rentals from income properties include all amounts from tenants, including recovery of operating costs.

Rental revenue from all leases is recognized on a straight-line basis over the term of the related lease. The difference between the rental revenue recognized and the amounts contractually due under the lease agreements is recorded in accrued rent receivable.

(f) Income taxes:

Pursuant to the terms of the REIT's Declaration of Trust, the REIT is required to distribute all taxable income to unitholders of the REIT and deduct such distributions and designations for Canadian income tax purposes.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

1. Significant accounting policies (continued):

Income taxes are accounted for using the asset and liability method, whereby future income tax assets and liabilities are determined based on differences between the carrying amounts of these balances and their corresponding tax basis. 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 (note 24).

Finance Trust qualifies as a mutual fund trust that is not a specified investment flow-through trust under the Income Tax Act (Canada). In accordance with the terms of Finance Trust's Declaration of Trust, all of the net income for tax purposes will be paid or payable to unitholders in the taxation year so that no income taxes are payable by Finance Trust. For financial statement reporting purposes, the tax deductibility of Finance Trust's distributions is treated as an exemption from taxation as Finance Trust distributed and is committed to continue distributing all of its taxable income to its unitholders.

(g) Unit option plan:

The REIT has a unit option plan available for officers, employees and certain trustees as disclosed in note 12(a). Any consideration paid by optionholders on exercise of unit options is credited to unitholders' equity. All options granted under the option plan are fair valued and expensed over the vesting period of three years.

(h) Cash and cash equivalents:

The Trusts consider deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less from the acquisition date as cash and cash equivalents.

(i) Restricted cash:

Restricted cash includes tenant rent deposits and amounts held in reserve by lenders to fund repairs and capital expenditures or to cover property tax payments as required by either a mortgage or under the terms of a purchase and sale agreement.

(j) Foreign currency translation:

The REIT accounts for its investments in the United States ("foreign operations") as self-sustaining operations. Assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rates in effect at the balance sheet dates and revenue and expenses are translated at the average exchange rates for the years. The foreign currency translation adjustment is recorded as a separate component of accumulated other comprehensive income (loss) until there is a reduction in the REIT's net investment in the foreign operations.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

1. Significant accounting policies (continued):

The U.S. dollar denominated bank indebtedness is designated as a hedge of the REIT's investment in self-sustaining operations. Accordingly, the accumulated unrealized gains or losses arising from the translation of this obligation are recorded as a foreign currency translation adjustment in accumulated other comprehensive income (loss).

Finance Trust's U.S. dollar denominated assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheets date and revenue and expenses are translated at the actual exchange rates incurred, resulting in any gains (losses) recorded in earnings.

(k) Derivative financial instruments:

Derivative financial instruments are utilized by the REIT in its management of its foreign currency, interest rate and utility price exposures. The REIT formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The REIT also formally assesses, both at the hedge's inception and on an ongoing basis, whether hedging relationships will be highly effective. The fair value of the hedging instrument is recorded on the combined balance sheets. The effective portion of the hedge is recorded in other comprehensive income (loss) and the ineffective portion is recognized in net earnings.

The REIT, in certain cases, enters into bond forward contracts to lock in interest rates on specific anticipated mortgages. For contracts qualifying as hedges, the gain or loss on settlement of the contract is reported in other comprehensive income (loss) and recognized as an adjustment to interest expense over the term of the related mortgage.

(l) Financial instruments:

The Trusts have designated their cash and cash equivalents, restricted cash and swap derivatives as held-for-trading, which are measured at fair value. Accounts receivable and mortgages and amount receivable are classified as loans and receivables, which are measured at amortized cost. Mortgages payable, debentures payable, accounts payable and accrued liabilities and bank indebtedness are classified as other financial liabilities, which are also measured at amortized cost. The Trusts had neither available-for-sale, nor held-to-maturity instruments as at or during the years ended December 31, 2009 and 2008.

(m) Properties under development:

Properties under development are stated at cost. If it is determined that the carrying amount exceeds the undiscounted estimated future net cash flows expected to be received from the ongoing use and residual value of the property, after taking into account estimated costs to complete the development, it is reduced to its estimated fair value.

Cost includes initial acquisition costs, other direct costs, realty taxes, capitalized interest and operating revenues and expenses during the period of development.

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
Years ended December 31, 2009 and 2008

1. Significant accounting policies (continued):

(n) Future changes in accounting policies:

International Financial Reporting Standards ("IFRS"):

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

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

(o) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the years. Actual results could differ from those estimates. A significant estimate made by management relates to the budgeted cost to complete the Bow development. This estimate is based on various assumptions relating to the components of the construction process. These assumptions are based on information available to management currently and given the possibility of change, the outcome of these estimates could differ from actual results.

2. Impact of new accounting standards:

(a) Goodwill and intangible assets:

Effective January 1, 2009, the Trusts adopted the new recommendation of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3064, Goodwill and Intangible Assets, on a retroactive basis by adjusting the prior year. This new section replaces Section 3062, Goodwill and Other Intangible Assets, and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets.

Commencing January 1, 2009, the Trusts no longer defer capital cost expenditures recoverable from its tenants and no longer record the amortization of these deferred expenditures over the period in which revenue is collected from tenants. This change requires the Trusts to capitalize capital expenditures recoverable from its tenants and amortize these over the useful life of the asset. If the capitalization criteria are not met, the Trusts expense the full amount in the period incurred.

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
Years ended December 31, 2009 and 2008

2. Impact of new accounting standards (continued):

The adoption by the Trusts of the new standards requires retroactive application to the 2008 quarterly and annual combined financial statements on January 1, 2009 as follows:

Balance sheet:

	Increase (decrease)
Impact of adjustment as at December 31, 2008	
Income properties	\$ 9,142
Deferred expenses	(19,220)
Assets	(10,078)
Future income tax liability	1,547
	\$ (8,531)
Non-controlling interest	\$ (430)
Opening accumulated net earnings as at January 1, 2008	(7,277)
Net earnings for the year ended December 31, 2008	(824)
Unitholders' equity	(8,101)
	\$ (8,531)

Statement of earnings:

Impact of adjustment Increase (decrease)	For the year ended December 31, 2008
Property operating costs	\$ 3,112
Depreciation and amortization	(2,069)
Net earnings from discontinued operations	219
Net earnings	(824)
Net earnings per unit - basic and diluted	-

Statement of cash flows:

There was no impact on the statement of cash flows as the amounts adjusted only impacted items within cash provided by operations.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

2. Impact of new accounting standards (continued):

(b) Credit risk and the fair value of financial assets and financial liabilities:

In January 2009, the Emerging Issues Committee ("EIC") of the CICA issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which clarifies that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. EIC-173 is to be applied retrospectively without adjustment of prior periods in interim and annual financial statements for periods ending on or after January 20, 2009. The Trusts adopted this recommendation in their fair value determinations effective January 1, 2009. The adoption of this guideline did not have any material effect on the Trusts' results, financial position or cash flows.

(c) Financial instruments - recognition and measurement:

Effective January 1, 2009, the Trusts prospectively adopted the CICA amendments to Section 3855, Financial Instruments - Recognition and Measurement. Amendments to this section requires an assessment to determine whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of held-for-trading category. In addition, the amendment prohibits the reclassification of a financial asset out of the held-for-trading category when the fair value of the embedded derivative in a combined contract cannot be reasonably measured. The adoption of the amendments to this standard did not have an impact on the Trusts' financial statements.

Effective January 1, 2009, the Trusts adopted the CICA amendments to Section 3855, Financial Instruments - Recognition and Measurement, in relation to the impairment of financial assets. Amendments to this section have revised the definition of "loans and receivables" and provided that certain conditions have been met, requires or permits reclassification of financial assets from the held-for-trading and available-for-sale categories into the loans and receivables category. The adoption of the amendments to this standard did not have an impact on the Trusts' financial statements.

(d) Financial instruments - disclosures:

In May 2009, the CICA amended Section 3862, Financial Instruments - Disclosures, to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These amendments are effective for the Trusts on December 31, 2009. The adoption of the amendments to this standard did not have a significant impact on the Trusts' financial statements.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

3. Income properties:

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

December 31, 2008 (note 2(a))	Cost	Accumulated depreciation and amortization	Net book value
Land	\$ 927,554	\$ -	\$ 927,554
Buildings	3,482,780	(383,557)	3,099,223
Building improvements (note 2(a))	13,519	(4,377)	9,142
Paving and equipment	149,926	(49,835)	100,091
	4,573,779	(437,769)	4,136,010
Intangible assets	486,676	(105,856)	380,820
	\$ 5,060,455	\$ (543,625)	\$ 4,516,830

During the year ended December 31, 2009, four income properties occupied by the tenants Circuit City and Bruno's Supermarkets, LLC (2008 - seven income properties occupied by Boscov's Department Stores) were impaired by \$14,764 (2008 - \$53,237) following a test for impairment triggered by the tenants vacating the premises following their bankruptcy announcements.

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

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

4. Properties under development:

Project	Address	2009	2008
The Bow (note 26(a))	5th Ave. at Centre Street, Calgary, AB	\$ 719,173	\$ 402,031
Bell Canada Phase III	Eglinton Ave. & Dixie Rd., Mississauga, ON	–	117,007
Heart Lake	Mayfield West Business Park, Caledon, ON	39,809	38,471
Airport Road	7900 Airport Road, Brampton, ON	35,552	32,687
		\$ 794,534	\$ 590,196

Bell Canada Phase III was completed and ready for its intended use in January 2009 and was transferred to income properties at that time.

5. Other assets:

	2009	2008
Tenant inducements	\$ 29,797	\$ 14,997
Deferred leasing expenses (net of accumulated amortization of \$19,145 (2008 - \$16,614))	27,542	28,276
Restricted cash	20,001	4,504
Future income tax asset (note 24)	14,316	12,254
Prepaid expenses and sundry assets	12,811	13,652
Accounts receivable	6,543	6,959
Swap derivatives (note 10(b))	3,463	–
	\$ 114,473	\$ 80,642

6. Cash and cash equivalents:

Cash and cash equivalents, at December 31, 2009, include cash on hand of \$9,281 (2008 - \$16,876) and bank term deposits of \$99,943 (2008 - \$336) at rates of interest varying between 0.11% to 0.26% (2008 - 0.75% to 1.95%).

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

7. Mortgages and amount receivable:

The REIT has mortgages receivable which are secured by income properties or properties under development as follows:

	2009	2008
Mortgage receivable bearing contractual interest at 6.00% per annum and repayable on December 1, 2010	\$ 57,589	\$ 57,050
Mortgage receivable bearing contractual interest at 5.30% per annum and repaid on December 15, 2009	-	16,360
Mortgage receivable bearing contractual interest at prime plus 1.15% per annum and repayable 60 days after demand	3,200	3,200
Mortgage receivable bearing contractual interest at 6.00% per annum and repayable on December 1, 2013	3,000	3,000
Amount receivable	-	10,461
	\$ 63,789	\$ 90,071

8. Mortgages payable:

The mortgages payable are secured by income properties and letters of credit in certain cases, bear fixed interest with a contractual weighted average rate of 6.2% (2008 - 6.2%) per annum and mature between 2010 and 2035. Included in mortgages payable at December 31, 2009 are U.S. dollar denominated mortgages of U.S. \$826,906 (2008 - U.S. \$861,232). The Canadian equivalents of these amounts are \$868,252 (2008 - \$1,050,703).

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

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
Years ended December 31, 2009 and 2008

8. Mortgages payable (continued):

Future principal mortgage payments are as follows:

Years ending December 31:

2010	\$	109,196
2011		169,399
2012		366,997
2013		195,280
2014		277,038
Thereafter		1,551,631
		<u>2,669,541</u>
Mortgages payable due on demand*		154,272
Deferred financing cost and mark-to-market adjustment arising on acquisitions		(5,337)
	\$	<u>2,818,476</u>

* Relates to 10 non-recourse mortgages to the REIT for income properties in which the tenants, Boscov's Department Stores, Circuit City and Bruno's Supermarkets, LLC, have filed for protection under Chapter 11 of the United States Bankruptcy Code. The REIT has handed over control of seven of these income properties to the lenders and therefore expects to be released from any further obligations under these non-recourse mortgages upon the transfer of title to the lenders.

9. Debentures payable:

				2009	2008	
		Contractual interest rate	Effective interest rate	Face value	Carrying value	Carrying value
2013 Convertible Debentures	(a)	6.65%	9.10%	\$ 115,000	\$ 106,734	\$ 104,820
Non-Convertible Debentures	(b)	11.50%	12.90%	200,000	188,767	-
2014 Convertible Debentures	(c)	6.75%	12.30%	150,000	119,427	-
2017 Convertible Debentures	(d)	6.00%	8.60%	175,000	150,830	-
				<u>\$ 565,758</u>	<u>\$ 104,820</u>	

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

9. Debentures payable (continued):

(a) 2013 Convertible Debentures:

In June 2008, the REIT completed a public offering of \$115,000 convertible unsecured subordinated debentures (the "2013 Convertible Debentures"), bearing interest at the annual contractual rate of 6.65% and an effective interest rate of 9.10%. The 2013 Convertible Debentures mature on June 30, 2013 and interest is payable semi-annually on June 30 and December 31. Each 2013 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at: (i) any time prior to the maturity date, and (ii) the business day immediately preceding the date specified by the REIT for redemption of the 2013 Convertible Debentures, at a conversion price of \$23.11 per Stapled Unit, being a conversion rate of approximately 43.2713 Stapled Units per \$1 principal amount, subject to adjustment upon the occurrence of certain events in accordance with the Indenture governing the 2013 Convertible Debentures.

On redemption or maturity of the 2013 Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the 2013 Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing it to be issued) a variable number of Stapled Units equal to the principal amount of the 2013 Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units. The 2013 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2011. Thereafter, but prior to June 30, 2012, the 2013 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2012 and prior to the maturity date, the 2013 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest. Upon a change of control, holders of the 2013 Convertible Debentures have the right to require the REIT to purchase the debentures at 101% of the principal amount plus accrued and unpaid interest.

The REIT accounted for the 2013 Convertible Debentures by valuing the holders' option to convert into Stapled Units and classifying such value as equity. The remaining value of the 2013 Convertible Debentures is classified as debt.

On issuance, the REIT recorded a liability of \$103,717, net of issue costs of \$4,239, and equity, which represents the holders' option to convert the 2013 Convertible Debentures into Stapled Units, of \$6,767, net of issue costs of \$277. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the 2013 Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding 2013 Convertible Debentures.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

9. Debentures payable (continued):

(b) Non-Convertible Debentures:

In April 2009, the REIT issued \$200,000 of unsecured debentures (the "Non-Convertible Debentures") bearing interest at the annual contractual rate of 11.50% and an effective interest rate of 12.90%. The Non-Convertible Debentures mature on April 24, 2014, with interest payable semi-annually on June 30 and December 31. The Non-Convertible Debentures are not redeemable on or before April 24, 2013, except upon the satisfaction of certain conditions upon the occurrence of a change of control. After April 24, 2013 and prior to the maturity date thereof, the Non-Convertible Debentures are redeemable in whole or in part at the option of the REIT at a redemption price equal to the principal amount thereof plus accrued and unpaid interest. Upon a change of control, the holders of the Non-Convertible Debentures have the right to require the REIT to purchase the Non-Convertible Debentures at 101% of the principal amount plus accrued and unpaid interest.

In addition, for no additional proceeds, the REIT issued, simultaneously with the Non-Convertible Debentures, 28,571,429 warrants to purchase Stapled Units at an exercise price of \$7.00 per Stapled Unit exercisable until April 24, 2014. In December 2009, the REIT repurchased the outstanding 28,571,429 warrants at a purchase price of \$185,714. The cost of the redemption was in excess of the assigned value of the warrants by \$177,181, whereby \$28,873 of such excess was recorded as a reduction to contributed surplus and \$148,308 was recorded as a reduction to accumulated net earnings.

The REIT accounted for the Non-Convertible Debentures and the warrants by discounting the stream of future payments of interest and principal, due under the Non-Convertible Debentures Indenture, at the prevailing market rate for a similar liability that is not issued simultaneously with warrants and allocated such amounts (net of associated issue costs) to the issuance of the Non-Convertible Debentures. The aggregate proceeds realized from the issuance of the Non-Convertible Debentures and warrants (net of issue costs), less the amount allocated to the Non-Convertible Debentures, has been allocated to the issue of the warrants and is classified as equity.

On issuance, the REIT recorded a liability of \$187,447, net of issue costs of \$1,288, and equity, which represents the warrants issued to purchase Stapled Units, of \$11,183, net of issue costs of \$82, with a further reduction of \$2,650 representing the initial future tax liability related to issuance of the Non-Convertible Debentures. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the Non-Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding Non-Convertible Debentures.

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Notes to Combined Financial Statements (continued)

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9. Debentures payable (continued):

(c) 2014 Convertible Debentures:

In July 2009, the REIT completed a public offering of \$150,000 Series B convertible unsecured subordinated debentures (the "2014 Convertible Debentures"), bearing interest at the annual contractual rate of 6.75% and an effective interest rate of 12.30%. The 2014 Convertible Debentures mature on December 31, 2014, and interest is payable semi-annually on June 30 and December 31. Each 2014 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at (i) any time prior to the maturity date and (ii) the business day immediately preceding the date specified by the REIT for redemption of the 2014 Convertible Debentures, at a conversion price of \$14.00 per Stapled Unit, being a conversion rate of approximately 71.4286 Stapled Units per \$1 principal amount, subject to adjustment upon the occurrence of certain events in accordance with the Indenture governing the 2014 Convertible Debentures.

On redemption or maturity of the 2014 Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the 2014 Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing it to be issued) a variable number of Stapled Units equal to the principal amount of the 2014 Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units. The 2014 Convertible Debentures may not be redeemed by the REIT on or before July 30, 2012. Thereafter, but prior to July 30, 2013, the 2014 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after July 30, 2013 and prior to the maturity date, the 2014 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest. Upon a change of control, holders of the 2014 Convertible Debentures have the right to require the REIT to purchase the debentures at 101% of the principal amount plus accrued and unpaid interest.

The REIT accounted for the 2014 Convertible Debentures by valuing the holders' option to convert into Stapled Units and classifying such value as equity. The remaining value of the 2014 Convertible Debentures is classified as debt.

On issuance, the REIT recorded a liability of \$117,579, net of issue costs of \$5,015, and equity, which represents the holders' option to convert the 2014 Convertible Debentures into Stapled Units, of \$26,305, net of issue costs of \$1,101. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the 2014 Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding 2014 Convertible Debentures.

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Notes to Combined Financial Statements (continued)

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

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9. Debentures payable (continued):

(d) 2017 Convertible Debentures:

In December 2009, the REIT completed a public offering of \$175,000 Series C convertible unsecured subordinated debentures (the "2017 Convertible Debentures"), bearing interest at the annual contractual rate of 6.00% and an effective interest rate of 8.60%. The 2017 Convertible Debentures mature on June 30, 2017, and interest is payable semi-annually on June 30 and December 31. Each 2017 Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at (i) any time prior to the maturity date and (ii) the business day immediately preceding the date specified by the REIT for redemption of the 2017 Convertible Debentures, at a conversion price of \$19.00 per Stapled Unit, being a conversion rate of approximately 52.6316 Stapled Units per \$1 principal amount, subject to adjustment upon the occurrence of certain events in accordance with the Indenture governing the 2017 Convertible Debentures.

On redemption or maturity of the 2017 Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the 2017 Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing it to be issued) a variable number of Stapled Units equal to the principal amount of the 2017 Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units. The 2017 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2013. Thereafter, but prior to June 30, 2015, the 2017 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2015 and prior to the maturity date, the 2017 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest. Upon a change of control, holders of the 2017 Convertible Debentures have the right to require the REIT to purchase the debentures at 101% of the principal amount plus accrued and unpaid interest.

The REIT accounted for the 2017 Convertible Debentures by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability and classifying such value as debt. The remaining value of the 2017 Convertible Debentures is classified as equity.

On issuance, the REIT recorded a liability of \$150,817, net of issue costs of \$6,446, and equity, which represents the holders' option to convert the 2017 Convertible Debentures into Stapled Units, of \$17,021, net of issue costs of \$716. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the 2017 Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding 2017 Convertible Debentures.

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

Notes to Combined Financial Statements (continued)
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10. Bank indebtedness:

The REIT has the following facilities:

- (a) A general operating facility which is secured by fixed charges over certain income properties due on December 31, 2011. The total facility at December 31, 2009 is \$284,650 (2008 - \$286,564) and can be drawn in either Canadian or U.S. dollars (to a maximum of \$100,000 Canadian for U.S. borrowings). The amount available at December 31, 2009, after taking into account the bank indebtedness drawn of \$13,560 (including amounts in note 25) (2008 - \$112,934) and the outstanding letters of credit and other items, is \$236,716 (2008 - \$125,536). The Canadian dollar bank indebtedness bears interest at rates approximating the prime rate of a Canadian chartered bank. At December 31, 2009, the Canadian prime interest rate was 2.25% (2008 - 3.50%) per annum.

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

Included in bank indebtedness at December 31, 2009 is U.S. \$33 (2008 - U.S. \$7,600). The Canadian equivalents of these amounts are \$35 (2008 - \$9,272). The U.S. dollar bank indebtedness bears interest at LIBOR rates.

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

These conditions have not been satisfied as at December 31, 2009 nor has any amount been drawn upon the credit facility.

The REIT entered into an interest rate swap that is intended to limit its interest rate exposure during the term of the Bow construction financing facility. The expected annual effective interest rate for this facility, including the cost of the swap, is 6.90%. The fair value of this interest rate swap as at December 31, 2009 is \$3,463 and has been recorded as an asset (note 5) resulting in an unrealized gain of \$3,463 for the year ended December 31, 2009 recognized in earnings.

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

Notes to Combined Financial Statements (continued)

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10. Bank indebtedness (continued):

- (c) The REIT had a facility to finance and construct a distribution centre in Ajax, Ontario. The facility and the outstanding letters of credit of \$3,722 (2008 - \$3,722) were discharged upon the sale of the property in December 2009.

11. Non-controlling interest:

Non-controlling interest represents the amount of equity related to the Class B units of HRLP, issued to participating vendors in exchange for properties acquired by HRLP. The accounts of HRLP are consolidated into the REIT and, thus, included in the combined financial statements. Class B units of HRLP are only exchangeable on a one-for-one basis, at the option of the holder, into Stapled Units. During the year ended December 31, 2008, 1,536,990 Class B units of HRLP were exchanged into Stapled Units. The conversion of these units was accounted for as a transfer of the carrying value recorded in non-controlling interest to unitholders' equity.

Holders of the Class B units of HRLP are entitled to receive distributions on a per unit amount equal to a per Stapled Unit amount provided to holders of Stapled Units. To fund the distributions to Class B units, HRLP held 5,437,565 Stapled Units at December 31, 2008.

Pursuant to the 2009 Reorganization, the 5,437,565 Stapled Units were redeemed in November 2009. As a result of the 2009 Reorganization, HRLP, the REIT, Finance Trust and H&R Portfolio LP Trust entered into an exchange and support agreement that provides, among other things, for (i) certain capital contributions to be made by the REIT in case HRLP has insufficient (a) funds to pay the required distributions on the Class B LP units of HRLP, or (b) Series 1 notes issued by U.S. Holdco to Finance Trust ("U.S. Holdco Notes") to pay the fair market value of the Finance Trust Units required to be delivered upon exchange of any Class B LP unit; and (ii) the mechanics whereby Class B LP units may be exchanged for Stapled Units.

The assigned value of the Stapled Units redeemed pursuant to the 2009 Reorganization exceeded the redemption price by \$28,873. This amount was recorded as contributed surplus.

	Amount	Number of Class B units
As at December 31, 2007	\$ 103,211	6,974,555
Adjustment to comply with new accounting standards (note 2(a))	(430)	-
As at January 1, 2008	102,781	6,974,555
Non-controlling interest from continuing operations	(34)	-
Non-controlling interest from discontinued operations (note 25)	3,863	-
Distributions on Class B units of HRLP	(9,498)	-
Exchange of Class B units of HRLP for Stapled Units	(21,745)	(1,536,990)
As at December 31, 2008	\$ 75,367	5,437,565

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

Notes to Combined Financial Statements (continued)
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11. Non-controlling interest (continued):

	Amount	Number of Class B units
As at December 31, 2008	\$ 75,367	5,437,565
Non-controlling interest from continuing operations	3,049	-
Non-controlling interest from discontinued operations (note 25)	621	-
Distributions on Class B units of HRLP	(3,915)	-
As at December 31, 2009	\$ 75,122	5,437,565

12. Unitholders' equity:

The REIT is an unincorporated open-ended trust. The beneficial interests in the REIT are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions.

Finance Trust is an unincorporated investment trust. The beneficial interests in Finance Trust are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions.

The units of the REIT are stapled with the units of Finance Trust effective October 1, 2008. These Stapled Units are listed and posted for trading on the TSX. The Trusts have entered into a support agreement ("Support Agreement") to coordinate the issuance of Stapled Units under various arrangements (note 12(c)).

The units of the Trusts are freely transferable and, other than as disclosed herein, the trustees of the Trusts shall not impose any restriction on the transfer of units. Provided that an event of uncoupling ("Event of Uncoupling") has not occurred: (a) each REIT unit may be transferred only together with a unit of Finance Trust; (b) no unit may be issued by the REIT to any person unless: (i) a unit of Finance Trust is simultaneously issued to such person, or (ii) the REIT has arranged that units will be consolidated (subject to any applicable regulatory approval) immediately after such issuance, such that each holder of a REIT unit will hold an equal number of Finance Trust units and units of the REIT immediately following such consolidation; and (c) a unitholder may require the REIT to redeem any particular number of units only if it also requires, at the same time, and in accordance with the provisions of the Finance Trust Declaration of Trust, Finance Trust to redeem that same number of units of Finance Trust. Equivalent provisions apply with respect to the transfer, issuance, consolidation and redemption of Finance Trust units.

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12. Unitholders' equity (continued):

An Event of Uncoupling shall occur only: (a) in the event that unitholders of the REIT vote in favour of the uncoupling of units of the Trusts such that the two securities will trade separately; or (b) at the sole discretion of the trustees of Finance Trust, but only in the event of the bankruptcy, insolvency, winding-up or reorganization (under an applicable law relating to insolvency) of the REIT or U.S. Holdco or the taking of corporate action by the REIT or U.S. Holdco in furtherance of any such action or the admitting in writing by the REIT or U.S. Holdco of its inability to pay its debts generally as they become due. The trustees of the Trusts shall use all reasonable efforts to obtain and maintain a listing for the units of their respective Trusts and, unless an Event of Uncoupling has occurred, the Stapled Units, on one or more stock exchanges in Canada.

The unitholders have the right to require the Trusts to redeem their units on demand. Provided that no Event of Uncoupling has occurred, unitholders who tender their units of one of the Trusts for redemption will also be required to tender for redemption corresponding units of the other Trust in accordance with the provisions of the respective Declarations of Trust. Upon the tender of their units for redemption, all of the unitholder's rights to and under such units are surrendered and the unitholder is entitled to receive a price per unit as determined by the applicable Declaration of Trust.

Upon valid tender for redemption of each unit of the REIT, the unitholder is entitled to receive a price per unit of the REIT as determined by a formula based on the market price of Stapled Units less an amount based on the principal amount of U.S. Holdco Notes per outstanding unit of Finance Trust. The redemption price payable by the REIT will be satisfied by way of a cash payment to the unitholder or, in certain circumstances, including where such payment would cause the REIT's monthly cash redemption obligations to exceed \$50 (subject to adjustment in certain circumstances or waiver by the trustees), an in specie distribution of notes of H&R Portfolio LP Trust (a subsidiary of the REIT).

Upon valid tender for redemption of each unit of Finance Trust, the unitholder is entitled to receive, except as provided below, a price per unit payable in cash equal to the Canadian dollar equivalent of the outstanding principal amount of the U.S. Holdco Notes as of the redemption date, divided by the total number of Finance Trust units issued and outstanding immediately prior to the redemption date. In certain circumstances, including where such payment would cause Finance Trust's monthly cash redemption obligations to exceed \$50 (subject to adjustment in certain circumstances or waiver by the trustees) the redemption price per Finance Trust unit being redeemed, to which a redeeming unitholder is entitled shall be the fair market value of the Finance Trust units being redeemed, as determined by the trustees, which shall be payable by way of delivery of U.S. Holdco Notes.

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
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12. Unitholders' equity (continued):

The following number of Stapled Units, or REIT units prior to the Plan of Arrangement, are issued and outstanding:

As at December 31, 2007	135,449,995
Issued on June 6, 2008 (at a price of \$19.75 per unit)	8,734,250
Issued under the Distribution Reinvestment Plan and Unit Purchase Plan (the "DRIP")	2,848,606
	<u>147,032,851</u>
Stapled Units held by a subsidiary (note 11)	(5,437,565)
As at December 31, 2008	<u>141,595,286</u>
As at December 31, 2008	147,032,851
Issued under the DRIP	1,261,744
Stapled Units redeemed from a subsidiary (note 11)	(5,437,565)
Options exercised	968,232
As at December 31, 2009	<u>143,825,262</u>

(a) Unit option plan:

As at December 31, 2009, a maximum of 8,800,000 Stapled Units were authorized to be issued to the REIT's officers, employees and certain trustees, of which 7,000,000 options (2008 - 6,400,000 units) have been granted. The exercise price of each option approximated the market price of the Stapled Units on the date of grant. The options vested at 33.3% per year from the grant date, being fully vested after three years, and expire ten years after the date of the grant.

During the year ended December 31, 2009, 600,000 options were granted (2008 - 600,000). The fair value of the unit options used to compute compensation cost is the estimated fair value of each option grant on the grant date. This was calculated using an option pricing model with the following weighted average assumptions: expected distribution yield is 7.27% (2008 - 8.69%); expected volatility is 45.00% (2008 - 22.57%); risk free interest rate is 1.83% (2008 - 3.18%); and expected option life is four years from the date of grant (2008 - four years). The weighted average grant-date fair value of the options in total is \$1,334 (2008 - \$775). Unit-based compensation expense of \$535 for the year ended December 31, 2009 (2008 - \$74) was recognized in income and charged to unitholders' equity.

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Notes to Combined Financial Statements (continued)
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12. Unitholders' equity (continued):

A summary of the status of the unit option plan as at December 31, 2009 and 2008 and the changes during the year ended on those dates are as follows:

	2009		2008	
	Units	Weighted average exercise price	Units	Weighted average exercise price
Outstanding, beginning of year	2,454,666	\$ 13.73	1,854,666	\$ 12.81
Granted	600,000	9.30	600,000	16.56
Exercised	(968,232)	12.46	-	-
Outstanding, end of year	2,086,434	\$ 13.05	2,454,666	\$ 13.73
Options exercisable, end of year	1,086,434	\$ 13.82	1,854,666	\$ 12.81

The options outstanding at December 31, 2009 are exercisable at varying prices ranging from \$9.30 to \$16.56 (2008 - \$12.01 to \$16.56) with a weighted average remaining life of 6.3 years (2008 - 4.7 years). The vested options are exercisable at varying prices ranging from \$13.12 to \$16.56 (2008 - \$12.01 to \$13.36) with a weighted average remaining life of 3.7 years (2008 - 3.1 years). Subsequent to December 31, 2009, an additional 600,000 options were granted.

(b) Distributions:

Under the REIT's Declaration of Trust, the income of the REIT shall be distributed as determined by the trustees. Notwithstanding the foregoing, the total amount of income of the REIT to be distributed to unitholders, due and payable on or before December 31 of any calendar year, shall not be less than the amount necessary to ensure that the REIT will not be liable to pay income tax under Part I of the Income Tax Act (Canada) for that year, after all permitted deductions under such act have been taken (or authorized to be taken by the trustees), and any such payment shall be considered to have been declared by the trustees and to have been payable no later than December 31 of that year. For the year ended December 31, 2009, the REIT declared per unit distributions of \$0.61 (2008 - \$1.40).

Pursuant to Finance Trust's Declaration of Trust, unitholders of Finance Trust are entitled to receive all of the Distributable Cash of Finance Trust, as defined in the Declaration of Trust. Distributable Cash means, subject to certain exceptions, all amounts received by Finance Trust less certain costs, expenses or other amounts payable by Finance Trust, and less any amounts which, in the opinion of the trustees, may reasonably be considered to be necessary to provide for the payment of any costs or expenditures that have been or will be incurred in the activities and operations of Finance Trust and to provide for payment of any tax liability of Finance Trust. Finance Trust paid per unit distributions of \$0.11 for the year ended December 31, 2009. For the period from inception on October 1, 2008 to December 31, 2008, total distributions paid were \$0.04 per unit.

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

Notes to Combined Financial Statements (continued)
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12. Unitholders' equity (continued):

The details of the distributions are as follows:

	2009	2008
Cash distributions to unitholders	\$ 93,811	\$ 152,341
October 1, 2008 non-cash distribution as a return of capital - pursuant to the Plan of Arrangement	-	132,500
Distributions issued under the DRIP	8,794	42,269
	\$ 102,605	\$ 327,110

(c) Support Agreement:

Pursuant to provisions of the Declarations of Trust for Finance Trust and the REIT, at all times, each REIT unit must be stapled to a Finance Trust unit (and each Finance Trust unit must be stapled to a REIT unit) unless there is an Event of Uncoupling. As part of the Plan of Arrangement, the Trusts entered into the Support Agreement which provided, among other things, for the co-ordination of the declaration and payment of all distributions so as to provide for simultaneous record dates and payment dates; for co-ordination so as to permit the REIT to perform its obligations pursuant to the REIT's Declaration of Trust, Unit Option Plan, DRIP and Unitholder Rights Plan; for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable and permit the REIT to perform its obligations arising under any security issued by the REIT (including securities convertible, exercisable or exchangeable into Stapled Units); for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable the REIT to perform its obligations or exercise its rights under its convertible debentures; and for Finance Trust to take all such actions and do all such things as are necessary or desirable to issue Finance Trust units simultaneously (or as close to simultaneously as possible) with the issue of REIT units and to otherwise ensure at all times that each holder of a particular number of REIT units holds an equal number of Finance Trust units, including participating in and cooperating with any public or private distribution of Stapled Units by, among other things, signing prospectuses or other offering documents.

In the event that the REIT issues additional REIT units, pursuant to the Support Agreement, the Trusts will coordinate so as to ensure that each subscriber receives both REIT units and Finance Trust units, which shall trade together as Stapled Units. Prior to such event, the REIT shall provide notice to Finance Trust to cause Finance Trust to issue and deliver the requisite number of Finance Trust units to be received by and issued to, or to the order of, each subscriber as the REIT directs. In consideration of the issuance and delivery of each such Finance Trust unit, the REIT (on behalf of the purchaser) or the purchaser, as the case may be, shall pay (or arrange for the payment of) a purchase price equal to the fair market value (as determined by Finance Trust in consultation with the REIT) of each such Finance Trust unit at the time of such issuance. The remainder of the subscription price for Stapled Units shall be allocated to the issuance of REIT units by the REIT.

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Notes to Combined Financial Statements (continued)

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12. Unitholders' equity (continued):

(d) Short form base shelf prospectus:

On May 11, 2009, the Trusts issued a short form base shelf prospectus allowing the Trusts to offer and issue the following securities: (i) unsecured debt securities; (ii) subscription receipts exchangeable for Stapled Units and/or other securities of the Trusts; (iii) warrants exercisable to acquire Stapled Units and/or other securities of the Trusts; and (iv) securities comprised of more than one of Stapled Units, debt securities, subscription receipts and/or warrants offered together as a unit, or any combination thereof having an offer price of up to \$500,000 in aggregate (or the equivalent thereof, at the date of issue, in any other currency or currencies, as the case may be) at any time during the 25-month period that the short form base shelf prospectus (including any amendments) remains valid. On July 17, 2009, the Trusts filed Amendment No. 1 to the short form base shelf prospectus dated May 11, 2009, to provide that the securities that may be offered and issued thereunder include senior unsecured debt securities of the REIT. On January 18, 2010, the Trusts filed Amendment No. 2 to the short form base shelf prospectus dated May 11, 2009 and amended July 17, 2009, to increase the aggregate offer price of securities that may be offered under the short form base shelf prospectus from \$500,000 to \$1,000,000 (or the equivalent thereof, at the date of issue, in any other currency or currencies, as the case may be). Upon any issuance of Stapled Units pursuant to the short form base shelf prospectus, Finance Trust will be required to issue Finance Trust units for a subscription price equal to the fair market value of the Finance Trust units (as determined by Finance Trust in consultation with the REIT) at the time of such issuance.

(e) Equity distribution agreement:

On June 5, 2009, the Trusts entered into an equity distribution agreement with Canaccord Capital Corporation who will act as agent for the issuance and sale of Stapled Units over an approximate two year period, by way of "at-the-market distributions" over the TSX. The timing of any sale over such approximate two year period, and the number of Stapled Units actually sold during such period, are at the discretion of the Trusts. Pursuant to applicable securities laws, the market value of Stapled Units sold pursuant to the equity distribution agreement must not exceed 10% of the aggregate market value of outstanding Stapled Units, as determined as at the last trading day of the month before the month in which the first trade under the equity distribution agreement is made. The Stapled Units will be distributed at market prices prevailing at the time of sale of such Stapled Units (if any) and, as a result, prices may vary between purchasers and during the period of distribution. At the time units are issued, Finance Trust will be required to issue Finance Trust units for a subscription price equal to the fair market value (as determined by Finance Trust in consultation with the REIT) of such Finance Trust units at the time of such issuance. Finance Trust will use its portion of the net proceeds of any given distribution of Stapled Units for the limited purposes set out in its Declaration of Trust. As of December 31, 2009, no trades were made pursuant to the equity distribution agreement.

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

Notes to Combined Financial Statements (continued)
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13. Accumulated other comprehensive loss:

	Cash flow hedges	Foreign operations	Total
Balance as at December 31, 2007	\$ (6,419)	\$ (78,791)	\$ (85,210)
Loss on derivatives designated as cash flow hedges	(1,777)	–	(1,777)
Transfer of realized loss on cash flow hedges to net earnings	538	–	538
Future income taxes (note 24)	(612)	–	(612)
Unrealized gain on translation of self-sustaining foreign operation	–	40,515	40,515
Transfer of realized loss on foreign exchange to net earnings	–	27,341	27,341
Balance as at December 31, 2008	(8,270)	(10,935)	(19,205)
Transfer of realized loss on cash flow hedges to net earnings	4,444	–	4,444
Future income taxes (note 24)	984	–	984
Unrealized loss on translation of self-sustaining foreign operation	–	(16,605)	(16,605)
Balance as at December 31, 2009	\$ (2,842)	\$ (27,540)	\$ (30,382)

14. Rentals from income properties:

	2009	2008
Rentals from income properties	\$ 597,286	\$ 581,997
Straight-lining of contractual rent	11,726	14,747
Rent amortization of tenant inducements	(2,772)	(2,060)
Rent amortization of above- and below-market rents	(1,075)	(2,730)
	\$ 605,165	\$ 591,954

15. Interest:

	2009	2008
Contractual interest on mortgages payable	\$ 181,442	\$ 182,965
Contractual interest on debentures payable	27,884	4,379
Effective interest rate accretion	5,564	1,096
Bank interest and charges	2,193	4,293
	217,083	192,733
Capitalized interest	(34,412)	(22,793)
	\$ 182,671	\$ 169,940

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

Notes to Combined Financial Statements (continued)
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16. Depreciation and amortization:

	2009	2008
		(note 2(a))
Depreciation of income properties	\$ 98,871	\$ 93,766
Amortization of intangible assets on acquisitions	24,207	23,380
Amortization of deferred leasing expenses	5,565	4,859
	<u>\$ 128,643</u>	<u>\$ 122,005</u>

17. Net earnings per unit:

	2009	2008
		(note 2(a))
Net earnings	\$ 86,525	\$ 97,706
Add net earnings attributable to non-controlling interest (note 11)	3,670	3,829
Diluted net earnings	<u>\$ 90,195</u>	<u>\$ 101,535</u>

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

	2009	2008
Basic Stapled Units	142,508,200	134,995,304
Effect of dilutive securities:		
Unit option plan	84,765	384,875
Warrants (note 9(b))	12,231,559	-
Non-controlling interest conversion to Stapled Units (note 11)	5,437,565	6,659,750
Diluted units	<u>160,262,089</u>	<u>142,039,929</u>
Net earnings per Stapled Unit:		
Basic	\$ 0.61	\$ 0.73
Diluted	\$ 0.56	\$ 0.72

The convertible debentures are anti-dilutive for the twelve months ended December 31, 2009 and 2008; therefore, the potential conversion into Stapled Units has not been included in the calculation of diluted units.

Although the warrants were redeemed on December 29, 2009, they are included in the denominator of the diluted earnings per share for the period in which they were outstanding (note 9(b)).

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

Notes to Combined Financial Statements (continued)

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18. Change in other non-cash operating items:

	2009	2008
Deferred expenses and tenant inducements	\$ (6,044)	\$ (9,659)
Accrued rent receivable	(11,746)	(16,911)
Prepaid expenses and sundry assets	849	8,188
Accounts receivable	849	(1,277)
Accounts payable and accrued liabilities	12,593	13,594
	\$ (3,499)	\$ (6,065)

19. Capital risk management:

The REIT's primary objectives when managing capital are:

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

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

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

The REIT's level of indebtedness is subject to the limitations set out in its Declaration of Trust. The REIT is limited to a total indebtedness to gross book value ratio of 65% (provided that for this purpose "indebtedness" excludes the 2013 Convertible Debentures, 2014 Convertible Debentures and 2017 Convertible Debentures). As at December 31, 2009, this ratio was 52.5% (2008 - 54.8%). Management uses this ratio as a key indicator in managing the REIT's capital.

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Notes to Combined Financial Statements (continued)
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19. Capital risk management (continued):

In addition to the above key ratio, the REIT's general operating facility (note 10(a)) has the following covenants which are required to be calculated based on the REIT's and Finance Trust's combined financial statements:

		2009	2008
	Prescribed ratios	Actual ratios	Actual ratios
(a) Maximum indebtedness to gross book value	65%	50.5%	54.6%
(b) Minimum debt service coverage ratio	1.2:1	1.55:1	1.35:1
(c) Minimum equity	\$1,300,000 plus 75% of net cash proceeds from future equity offerings	\$1,513,666	\$1,651,688

In addition to the above ratios, the REIT's Bow construction facility (note 10(b)) has the following covenants as at December 31, 2009, which are required to be calculated based on the Trusts' combined financial statements:

		2009	2008
	Prescribed ratios	Actual ratios	Actual ratios
(a) Maximum indebtedness to gross book value	65%	56.8%	n/a
(b) Minimum debt service coverage ratio	1.2:1	1.47:1	n/a
(c) Minimum equity	\$1,350,000 plus 75% of net cash proceeds from future equity offerings	\$1,588,788	n/a
(d) Maximum distributions	Limited to the lesser of \$0.72 per unit annually or 60% of funds from operations	\$0.72	n/a

Each of the terms above are defined within their respective facilities. As such, the calculated ratio for each covenant will differ between each facility.

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19. Capital risk management (continued):

The REIT's mortgage providers also have minimum limits on debt-to-service coverage ratios ranging from 1.10 to 1.50 as at December 31, 2009 and December 31, 2008. The REIT monitors these ratios and is in compliance with such external requirements, except for the mortgages due on demand (note 8).

20. Risk management:

(a) Credit risk:

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

(b) Liquidity risk:

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

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

The contractual obligations for mortgages payable are disclosed in note 8. The REIT also has contractual obligations, as described in note 9, for the 2013 Convertible Debentures of \$115,000 maturing in 2013, for the Non-Convertible Debentures of \$200,000 maturing in 2014, for the 2014 Convertible Debentures of \$150,000 maturing in 2014 and for the 2017 Convertible Debentures of \$175,000 maturing in 2017.

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20. Risk management (continued):

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

Management measures its liquidity risk through review of financial covenants contained in debt agreements and in accordance with the Declaration of Trust. In order to maintain liquidity, the REIT has a general operating facility, as described in note 10(a), available to draw on to fund its obligations.

(c) Market risk:

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

(i) Currency risk:

A portion of the REIT's properties are located in the United States and therefore, the REIT is subject to foreign currency fluctuations that may impact its financial position and results. In order to mitigate the risk, the REIT's debt on these properties is also held in U.S. dollars to act as a natural hedge.

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.14 for the year ended December 31, 2009 would have decreased other comprehensive income by approximately \$18,800 (2008 - \$29,000) and increased net earnings by approximately \$2,300 (2008 - \$5,100). This analysis assumes that all the variables, in particular interest rates, remain constant (a \$0.10 weakening of the Canadian dollar against the U.S. dollar at December 31, 2009 would have had the equal but opposite effect).

(ii) Interest rate risk:

The REIT is exposed to interest rate risk on its borrowings. It minimizes this risk by obtaining long-term fixed interest rate debt. At December 31, 2009, the percentage of fixed rate debt to total debt was 99.6% (2008 - 96.7%). As at December 31, 2009, the REIT does not account for any of its fixed rate financial liabilities as held-for-trading. Therefore, a change in interest rates at the reporting date would not affect net income with respect to these fixed rate instruments.

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20. Risk management (continued):

The bank indebtedness is subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2009 would have decreased net earnings by approximately \$500 (2008 - \$1,100). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

(d) Fair values:

The fair values of the Trusts' mortgages and amount receivable, accounts receivable, cash and cash equivalents, bank indebtedness and accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short periods to maturity of these financial instruments.

The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using year-end market rates for debt of similar terms and credit risks. Based on these assumptions, the fair value of mortgages payable at December 31, 2009 has been estimated at \$2,637,203 (2008 - \$2,935,035) compared with the carrying value of \$2,818,476 (2008 - \$3,157,470).

The fair value of the debentures payable has been determined by discounting the cash flows of these financial obligations using year-end market rates for debt of similar terms and credit risks. Based on these assumptions, the fair value of debentures payable at December 31, 2009 has been estimated at \$704,935 (2008 - \$93,150) compared with the carrying value of \$565,758 (2008 - \$104,820).

21. Joint venture and co-ownership activities:

These combined financial statements include the REIT's proportionate share of assets, liabilities, revenue, expenses and cash flows of the joint ventures and co-ownerships. The REIT's proportionate share of these joint ventures and co-ownerships range between 20% and 98.5%, summarized as follows:

	2009	2008
Assets	\$ 157,007	\$ 157,557
Liabilities	90,133	92,292
Revenue	26,275	39,211
Expenses	18,695	26,484
Operating income from properties	7,580	12,727
Cash flows provided by operations	11,252	10,788
Cash flows used in financing	(6,784)	(18,960)
Cash flows provided by (used in) investments	(5,453)	9,373

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22. Related party transactions:

H&R Property Management Ltd. (the "Property Manager"), a company partially owned by family members of the Chief Executive Officer, provides property management services for substantially all properties owned by the REIT, including leasing services, for a fee of 2% of gross revenue. The Property Manager also provides support services in connection with the acquisition, disposition and development activities of the REIT and is also entitled to an incentive fee. Acquisitions and development support services are provided for a fee of 2/3 of 1% of total acquisition and development costs, as defined in the agreement which is effective January 1, 2007. Effective January 1, 2008, the support services relating to dispositions of income properties are provided for a fee of 10% of the gain on sale of income properties adjusted for the add back of accumulated depreciation and amortization. The current agreement expires on January 1, 2010 and was automatically renewed for a five-year period. There is one additional automatic five-year extension.

During the year ended December 31, 2009, the REIT recorded fees pursuant to this agreement of \$13,842 (2008 - \$14,494), of which nil (2008 - \$553) was capitalized to the cost of the income properties acquired, \$2,073 (2008 - \$2,111) was capitalized to properties under development and \$2,795 (2008 - \$2,317) was capitalized to deferred leasing expenses. Approximately 71% of these fees are recoverable from tenants. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the year ended December 31, 2009, a further amount of \$3,630 (2008 - \$3,520) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager. Of this amount, \$3,630 (2008 - \$1,500) has been waived by the Property Manager and nil (2008 - \$2,020) has been expensed in the combined statements of earnings.

Pursuant to the above agreements, as at December 31, 2009, \$857 (2008 - \$1,022) was payable to the Property Manager.

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the year ended December 31, 2009 is \$1,260 (2008 - \$1,160).

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

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
Years ended December 31, 2009 and 2008

23. Segmented disclosures:

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

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

Income properties and properties under development:

	2009		2008	
				(note 2(a))
Canada	\$	3,823,522	\$	3,758,837
United States		1,095,868		1,348,189
	\$	4,919,390	\$	5,107,026

Net property operating income:

2009	Canada	United States	Total
Operating revenue	\$ 506,679	\$ 104,708	\$ 611,387
Property operating costs	(177,351)	(18,264)	(195,615)
Interest	(125,294)	(57,377)	(182,671)
Depreciation and amortization	(91,625)	(37,018)	(128,643)
Net property operating income	\$ 112,409	\$ (7,951)	\$ 104,458

2008 (note 2(a))	Canada	United States	Total
Operating revenue	\$ 483,522	\$ 111,726	\$ 595,248
Property operating costs	(177,146)	(18,894)	(196,040)
Interest	(115,029)	(54,911)	(169,940)
Depreciation and amortization	(87,810)	(34,195)	(122,005)
Net property operating income	\$ 103,537	\$ 3,726	\$ 107,263

24. Income taxes:

The REIT currently qualifies as a mutual fund trust for Canadian income tax purposes. On June 22, 2007, legislation relating to the federal income taxation of a specified investment flow-through trust or partnership (a "SIFT") received royal assent (the "SIFT Rules"). A SIFT includes a publicly listed or traded partnership and trust, and generally includes an income trust. The REIT is a SIFT, as discussed below.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

24. Income taxes (continued):

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

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

Under the SIFT Rules, the new taxation regime will not apply to a real estate investment trust that meets prescribed conditions relating to the nature of its income and investments (the "REIT Conditions"). As currently structured, the REIT does not meet the REIT Conditions and therefore is a SIFT. The REIT intends to restructure to qualify for the REIT exemption prior to 2011.

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

Due to the SIFT Rules, the REIT commenced recognizing future income tax assets and liabilities with respect to the temporary differences between the carrying amounts and tax basis of its assets and liabilities, including those related to its subsidiary trusts, that are expected to reverse in or after 2011. Future income tax assets and liabilities are recorded using tax rates and laws expected to apply when the temporary differences are expected to reverse.

The REIT has certain corporate subsidiaries in Canada and the United States which are subject to tax on their respective taxable income at the applicable legislated rates.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

24. Income taxes (continued):

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and liabilities are as follows:

	2009	2008
Future income tax liabilities:		
Income properties	\$ 98,875	\$ 109,121
Properties under development	10,812	5,437
Accrued rent receivable	26,839	27,868
Mortgages receivable	181	405
Mortgages payable	-	1,176
Other assets	1,415	-
	<u>138,122</u>	<u>144,007</u>
Future income tax assets:		
Intangible liabilities	10,480	11,369
Deferred expenses	2,408	632
Issue costs	1,147	253
Mortgages payable	281	-
	<u>14,316</u>	<u>12,254</u>
Net future income tax liability	<u>\$ 123,806</u>	<u>\$ 131,753</u>

At December 31, 2009, the U.S. subsidiaries had accumulated net operating losses and deferred interest deductions available for carryforward for income tax purposes of approximately \$105,838. The losses expire between 2018 and 2029. The deferred interest deductions do not generally expire. The net future tax assets of these corporate subsidiaries of \$54,204 consist of net operating losses, deferred interest deductions and tax and book basis differences relating to U.S. income properties and accrued rent receivable against which a valuation allowance of \$54,204 has been recorded.

Income tax (recovery) expense consists of the following:

	2009	2008
Income tax (recovery) expense included in the determination of net earnings from continuing operations:		
Current	\$ 364	\$ 1,598
Future	(9,613)	15,628
	<u>(9,249)</u>	<u>17,226</u>
Future income tax included in the determination of other comprehensive income	(984)	612
	<u>\$ (10,233)</u>	<u>\$ 17,838</u>

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

Notes to Combined Financial Statements (continued)
(In thousands of dollars, except unit and per unit amounts)
Years ended December 31, 2009 and 2008

24. Income taxes (continued):

A reconciliation of expected income tax based upon the 2009 and 2008 statutory rates to the recorded income tax expense is as follows:

	2009	2008
Income tax computed at the Canadian statutory rate of nil applicable to the REIT for 2009 and 2008	\$ -	\$ -
Future income tax arising from a change in tax status with the enactment of the SIFT Rules	-	-
Increase (decrease) of future income tax arising from change in:		
Tax rates	(14,053)	-
Estimate of expected reversal of temporary differences	3,456	16,900
Future income tax applicable to Canadian corporate subsidiaries	-	(660)
U.S. income tax	364	1,598
Future income tax included in the determination of other comprehensive income (loss)	984	(612)
	<u>\$ (9,249)</u>	<u>\$ 17,226</u>

25. Assets held for sale and discontinued operations:

One industrial and one office property are currently held for sale as at December 31, 2009 (2008 - one industrial and one retail property).

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

	2009	2008 (note 2(a))
Assets		
Income properties (net of accumulated depreciation of \$3,418 (2008 - \$3,422))	\$ 17,465	\$ 28,804
Accrued rent receivable	188	13
Cash and cash equivalents	281	471
Prepaid expenses and sundry assets	105	113
Accounts receivable	36	469
Deferred leasing expenses (net of accumulated amortization of \$1,206 (2008 - nil))	960	-
	<u>\$ 19,035</u>	<u>\$ 29,870</u>
Liabilities		
Mortgages payable	\$ -	\$ 5,959
Bank indebtedness (note 10)	4	-
Accounts payable and accrued liabilities	2,211	2,192
	<u>\$ 2,215</u>	<u>\$ 8,151</u>

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

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

The REIT sold seven properties during the year ended December 31, 2009. As at December 31, 2009, two income properties met the held-for-sale criteria and as a result are reported in discontinued operations. For the year ended December 31, 2008, there were 16 properties sold. The results of operations from these properties have been separately disclosed below.

Net earnings (loss) from discontinued operations:

	2009	2008
		(note 2(a))
Operating revenue:		
Rentals from income properties	\$ 17,533	\$ 36,851
Straight-lining of contractual rent	1,264	1,085
Rent amortization of tenant inducements	(92)	-
Rent amortization of above- and below-market rents	8	(23)
	18,713	37,913
Interest income	3	52
	18,716	37,965
Operating expenses:		
Property operating costs	4,700	12,054
Contractual interest on mortgages payable	5,759	9,697
Effective interest rate accretion	280	140
Bank interest and charges	11	359
Depreciation and amortization	1,766	4,388
	12,516	26,638
Net property operating income	6,200	11,327
Impairment loss on income properties	-	(428)
Gain on sale of income properties	10,649	71,420
Non-controlling interest (note 11)	(621)	(3,863)
Net earnings from discontinued operations	\$ 16,228	\$ 78,456

26. Commitments and contingencies:

- (a) The REIT is currently undertaking significant development activities for the two million square foot office building in Calgary, Alberta (the "Bow"), which is fully pre-leased to EnCana Corporation for a 25-year term. The REIT has committed to incurring additional construction and development costs for this project of approximately \$828,000, including capitalized interest, over the remaining construction period, of which approximately \$480,000 is expected to be incurred during the next twelve months. As at December 31, 2009, the total cost incurred on the project amounted to \$719,173 (note 4). This budget includes the construction of 1,360 parking stalls. Construction commenced in the spring of 2007 and is planned to be completed in 2012 to meet the completion timetable. In certain circumstances, should the delivery of tranches of space within the project be delayed, the REIT will be liable to the tenant for certain delay costs which may be significant. While the difficult economic conditions at the end of 2008 and the first half of 2009 impacted the REIT's financing strategy, the REIT was able to arrange financing for the Bow including the Bow Facility (note 10(b)) and issue the Non-Convertible Debentures, the 2014 and 2017 Convertible Debentures (note 9) during the year ended December 31, 2009.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

26. Commitments and contingencies (continued):

- (b) In the normal course of operations, the REIT has issued letters of credit in connection with developments, financings, operations and acquisitions. As at December 31, 2009, the REIT has outstanding letters of credit totalling \$34,349 (2008 - \$51,791), including \$18,164 (2008 - \$22,566) which has been pledged as security for certain mortgages payable. These letters of credit are secured in the same manner as the bank indebtedness (note 10(a)).
- (c) The REIT provides guarantees on behalf of third parties, including co-owners. As at December 31, 2009, the REIT issued guarantees amounting to \$43,278 (2008 - \$51,340), expiring between 2011 and 2016, relating to the co-owner's share of mortgage liability. In addition, the REIT continues to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable until such debts are extinguished or the lenders agree to release the REIT's covenants. At December 31, 2009, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$119,150 (2008 - \$14,348) which expires between 2013 and 2018. There have been no defaults by the primary obligor for debts on which the REIT has provided its guarantees and as a result no contingent loss on these guarantees has been recognized in these financial statements.

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

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

27. Comparative figures:

Certain 2008 comparative figures have been reclassified to conform with the presentation adopted in 2009.

28. Subsequent events:

- (a) In January 2010, the REIT sold a 179,000 square foot industrial building located in Mississauga, Ontario for gross proceeds of \$12,250.
- (b) In February 2010, the REIT issued \$115,000 of 5.196% Series A senior unsecured debentures maturing on February 3, 2015 and \$115,000 of 5.902% Series B senior unsecured debentures maturing on February 3, 2017.

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

Notes to Combined Financial Statements (continued)

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

Years ended December 31, 2009 and 2008

28. Subsequent events (continued):

- (c) In February 2010, the REIT repurchased the outstanding Non-Convertible Debentures for a total repurchase price of approximately \$230,000. The repurchase price included accrued interest of approximately \$2,100. The REIT will recognize a one time non-recurring charge to the combined statement of earnings of approximately \$38,900, representing the difference between the repurchase price, excluding accrued interest expense, and the approximate carrying value of the Non-Convertible Debentures of \$189,000.
- (d) In February 2010, the REIT entered into an agreement to purchase a 93,000 square foot retail property located in Parma, Ohio for gross proceeds of U.S. \$18,000.

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

For the Year ended December 31, 2009

Dated: February 25, 2010

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SECTION I

FORWARD-LOOKING DISCLAIMER

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

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

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

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

All forward-looking statements in this MD&A are qualified by these cautionary statements. These forward-looking statements are made as of February 25, 2010 and the Trusts, except as required by applicable law, assume no obligation to update or revise them to reflect new information or the occurrence of future events or circumstances. All information for the three months ended December 31, 2009 and 2008 is unaudited and have not been reviewed by an auditor.

NON-GAAP FINANCIAL MEASURES

Same-asset property operating income, funds from operations ("FFO"), adjusted funds from operations ("AFFO") and Gross Book Value ("GBV") are all supplemental financial measures used by management to track the Trusts' financial performance. Such measures are not recognized under Canadian generally accepted accounting principles ("GAAP") and therefore do not have

standardized meanings prescribed by GAAP. Management believes that these non-GAAP financial measures are a meaningful measure of operating performance as they reject the assumption that the value of real estate investments diminishes predictably over time. These non-GAAP financial measures should not be construed as alternatives to comparable financial measures calculated in accordance with GAAP. Further, the Trusts' method of calculating such supplemental financial measures may differ from the methods of other real estate investment trusts or other issuers and accordingly, such supplemental financial measures used by management may not be comparable to similar measures presented by other real estate investment trusts or other issuers.

OVERVIEW

The REIT is an unincorporated open-ended trust created by a Declaration of Trust and governed by the laws of the Province of Ontario. Unitholders are entitled to have their REIT units comprising part of the Stapled Units (as defined below), redeemed at any time on demand payable in cash (subject to monthly limits) and/or *in specie*, provided that the corresponding Finance Trust units are being contemporaneously redeemed.

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

The REIT has two primary objectives:

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

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

Currently, the REIT's main focus is on the construction of the Bow in Calgary, AB. The total budget for the project is \$1.5 billion net of rent received during the construction period. The Bow is a 2-million square foot head office complex pre-leased to EnCana Corporation for a term of 25 years. EnCana Corporation is scheduled to begin occupancy in 2011. The project is currently on schedule and on budget. The total annualized year one projected income from the Bow is expected to be \$94.3 million. Rent step ups will be 0.75% per annum on the office space and 1.5% per annum on the parking income for the full 25-year term.

The primary purpose of Finance Trust is to be a flow-through vehicle to allow the REIT to indirectly access the capital markets in a tax-efficient manner by indirectly borrowing money from the REIT's unitholders. Finance Trust's primary activity is to hold debt issued by H&R REIT (U.S.) Holdings Inc. ("U.S. Holdco"), a wholly owned U.S. subsidiary of the REIT. As at December 31, 2009, Finance Trust holds U.S. \$122.4 million of aggregate principal amount of notes payable by U.S. Holdco ("U.S. Holdco Notes"). Subject to cash flow requirements, Finance Trust intends to distribute to its unitholders, who are also unitholders of the REIT, all of its cash flow, consisting primarily of interest paid by U.S. Holdco, less administrative and other expenses and amounts to satisfy liabilities.

Mechanics of "Stapling" the Units of Finance Trust and the REIT

Pursuant to the provisions of the Declarations of Trust for Finance Trust and the REIT at all times each REIT unit must be "stapled" to a Finance Trust unit (and each Finance Trust unit must be "stapled" to a REIT unit) unless there is an "event of uncoupling" (as described below). As part of the Plan of Arrangement, as described in the REIT's information circular dated August 20, 2008, the REIT and Finance Trust entered into a support agreement (the "Support Agreement") which provided, among other things, for the co-ordination of the declaration and payment of all distributions so as to provide for simultaneous record dates and payment dates; for co-ordination so as to permit the REIT to perform its obligations pursuant to the REIT's Declaration of Trust, Unit Option Plan, Distribution Reinvestment Plan and Unit Purchase Plan ("DRIP") and Unitholder Rights Plan; for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable and permit the REIT to perform its obligations arising under

any security issued by the REIT (including securities convertible, exercisable or exchangeable into Stapled Units); for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable the REIT to perform its obligations or exercise its rights under its convertible debentures; and for Finance Trust to take all such actions and do all such things as are necessary or desirable to issue Finance Trust units simultaneously (or as close to simultaneously as possible) with the issue of REIT units and to otherwise ensure at all times that each holder of a particular number of REIT units holds an equal number of Finance Trust units, including participating in and cooperating with any public or private distribution of Stapled Units by, among other things, executing prospectuses or other offering documents.

In the event that the REIT issues additional REIT units, pursuant to the Support Agreement, the REIT and Finance Trust will coordinate so as to ensure that each subscriber receives both REIT units and Finance Trust units, which shall trade together as Stapled Units. Prior to such event, the REIT shall provide notice to Finance Trust to cause Finance Trust to issue and deliver the requisite number of Finance Trust units to be received by and issued to, or to the order of, each subscriber as the REIT directs. In consideration of the issuance and delivery of each such Finance Trust unit, the REIT (solely as agent for and on behalf of the purchaser) or the purchaser, as the case may be, shall pay (or arrange for the payment of) a purchase price equal to the fair market value (as determined by Finance Trust in consultation with the REIT) of each such Finance Trust unit at the time of such issuance. The remainder of the subscription price for Stapled Units shall be allocated to the issuance of REIT units by the REIT. The proceeds received by Finance Trust from any such issuance shall be invested in additional notes of the same series as the U.S. Holdco Notes or distributed to unitholders of Finance Trust.

An event of uncoupling ("Event of Uncoupling") shall occur only: (a) in the event that unitholders of the REIT vote in favour of the uncoupling of units of Finance Trust and units of the REIT such that the two securities will trade separately; or (b) at the sole discretion of the trustees, but only in the event of the bankruptcy, insolvency, winding-up or reorganization (under an applicable law relating to insolvency) of the REIT or U.S. Holdco or the taking of corporate action by the REIT or U.S. Holdco in furtherance of any such action or the admitting in writing by the REIT or U.S. Holdco of its inability to pay its debts generally as they become due.

Investment Restrictions

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

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

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

Financial Highlights

(in '000's except units and per unit amounts)	December 31, 2009	December 31, 2008
Total assets	\$5,351,123	\$5,442,074
Debt to gross book value of assets (per the Declaration of Trust)	52.5%	54.8%
Debt to gross book value of assets	56.8%	56.4%
Units outstanding	143,825	141,595
Property rental revenue	\$605,165	\$591,954
Property operating income	409,550	395,914
Adjusted funds from operations ("AFFO")	223,396	214,269
Weighted average number of basic units for AFFO	147,946	141,655
Adjusted funds from operations per basic unit	\$1.51	\$1.51
Distributions paid per unit	\$0.72	\$1.44
Payout ratio per unit as a % of basic AFFO	47.7%	95.4%

AFFO is reconciled to cash provided by operations, being the most comparable GAAP measure to this non-GAAP financial measure. See page 28.

Key Performance Drivers

OPERATIONS	Year ended	Office	Industrial	Retail	Total*
	December 31				
Occupancy ⁽¹⁾	2009	98.4%	98.9%	99.9%	99.0%
	2008	98.9%	98.6%	99.9%	98.9%
Occupancy – same asset ⁽²⁾	2009	98.3%	98.9%	99.9%	99.0%
	2008	98.9%	98.4%	99.9%	98.8%
Average contractual rent per square foot ⁽³⁾	2009	\$19.87	\$5.76	\$12.41	\$10.10
	2008	\$19.24	\$5.85	\$13.37	\$10.12

* weighted average total

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

⁽²⁾ Same asset refers to those properties owned by the REIT for the entire two-year period ended December 31, 2009 and excludes any assets classified as discontinued operations and those assets whose tenants terminated their leases due to U.S. bankruptcies.

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

	December 31 2009	December 31 2008
Average remaining term to maturity of leases (years)	10.5	11.5
Average remaining term to maturity of mortgages payable (years)	8.3	9.3

Portfolio Overview

The geographic diversification of the REIT's portfolio (excluding those properties whose tenants have filed for Chapter 11 protection with a United States bankruptcy court) as at December 31, 2009 is outlined in the charts below:

NUMBER OF PROPERTIES	Ontario	United States	Alberta	Quebec	Other	Total
Office	23	2	4	1	4	34
Industrial	54	16	19	11	19	119
Retail	32	72	5	5	3	117
Total	109	90	28	17	26	270

SQUARE FEET (in thousands)	Ontario	United States	Alberta	Quebec	Other	Total
Office	5,285	258	1,406	452	884	8,285
Industrial	9,629	6,314	2,810	2,850	1,176	22,779
Retail	1,751	4,348	515	498	524	7,636
Total	16,665	10,920	4,731	3,800	2,584	38,700

Properties under development (in thousands of dollars)

Project	Address	December 31, 2009	December 31, 2008
The Bow	5 th Ave. At Centre Street, Calgary, AB	\$719,173	\$402,031
Bell Phase III	Eglinton Ave. & Dixie Rd., Mississauga, ON	-	117,007
Heart Lake	Mayfield West Business Park, Caledon, ON	39,809	38,471
Airport Road	7900 Airport Rd., Brampton, ON	35,552	32,687
		\$794,534	\$590,196

Top Twenty Sources of Revenue by Tenant

	Tenant	% of rentals from income properties	Number of locations	REIT owned sq.ft. (in 000's)	Average lease term to maturity (years)
1.	Bell Canada	11.6	4	1,734	15.8
2.	TransCanada Pipelines Limited	7.1	2	950	11.2
3.	Telus Communications	6.0	2	943	13.4
4.	Bell Mobility	5.6	2	775	15.9
5.	Rona Inc.	3.9	14	2,151	9.9
6.	Versacold Logistics Canada Inc.	3.4	12	1,733	17.0
7.	Canadian Tire Corp.	3.4	4	2,189	16.7
8.	Royal Bank of Canada	3.1	4	451	2.9
9.	Lowes Companies Inc.	2.5	11	1,435	9.2
10.	Nestle USA	2.1	3	2,168	7.8
11.	Shell Oil Products	1.9	18	249	12.6
12.	Nestle Canada Inc.	1.9	1	170	9.7
13.	Purolator Courier	1.7	12	1,071	11.4
14.	Finning International	1.6	16	893	12.4
15.	Marsh Supermarkets.	1.4	9	548	16.8
16.	Public Works of Canada	1.4	3	238	6.8
17.	Hudson's Bay Company	1.1	3	937	9.2
18.	Sobey's Inc.	1.1	10	339	12.1
19.	BJ's Wholesale Club Inc.	1.1	4	452	12.3
20.	Sony Pictures Entertainment Inc.	1.0	1	172	14.5
	Total	62.9%	135	19,598	

The percentages of rentals from income properties are based on estimated annualized gross revenue excluding the straight lining of contractual rent and discontinued operations.

Lease Expiries

Year ending December 31	Office		Industrial		Retail		Total	
	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry
2010	0.7	20.24	1.5	5.54	0.3	24.09	2.5	11.88
2011	0.7	18.97	1.0	7.92	0.1	9.36	1.8	12.30
2012	0.9	17.28	2.2	5.21	0.1	21.15	3.2	9.10
2013	0.5	18.26	3.6	5.57	0.4	9.51	4.5	7.33
2014	1.5	15.37	3.5	4.47	0.4	8.05	5.4	7.76
	4.3	17.48	11.8	5.37	1.3	13.31	17.4	9.03

MORTGAGES PAYABLE	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2010	\$95,315	\$13,881	\$109,196	4.1%	6.2%
2011	99,153	70,246	169,399	6.3%	6.5%
2012	98,300	268,697	366,997	13.7%	6.7%
2013	93,872	101,408	195,280	7.3%	7.5%
2014	94,406	182,632	277,038	10.4%	6.2%
Thereafter			1,551,631	58.2%	
			2,669,541	100%	
Mortgages payable due on demand ⁽¹⁾			154,272		
Deferred financing cost and mark-to-market adjustment arising on acquisitions ⁽²⁾			(5,337)		
Total			\$2,818,476		

⁽¹⁾ Relates to 10 non-recourse mortgages to the REIT for income properties in which the tenants (Boscov's Department Stores, Circuit City and Bruno's Supermarkets LLC), have filed for protection under Chapter 11 of the United States Bankruptcy Code. The REIT has handed over control of seven of these income properties to the lenders and therefore expects to be released from any further obligations under these non-recourse mortgages upon the transfer of title to the lenders.

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

OUTLOOK

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

Equity and credit markets have eased dramatically over the past six months and continue to steadily improve which has allowed us to reduce our real estate financing costs and shore up our balance sheet. More abundant and cheaper capital has also increased demand for commercial properties, placing downward pressure on cap rates and thereby increasing the market value of our portfolio.

We expect to resume our acquisition strategy this year on a very select and disciplined basis. There are currently few opportunities in Canada to acquire high-quality properties at attractive pricing, and we expect that this condition will persist until such time as development activity resumes to more historical levels, which will only occur once the economy returns to good health. In the United States however, the recovery in the commercial real estate markets has been much slower, as securing financing remains a challenge and the overall economy is still struggling to find its footing, which may create acquisition opportunities for the REIT.

SECTION II

SELECTED ANNUAL INFORMATION

The following table summarizes certain financial information of the Trusts for the years indicated below:

(in thousands of dollars except per unit amounts)	Year Ended December 31 2009	Year Ended December 31 2008 ⁽¹⁾	Year Ended December 31 2007 ⁽¹⁾
Rentals from income properties	\$605,165	\$591,954	\$572,351
Interest income	6,222	3,294	2,574
Net property operating income	104,458	107,263	99,571
Net earnings (loss) from continuing operations	70,297	19,250	(23,377)
Net earnings (loss) per unit from continuing operations			
(basic)	0.50	0.15	(0.19)
(diluted) ⁽²⁾	0.46	0.14	(0.18)
Net earnings (loss)	86,525	97,706	(2,193)
Net earnings (loss) per unit			
(basic)	0.61	0.73	(0.02)
(diluted) ⁽²⁾	0.56	0.72	(0.02)
Total assets	5,351,123	5,442,074	5,050,773
Mortgages payable ⁽³⁾	2,818,476	3,157,470	3,022,391
Debentures payable	565,758	104,820	-
Cash distributions per unit	\$0.72	\$1.44	\$1.37

Notes:

⁽¹⁾ Certain items have been reclassified to conform with the presentation adopted in the current year.

⁽²⁾ The calculation to determine "net earnings (loss) per unit from continuing operations (diluted)" and "net earnings (loss) per unit (diluted)" gives effect to the issue of units pursuant to outstanding options where dilutive and non-controlling interest conversion to units.

⁽³⁾ Including discontinued operations.

Over the last few years, total assets have remained relatively constant. Rentals from income properties and net property operating income have steadily increased despite property dispositions of approximately \$519 million over the past 2 years. This is due to completed property developments and built in rental escalations.

SECTION III

RESULTS OF OPERATIONS

(in thousands of dollars except per unit amounts)	Three months ended December 31			Year ended December 31		
	2009	2008	% Change	2009	2008	% Change
Operating revenue:						
Rentals from income properties	\$151,668	\$151,257	-	\$605,165	\$591,954	2
Interest income	1,621	1,045	55	6,222	3,294	89
	153,289	152,302	1	611,387	595,248	3
Operating expenses:						
Property operating costs	50,535	53,438	(5)	195,615	196,040	-
Interest	46,284	42,704	8	182,671	169,940	8
Depreciation and amortization	34,864	29,653	18	128,643	122,005	5
	131,683	125,795	5	506,929	487,985	4
Net property operating income	21,606	26,507	(18)	104,458	107,263	(3)
Impairment loss on income properties	(268)	(3,006)		(14,764)	(53,237)	
Unrealized gain (loss) on swap derivatives	(1,213)	-		3,463	-	
Net loss on foreign exchange	(2,125)	(10,915)		(20,509)	(7,090)	
Trust expenses	(2,600)	(3,664)		(8,551)	(10,494)	
Net earnings before income taxes, non-controlling interest and discontinued operations	15,400	8,922		64,097	36,442	
Income tax recovery (expense)	17,395	(4,595)		9,249	(17,226)	
Net earnings before non-controlling interest and discontinued operations	32,795	4,327		73,346	19,216	
Non-controlling interest	(1,307)	813		(3,049)	34	
Net earnings from continuing operations	31,488	5,140		70,297	19,250	
Net earnings from discontinued operations	(1,618)	40,686		16,228	78,456	
Net earnings	\$29,870	\$45,826		\$86,525	\$97,706	
Basic net earnings per unit						
Continuing operations	\$0.22	\$0.04		\$0.50	\$0.15	
Discontinued operations	(0.01)	0.29		0.11	0.58	
	\$0.21	\$0.33		\$0.61	\$0.73	
Diluted net earnings per unit						
Continuing operations	\$0.20	\$0.03		\$0.46	\$0.14	
Discontinued operations	(0.01)	0.29		0.10	0.58	
	\$0.19	\$0.32		\$0.56	\$0.72	

The changes for both the three months and year ended December 31, 2009 are mainly due to the increased interest expense, the change in impairment loss on income properties, the income tax recovery, the gains realized on sales of income properties in net earnings from discontinued operations and the increase of the Canadian dollar as compared to the U.S. dollar between 2009 and 2008.

The changes to disclosure requirements that apply for the fiscal year beginning January 1, 2009 are outlined in Section V.

Rentals from Income Properties

Rentals from income properties ("rentals") include all amounts earned from tenants related to lease agreements, including basic rent, parking income, operating cost recoveries and realty tax recoveries. Rentals from properties sold or where an asset meets the held-for-sale criteria have been recorded under net earnings from discontinued operations during the year ended December 31, 2009 and 2008.

Rentals from Income Properties (in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Same-asset – current rentals	\$145,290	\$145,285	\$5	\$576,759	\$561,755	\$15,004
Same-asset – straight-lining of contractual rent	2,520	3,601	(1,081)	12,623	15,879	(3,256)
Acquisitions – current rentals and straight-lining of contractual rent	3,979	82	3,897	14,945	82	14,863
Terminated leases due to U.S. bankruptcies	(121)	2,289	(2,410)	838	14,238	(13,400)
Total rentals	\$151,668	\$151,257	\$411	\$605,165	\$591,954	\$13,211

The change in same-asset current rentals of \$15.0 million for the year ended December 31, 2009 as compared to the same 2008 period is primarily due to the following items:

- same-asset current rentals from properties in the United States have increased by \$6.1 million primarily due to the increase in the U.S. dollar as compared to the Canadian dollar upon the conversion to Canadian dollars;
- an increase of \$5.6 million of additional rent recoverable from tenants in accordance with their leases with no corresponding expenses as these items were capitalized to building improvements;
- an increase of \$3.3 million due to rent increases during the term of tenant leases. This increase is offset by a decrease to the straight-lining of contractual rent which has an inverse relationship with current rentals;
- an increase of \$1.8 million due to an adjustment in rent amortization of above- and below-market rents for one particular tenant in 2008; and
- a decrease of \$1.6 million in tenant recoveries due to lower property operating expenses.

Property Operating Costs

Property operating costs include costs relating to such items as cleaning, interior and exterior building repairs and maintenance, elevator, HVAC and insurance (collectively "building operating costs"); realty taxes; utilities and property management fees (see "Related Party Transactions") among other items. For Q4 2009, building operating costs, realty taxes, utilities and property management fees represented 22.2%, 51.3%, 12.3%, and 4.2% respectively of total property operating costs (Q4 2008 - 25.1%, 50.5%, 10.0% and 5.3%). For the year ended December 31, 2009, these costs represented 19.6%, 54.2%, 11.8% and 4.5% respectively of property operating costs (December 31, 2008 - 21.2%, 52.2%, 11.5% and 5.7%).

Property Operating Costs (in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Same-asset property operating costs	\$49,137	\$53,081	(\$3,944)	\$189,559	\$193,062	(\$3,503)
Acquisitions	1,332	4	1,328	4,852	4	4,848
Terminated leases due to U.S. bankruptcies	66	353	(287)	1,204	2,974	(1,770)
Total property operating costs	\$50,535	\$53,438	(\$2,903)	\$195,615	\$196,040	(\$425)

The decrease in same-asset property operating costs of \$3.9 million for Q4 2009 as compared to Q4 2008 is due primarily to the following reasons:

- lower expenses related to the REIT's U.S. properties of \$1.7 million due primarily to the change in foreign exchange rates;
- lower management fees of \$0.7 million; and
- lower expenses of \$1.6 million.

The decrease in same-asset property operating costs for the year of \$3.5 million is due primarily to the following reasons:

- higher expenses related to the REIT's U.S. properties of \$0.6 million due primarily to the change in foreign exchange rates;
- lower management fees of \$2.5 million; and
- lower expenses of \$1.6 million.

Same-Asset Property Operating Income *

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Same-asset rentals	\$147,810	\$148,886	(\$1,076)	\$589,382	\$577,634	\$11,748
Same-asset - property operating costs	49,137	53,081	(3,944)	189,559	193,062	(3,503)
Total same-asset - property operating income *	98,673	95,805	2,868	399,823	384,572	15,251
Total same-asset - property operating income excluding straight-lining of contractual rent	\$96,153	\$92,204	\$3,949	\$387,200	\$368,693	\$18,507

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

Total same-asset property operating income, excluding straight-lining of contractual rent, has increased by \$3.9 million for the three months ended December 31, 2009 and by \$18.5 million for the year ended December 31, 2009 as compared to the respective 2008 periods. Same-asset property operating income split between Canada and the United States is shown below.

Canada (in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Same-asset current rentals	\$122,045	\$117,740	\$4,305	\$475,747	\$466,866	\$8,881
Same-asset property operating costs	45,330	47,559	(2,229)	172,535	176,607	(4,072)
Same-asset property operating income excluding straight-lining of contractual rent	76,715	70,181	6,534	303,212	290,259	12,953
United States (in thousands of dollars)						
Same-asset current rentals	\$23,245	\$27,545	(\$4,300)	\$101,012	\$94,889	\$6,123
Same-asset property operating costs	3,807	5,522	(1,715)	17,024	16,455	569
Same-asset property operating income excluding straight-lining of contractual rent *	19,438	22,023	(2,585)	83,988	78,434	5,554
Total same-asset property operating income *	\$96,153	\$92,204	\$3,949	\$387,200	\$368,693	\$18,507

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

The increase in the Canadian same-asset property operating income for the three months and the year ended December 31, 2009 as compared to the three months and the year ended December 31, 2008 is primarily due to (i) increased recoverable amounts from tenants for expenditures capitalized to building improvements of \$2.1 million and \$5.6 million respectively; (ii) the decrease in management fees of \$0.7 million and \$2.5 million respectively; (iii) the increase of \$3.0 million and \$1.8 million respectively of the

adjustment in rent amortization of above- and below-market rent for one particular tenant in 2008 and (iv) contractual rental increases in accordance with lease agreements of \$1.1 million and \$3.3 million.

The increase in the U.S. same-asset property operating income for the year is due primarily to the strengthening of the U.S. dollar. The decrease in Q4 2009 is due primarily to the weakening of the U.S. dollar quarter over quarter. Had the U.S. same-asset property operating income been reported in U.S. dollars, there would have been minimal changes both quarter over quarter and year over year.

Interest Income

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Interest income	\$1,621	\$1,045	\$576	\$6,222	\$3,294	\$2,928

Interest income increased when comparing both Q4 2009 to Q4 2008 and for the year ended December 31, 2009 as compared to December 31, 2008. The increase is primarily due to two new vendor take back mortgages totalling \$61 million which the REIT granted upon the sale of 110 Bloor Street West in Toronto, Ontario in December of 2008.

Interest

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Contractual interest on mortgages payable	\$44,352	\$47,085	(\$2,733)	\$181,442	\$182,965	(\$1,523)
Contractual interest on debentures payable	10,334	1,944	8,390	27,884	4,379	23,505
Effective interest rate accretion	2,069	558	1,511	5,564	1,096	4,468
Bank interest and charges	190	806	(616)	2,193	4,293	(2,100)
	56,945	50,393	6,552	217,083	192,733	24,350
Capitalized interest	(10,661)	(7,689)	(2,972)	(34,412)	(22,793)	(11,619)
Mortgage and other interest expense	\$46,284	\$42,704	\$3,580	\$182,671	\$169,940	\$12,731

Included in mortgage interest for the three months ended December 31, 2009 is an accrual of \$2.4 million (Q4 2008 - \$1.9 million) which relates to interest accrued for the mortgages on those properties where the tenant has filed for protection under Chapter 11 of the United States Bankruptcy Code. The amount accrued for the year is \$10.1 million (2008 - \$2.5 million). Upon the lender taking title to the properties and releasing the REIT's subsidiaries from all obligations under these mortgages this accrual will be reversed into income. During the fourth quarter of 2009, the REIT was released from its obligation on one of the mortgages which related to one of the income properties tenanted by Bruno's Supermarkets LLC. As at both December 31, 2009 and 2008, the REIT's weighted average contractual mortgage rate was 6.2%.

Debenture interest increased due to the REIT issuing \$115 million of convertible debentures in June 2008 (at a contractual annual interest rate of 6.65%), \$200 million of non-convertible debentures in April 2009 (at a contractual annual interest rate of 11.50%), \$150 million of convertible debentures in July 2009 (at a contractual annual interest rate of 6.75%) and \$175 million of convertible debentures in December 2009 (at a contractual annual interest rate of 6.00%).

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

Impairment Loss on Income Properties

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Impairment loss on income properties	\$268	\$3,006	(\$2,738)	\$14,764	\$53,237	(\$38,473)

On November 10, 2008, a tenant, Circuit City, filed for Chapter 11 protection with a United States bankruptcy court. The tenant subsequently terminated its lease on March 22, 2009. The industrial building occupied by Circuit City has a gross leasable area of approximately 1,078,000 square feet. The REIT has written down the property to its estimated fair value of USD \$19.8 million.

On February 5, 2009, Bruno's Supermarkets LLC filed for Chapter 11 protection and on May 31, 2009 terminated its leases for the three retail properties owned by the REIT. On November 4, 2009, the lender accepted title to one of the properties located in Demopolis, Alabama. As a result, the income property of \$6.7 million and the mortgage of \$6.8 million were written off/discharged from the balance sheet with the difference being recorded as an impairment loss. The REIT has written down the value of the remaining two properties to their estimated fair value of USD \$9.9 million. This represented the fair value of the properties as required under GAAP. The amount that was recorded in 2008 was due to a tenant, Boscov's Department Stores, which filed for Chapter 11 protection with a United States bankruptcy court on August 4, 2008. The tenant terminated all seven leases, and the REIT wrote down the properties to their estimated fair value of USD \$106.9 million.

The impairment of these properties has led to an impairment loss of \$0.3 million for the three months ended December 31, 2009 (Q4 2008 - \$3.0 million) and of \$14.8 million for the year ended December 31, 2009 (2008 - \$53.2 million).

Unrealized Gain (Loss) on Swap Derivatives

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Unrealized gain (loss) on swap derivatives	(\$1,213)	-	(\$1,213)	\$3,463	-	\$3,463

Upon entering into the construction facility for the Bow, the REIT entered into an interest rate swap which is intended to lock the effective interest rate on the construction facility at 6.90%. At the end of each reporting period, the interest rate swap must be marked to market, resulting in an unrealized gain or loss recorded in net earnings. Upon the construction facility being utilized, the difference between the hedged rate and the actual rate will be recorded as a realized gain or loss in net earnings. A realized gain or loss will be recorded upon maturity of the swap which will coincide with the maturity of the construction facility.

Net Loss on Foreign Exchange

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Net loss on foreign exchange	\$2,125	\$10,915	(\$8,790)	\$20,509	\$7,090	\$13,419

The net loss on foreign exchange, which was recorded in Finance Trust, is due to a difference in exchange rates, between January 1, 2009 and December 31, 2009 as the notes receivable from U.S. Holdco (which is eliminated upon combination) are denominated in U.S. dollars while the financial statements of Finance Trust are expressed in Canadian dollars.

In connection with the Plan of Arrangement, the REIT was required to record a realized loss upon the repayment of the existing U.S. dollar loan it had with its wholly owned subsidiary. The loan represented its net investment in U.S. Holdco prior to the REIT's intention to repatriate the loan on October 1, 2008 (the date the loan was repaid). The cumulative amount of foreign currency, which was reported in other comprehensive income, was realized and reduced by \$27.3 million.

Trust Expenses

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Trust expenses	\$2,600	\$3,664	(\$1,064)	\$8,551	\$10,494	(\$1,943)

Trust expenses are primarily comprised of salaries, professional fees and trustee fees. Trust expenses decreased quarter over quarter and year over year. The primary reason for the decrease is due to \$1.6 million for Q4 2008 and \$3.8 million for the year ended December 31, 2008 of non-recurring costs which were incurred in 2008 with regards to the Plan of Arrangement offset by costs incurred with respect to the implementation of IFRS totalling \$0.5 million for the three months and year ended December 31, 2009 respectively (see page 36).

<i>Income Tax Expense (Recovery)</i> <i>(in thousands of dollars)</i>	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Current income taxes	\$85	(\$345)	\$430	\$364	\$1,598	(\$1,234)
Future income taxes	(17,480)	4,940	(22,420)	(9,613)	15,628	(25,241)
Total income taxes	(\$17,395)	\$4,595	(\$21,990)	(\$9,249)	\$17,226	(\$26,475)

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

Due to the enactment of the specified investment flow-through ("SIFT") rules on June 22, 2007, the REIT commenced recognizing future income tax assets and liabilities with respect to the temporary differences between the carrying amounts and tax bases of its assets and liabilities, including those related to its subsidiary trusts, that are expected to reverse in or after 2011. The SIFT rules are not expected to apply to the REIT before 2011 as they provide a transition period for publicly traded trusts such as the REIT that qualified as a SIFT trust prior to November 1, 2006 provided the REIT does not at any time after December 15, 2006 exceed the normal growth guidelines released by the Department of Finance. In addition, the SIFT rules do not apply to an entity that qualifies for the REIT exemption. On March 12, 2009, legislation for technical amendments to the SIFT rules received royal assent. These technical amendments make it easier to qualify for the REIT exemption, including removing any distinction between Canadian and foreign real properties.

The REIT does not currently meet certain technical requirements for the REIT exemption. Management is of the view that it can make changes that are within its control in order to qualify for the REIT exemption prior to 2011. One of these changes which occurred was the purification of H&R Portfolio Limited Partnership to remove the circularity of ownership which was an issue for SIFT purposes. This change occurred on November 30, 2009. As the REIT currently does not qualify for the REIT exemption, GAAP requires the REIT to prepare its accounts on the basis that the new rules currently apply. Future income tax assets or liabilities are recorded using tax rates and laws expected to apply when the temporary differences are expected to reverse. The SIFT rules resulted in the REIT recording a future income tax recovery of \$17.5 million reflected in consolidated earnings for the three months ended December 31, 2009 and a future income tax recovery of \$0.1 million reflected in other comprehensive income. For the year ended December 31, 2009, a future income tax recovery of \$9.6 million has been recorded in consolidated earnings and a future income tax recovery of \$1.0 million reflected in other comprehensive income. The significant reason for the recording of a recovery is due to a decrease in enacted tax rates for temporary differences expected to reverse beyond 2014. Temporary differences expected to reverse in or after 2011 have been measured using a tax rate of 28.25% in 2011 and 25% for temporary differences expected to reverse beyond 2014.

See the "Tax Risk" section for a discussion of draft legislation proposed by the Minister of Finance regarding the federal income taxation of publicly listed or traded income trusts and certain other flow-through entities.

Net Earnings (loss) from Discontinued Operations

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

Net Earnings (loss) from Discontinued Operations

(in thousands of dollars)	Three months ended December 31			Year ended December 31		
	2009	2008	Change	2009	2008	Change
Net property operating income	\$1,439	\$1,841	(\$402)	\$6,200	\$11,327	(\$5,127)
Impairment loss on income properties	-	(428)	428	-	(428)	428
Gain (loss) on sale of income properties	(3,118)	41,160	(44,278)	10,649	71,420	(60,771)
Non-controlling interest	61	(1,887)	1,948	(621)	(3,863)	3,242
Net earnings (loss) from discontinued operations	(\$1,618)	\$40,686	(\$42,304)	\$16,228	\$78,456	(\$62,228)

During the three months ended December 31, 2009, the REIT sold one income property (December 31, 2008 - one) for gross proceeds of \$140.0 million (Q4 2008 - \$79.0 million). For the year ended December 31, 2009, the REIT sold seven income properties (December 31, 2008 - 16) for gross proceeds of \$216.6 million (2008 - \$302.7 million). The net earnings (loss) from discontinued operations include the results from these properties as well as from the properties currently held for sale.

Dispositions from January 1, 2009 to December 31, 2009

Property	Property Type	Date Sold	Square Footage	Gross Proceeds (\$ Millions)	Ownership Interest disposed
2435 EW Connector, Austell, GA	Retail	Feb 10, 2009	115,396	\$16.4	100%
97 Thames Rd., E. Exeter, ON	Industrial	Mar 16, 2009	84,000	4.4	100%
1711 Springfield Rd., Kelowna, BC	Retail	June 3, 2009	110,178	18.4	100%
6660 Financial Drive, Mississauga, ON	Industrial	July 16, 2009	164,236	11.8	100%
2089 West Neways Dr., Springville, UT	Office	July 28, 2009	84,511	8.6	55%
75 Frontenac Dr., Markham, ON	Industrial	Aug 04, 2009	243,614	17.0	100%
500 Bayly St. E., Ajax, ON	Industrial	Dec 18, 2009	909,286	140.0	100%
Total			1,711,221	\$216.6	

Dispositions from January 1, 2008 to December 31, 2008

Property	Property Type	Date Sold	Square Footage	Gross Proceeds (\$ Millions)	Ownership Interest disposed
6580 Millcreek Dr., Mississauga, ON	Industrial	Mar 05, 2008	249,634	\$21.2	100%
6590 Millcreek Dr., Mississauga, ON	Industrial	Mar 05, 2008	225,694	19.2	100%
1750 Deptford Centre Rd., Deptford, NJ	Retail	May 20, 2008	175,752	13.8	55%
720 Maloney Blvd., Gatineau, QC	Retail	June 26, 2008	283,970	43.6	100%
220 Chain Lake Drive, Halifax, NS	Retail	June 26, 2008	138,027	17.4	100%
1701 Merivale Rd., Ottawa, ON	Retail	June 26, 2008	127,489	32.7	100%
1160 Desserte Ouest, Laval, QC	Retail	June 26, 2008	116,147	10.9	100%
878-894, 900 Tower St., S, Fergus, ON	Retail	June 26, 2008	105,955	9.1	100%
1345-1365 Huron St. and 1250-1270 Highbury Ave., London, ON	Retail	June 26, 2008	87,529	15.2	100%
448 St. Clair St., Chatham, ON	Retail	June 26, 2008	71,423	8.7	100%
110 North Front St., Belleville, ON	Retail	June 26, 2008	66,714	10.2	100%
857 Cecile Blvd., Hawkesbury, ON	Retail	June 26, 2008	54,950	3.8	100%
900 Aberdeen Ave., Hawkesbury, ON	Retail	June 26, 2008	17,032	4.3	100%
21 College St. W., Belleville, ON	Retail	June 26, 2008	5,211	0.3	100%
2810 Matheson Blvd., E, Mississauga, ON	Office	Aug 19, 2008	129,103	13.3	50%
110 Bloor St., W., Toronto, ON	Office	Dec 05, 2008	86,164	79.0	100%
Total			1,940,794	\$ 302.7	

Properties currently held for sale

Property	Property Type	Square Footage	Ownership Interest
2390 Argentia, Mississauga, ON	Industrial	179,054	100%
110 Sheppard Ave. E., North York, ON	Office	154,022	50%

The REIT has entered into purchase and sale agreements for the above income properties with closings for both expected before March 15, 2010. Prior to December 31, 2009, for both income properties, all conditions to complete the sale by the REIT were waived by the parties to the purchase and sale agreements. See Subsequent Events for further information.

SEGMENTED INFORMATION

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

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

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

Net property operating income for the three months ended December 31, 2009

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$129,512	\$23,777	\$153,289
Property operating costs	(46,640)	(3,895)	(50,535)
Interest	(33,291)	(12,993)	(46,284)
Depreciation and amortization	(23,028)	(11,836)	(34,864)
Net property operating income	\$26,553	(\$4,947)	\$21,606

Net property operating income for the three months ended December 31, 2008

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$121,690	\$30,612	\$152,302
Property operating costs	(48,097)	(5,341)	(53,438)
Interest	(26,938)	(15,766)	(42,704)
Depreciation and amortization	(20,583)	(9,070)	(29,653)
Net property operating income	\$26,072	\$435	\$26,507

For the three months ended December 31, 2009, the net property operating income for properties located in the United States is a loss of \$4.9 million as compared to income of \$0.4 million for the three months ended December 31, 2008. The change of \$5.4 million is primarily composed of a decrease in net property operating income of \$5.4 million from those properties where the tenants have terminated their leases due to U.S. bankruptcies. Of this amount, \$4.5 million was a catch up in depreciation expense from October 1, 2008.

Had the net property income for properties located in the United States been shown in U.S. dollars, and excluding the item above, it would have shown income of \$2.0 million for the three months ended December 31, 2009 as compared to income of \$1.7 million for the three months ended December 31, 2008. The increase of \$0.3 million is primarily due to a decrease in mortgage and other interest expense.

Net property operating income for the year ended December 31, 2009

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$506,679	\$104,708	\$611,387
Property operating costs	(177,351)	(18,264)	(195,615)
Interest	(125,294)	(57,377)	(182,671)
Depreciation and amortization	(91,625)	(37,018)	(128,643)
Net property operating income	\$112,409	(\$7,951)	\$104,458

Net property operating income for the year ended December 31, 2008

(in thousands of dollars)	Canada	United States	Total
Operating revenue	\$483,522	\$111,726	\$595,248
Property operating costs	(177,146)	(18,894)	(196,040)
Interest	(115,029)	(54,911)	(169,940)
Depreciation and amortization	(87,810)	(34,195)	(122,005)
Net property operating income	\$103,537	\$3,726	\$107,263

For the year ended December 31, 2009, the net property operating income for properties located in the United States is a loss of \$8.0 million as compared to income of \$3.7 million for the year ended December 31, 2008. The change of \$11.7 million is primarily composed of a decrease in net property operating income of \$13.4 million from those properties where the tenants have terminated their leases due to U.S. bankruptcies.

Had the net property operating income for properties located in the United States been shown in U.S. dollars, and excluding the item above, it would have shown income of \$7.5 million for the year ended December 31, 2009 as compared to income of \$6.3 million for the year ended December 31, 2008. The increase of \$1.2 million is primarily due to a decrease in mortgage and other interest expense.

ASSETS
Income Properties

There were no properties acquired during the year ended December 31, 2009. The table below lists the properties acquired during the year ended December 31, 2008. These acquisitions less the mortgages assumed at closing were funded from the REIT's general operating facility and from the proceeds received from the securities offering that was completed in June 2008.

2008 Acquisitions:

Property	Property Type	Date Acquired	Square Footage	Purchase Price (\$ Millions)	Contractual Mortgages Assumed on Closing (\$ Millions)	Ownership Interest Acquired
200 Monroeville Mall, Monroeville, PA	Retail	Feb 12, 2008	263,700	\$11.7	\$8.7	* 45%
301 South Hills Village, Pittsburgh, PA	Retail	Feb 12, 2008	264,855	11.5	8.6	* 45%
8220 Perry Hall Blvd., Nottingham, MD	Retail	Feb 12, 2008	219,996	10.3	7.7	* 45%
10300 Mill Run Circle, Owings Mill, MD	Retail	Mar 24, 2008	293,060	10.5	7.8	* 45%
7900 Richie Hwy., Glen Burnie, MD	Retail	Mar 24, 2008	274,050	10.6	7.9	* 45%
500 Montgomery Mall, North Wales, PA	Retail	Mar 24, 2008	182,541	9.3	6.9	* 48%
2300 East Lincoln Hwy., Langhorne, PA	Retail	Mar 24, 2008	181,212	9.4	6.9	* 48%
SE corner of Washington Rd., & Harrison Rd., Thompson, GA ⁽¹⁾	Retail	Oct 16, 2008	14,550	5.4	-	100%
Total			1,693,964	\$ 78.7	\$54.5	

* Indicates non-recourse. Non-recourse mortgages are generally non-recourse to the REIT but have recourse to the specific property to which the mortgage applies

⁽¹⁾ Upon the sale of a property in 2007, the mortgage on that property was not discharged. That mortgage was transferred to this property upon its purchase. The amount of the mortgage outstanding at the date of acquisition was \$2.9 million with an interest rate of 5.8%

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

Income properties decreased by \$186.5 million which arose as a result of the U.S. dollar converting at \$1.05 Canadian at December 31, 2009 as compared to \$1.22 Canadian at December 31, 2008.

After accounting for the change in foreign exchange, the transfer of a \$119 million property from properties under development to income properties, the dispositions and impairment write down mentioned previously and for depreciation and amortization expensed, income properties decreased by 9% to \$4.12 billion at December 31, 2009 from \$4.52 billion at December 31, 2008.

The portfolio remains in good condition. The average age of the total portfolio from the date built or renovated is 16.3 years at December 31, 2009 (December 31, 2008 - 14.9 years) and the split between type of asset by age of property is as follows:

Average Age by Type of Asset	December 31, 2009 (years)	December 31, 2008 (years)
Office	18.4	18.1
Industrial	16.9	15.0
Retail	12.1	11.2
Total	16.3	14.9

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

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

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

Book Value by Type of Asset (millions)	December 31, 2009	December 31, 2008
Office	\$1,565	\$1,493
Industrial	1,388	1,655
Retail	1,172	1,369
	\$4,125	\$4,517

Book Value by Region (millions)	December 31, 2009	December 31, 2008
Ontario	\$1,763	\$1,846
Alberta	595	608
Other	433	471
Quebec	238	244
Canada	3,029	3,169
United States	1,096	1,348
Total	\$4,125	\$4,517

As part of the change in accounting policy effective January 1, 2009 (see "Changes to Significant Accounting Policies for 2009") whereby capital expenditures are now either capitalized and depreciated or expensed in the year incurred, the REIT expects to incur the following costs:

Year	Total Amount Expected to Incur	Amount Expected to be Capitalized	Amount Expected to be Expensed to Property Operating Costs	Total Expected Recovery	Amount Expected to be Recovered in the Year Incurred	Amount Expected to be Recovered thereafter
2010	\$24 million	\$18 million	\$6 million	\$21 million	\$16 million	\$5 million
2011	\$14 million	\$10 million	\$4 million	\$12 million	\$10 million	\$2 million

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

Properties Under Development

The REIT entered into agreements to develop the Bow, a 2 million square foot head office complex in Calgary, Alberta for a budgeted cost of approximately \$1.5 billion, including expected capitalized interest, and net of rent received during the construction period. The budget includes the cost to construct 1,360 parking stalls. The total budget includes approximately \$41 million in development cost contingencies. The REIT has entered into fixed price contracts amounting to approximately 82% of the budgeted \$1.1 billion of hard construction costs. As a result, together with the costs incurred to date, the REIT has effectively locked in approximately 87% of the total budget before contingencies. See Section VI for a discussion on development and financing risk relating to the Bow.

The REIT is expecting to incur approximately \$233 million of the Bow's development costs over the next six months. See "Liquidity and Capital Resources" for the budget breakdown and the anticipated sources of funds.

The building is fully pre-leased to EnCana Corporation for 25 years. EnCana Corporation will begin to occupy the building in tranches scheduled to commence in the second half of 2011 with the final tranche occurring in 2012. The total annualized year one projected income from the Bow is expected to be \$94.3 million. Rent step ups will be 0.75% per annum on the office space and 1.5% per annum on the parking income for the full 25-year term. During the year ended December 31, 2009, the REIT incurred additional costs of \$317.2 million in this project to bring the REIT's total investment to \$719.2 million (December 31, 2008 - \$402.0 million). Structural steel erection has now reached the 33rd floor. Metal deck installation is complete to the 31st floor.

During Q4 2007, the REIT exercised its purchase option and commenced construction of the 348,000 square foot Phase III expansion of Bell Canada's state-of-the-art office complex in Mississauga, Ontario. The project had a construction cost of \$119 million. This project was transferred to income properties in Q1 2009 once the asset was available for use. The tenant commenced paying rent from January 1, 2009.

An investment was made in March 2006 (in which the REIT has an 80% interest) to purchase 72 acres of development land located on Airport Road in Mississauga, Ontario. The project is expected to provide a total of 1.6 million square feet of single tenant industrial distribution facilities upon completion. The REIT has granted a mortgage receivable to the joint venture for \$16 million in total.

In August 2008, an investment was made to purchase 98.6 acres of development land located in Caledon, Ontario. The land forms part of the planned community of Mayfield West. The project is expected to produce 1,750,000 sq.ft. of industrial properties.

Accrued Rent Receivable

Certain leases call for rental payments that increase over the lease term. To comply with Canadian GAAP, the rental revenue from these leases are recorded on a straight-line basis, resulting in accruals for rents that are not billable or due until future periods. Accrued rent receivable has increased by 7% or \$7.9 million from \$117.3 million at December 31, 2008 to \$125.2 million at December 31, 2009 with a corresponding increase to rentals from income properties.

The chart below lists some of the larger contractual rental step ups for the REIT occurring over the next 12 months:

Property	Sq.ft.	Rent Increase (\$ psf)	Effective date of increase	Annualized Rental Increases (in thousands of dollars)
1400 Church St.	716,261	0.58	Jan 17, 2010	415
Purolator Courier Portfolio (9 properties)	726,448	0.90	April 1, 2010	654
Shell Oil Company (2 properties)	27,450	6.13	May 1, 2010	168
Northpointe Shopping Centre	85,423	2.75	May 5, 2010	235
500 Palladium Dr.	329,612	0.80	June 1, 2010	264
300 Humber College Blvd.	114,316	0.83	Nov 1, 2010	95

Cash and cash equivalents

Cash and cash equivalents increased to \$109.2 million at December 31, 2009 from \$17.2 million at December 31, 2008 primarily due to the 2017 Convertible Debentures which were issued at the end of December 2009.

<i>Mortgages and Amount Receivable (in thousands of dollars)</i>	December 31, 2009	December 31, 2008
Mortgage receivable bearing contractual interest at 6.00% per annum and repayable on December 1, 2010	\$57,589	\$57,050
Mortgage receivable bearing contractual interest at 5.30% per annum and repaid on December 15, 2009	-	16,360
Mortgage receivable bearing contractual interest at prime plus 1.15% per annum and repayable 60 days after demand	3,200	3,200
Mortgage receivable bearing contractual interest at 6.00% per annum and repayable on December 1, 2013	3,000	3,000
Amount receivable	-	10,461
Mortgages and Amount Receivable	\$63,789	\$90,071

Amount receivable related to the sale of 10 income properties during 2008, whereby the purchaser agreed to assume an aggregate mortgage balance of \$82.6 million and indemnify the REIT until such time that the lenders consent and release the REIT in respect of these mortgages. The releases on the final two mortgages with a balance of \$10.5 million were obtained during 2009.

<i>Other Assets (in thousands of dollars)</i>	December 31, 2009	December 31, 2008
Tenant inducements	\$29,797	\$14,997
Deferred leasing expenses	27,542	28,276
Restricted cash	20,001	4,504
Future income tax assets	14,316	12,254
Prepaid expenses and sundry assets	12,811	13,652
Accounts receivable	6,543	6,959
Swap derivatives	3,463	-
Other Assets	\$114,473	\$80,642

Tenant inducements represent those costs for which the REIT has given the tenant cash as an inducement to enter into a lease agreement. This amount is amortized over the life of the applicable lease and the amortization is deducted from rentals from income properties. Tenant inducements for the period ended December 31, 2009 increased by \$14.8 million primarily due to inducements payable for Bell Canada Phase III amounting to \$17.5 million offset by normal amortization. This inducement was part of the construction budget.

Restricted cash increased from \$4.5 million at December 31, 2008 to \$20.0 million at December 31, 2009 due primarily to \$6.1 million which is being held in escrow relating to construction holdbacks subject to mortgage financing for Bell Canada Phase III along with \$9.8 million from one tenant who paid their rent in advance for the majority of 2010.

Swap derivatives represent the fair value of the interest rate swap on the Bow construction facility. The fair value as at December 31, 2009 is \$3.5 million.

LIABILITIES

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

	December 31, 2009	December 31, 2008
Total debt to GBV per the Declaration of Trust ⁽¹⁾	52.5%	54.8%
Total debt to GBV	56.8%	56.4%
Non-recourse debt as a percentage of total debt	44.9%	51.4%
Floating rate debt as a percentage of total debt	0.4%	3.3%
Canadian properties total debt to GBV	56.6%	54.0%
U.S. properties total debt to GBV	66.5%	68.2%

⁽¹⁾ Total debt per the REIT's Declaration of Trust excludes all convertible debentures and the notes payable to Finance Trust and includes guarantees of \$119.2 million (December 31, 2008 - \$14.3 million). The REIT's calculation of total debt to GBV is not recognized under GAAP and therefore does not have a standardized meaning prescribed by GAAP.

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

Mortgages Payable

Mortgages payable decreased from the December 31, 2008 figure of \$3.15 billion to \$2.82 billion as at December 31, 2009. The decrease is primarily due to a decrease in the U.S. dollar whereby the conversion rate at December 31, 2008 was \$1.22 and at December 31, 2009 was \$1.05, resulting in a decrease of \$145.2 million. In addition to this change, other items affecting mortgages payable are the repayment and discharge of eight mortgages totalling \$61.9 million, the assumption of \$116.9 million of mortgages by the purchasers upon the sale of properties along with regular principal repayments of \$91.7 million. During the quarter ended September 30, 2009, a mortgage totalling \$85 million was advanced on Bell Canada Phase III. The mortgage bears interest at a contractual rate of 6.5% and is for a term of 5 years.

The mortgages bear interest at the weighted average rate of 6.2% (December 31, 2008 – 6.2%) and mature between 2010 and 2035. The weighted average term to maturity of the REIT's mortgages is 8.3 years (December 31, 2008 - 9.3 years). Going forward based on current market conditions and current lenders, the REIT anticipates being able to refinance all its debt as it matures. Notwithstanding this, the REIT may choose to repay some of its mortgages as they mature. Of the total mortgage balance, only 4.1% will mature in 2010. The mortgages coming due before the end of 2010 bear interest at a weighted average rate on maturity of 6.2%. For a further discussion of interest rate risk, please see "Risks and Uncertainties".

Segmented disclosure by geographic location is provided as follows:

(in thousands of dollars)	December 31, 2009	December 31, 2008
Canada	\$1,950,224	\$2,100,808
United States	868,252	1,050,703
Total	\$2,818,476	\$3,151,511

Debentures Payable

	Contractual Interest Rate	Effective Interest Rate	Face Value	Carrying Value December 31, 2009	Carrying Value December 31, 2008
2013 Convertible Debentures	6.65%	9.10%	\$115 million	\$106.8 million	\$104.8 million
Non-Convertible Debentures	11.50%	12.90%	\$200 million	188.8 million	Nil
2014 Convertible Debentures	6.75%	12.30%	\$150 million	119.4 million	Nil
2017 Convertible Debentures	6.00%	8.60%	\$175 million	150.8 million	Nil
			\$640 million	\$565.8 million	\$104.8 million

During the year ended December 31, 2009, the REIT issued \$525 million of debentures of which \$325 million are convertible into Stapled Units. The 2014 Convertible Debentures are convertible at \$14.00 per Stapled Unit and the 2017 Convertible Debentures are convertible at \$19.00 per Stapled Unit.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities increased by \$37.7 million from \$129.3 million at December 31, 2008 to \$167.0 million at December 31, 2009. The change is mostly due to an increase in accruals relating to properties under development and tenant inducements. These accruals at December 31, 2009 totalled \$74.5 million as compared to \$48.8 million at December 31, 2008. The total interest accrued to date on the non-recourse mortgages under default is \$11.7 million (December 31, 2008 - \$2.8 million). There is also a general increase in other payables and accruals relating to transactions occurring in the normal course of business operations.

Future Income Tax Liability

The SIFT rules (as defined in income taxes on page 14) resulted in the REIT including a future income tax liability of \$138.1 million in the consolidated balance sheet at December 31, 2009 (December 31, 2008 - \$144.0 million) with a corresponding future income tax recovery of \$9.6 million reflected in consolidated earnings for the year ended December 31, 2009. The primary reason for the decrease in this liability is due to the enactment of lower provincial tax rates that impacts temporary differences reversing beyond 2014. Temporary differences expected to reverse in or after 2011 have been measured using a tax rate of 28.25% in 2011 and 25% for temporary differences expected to reverse beyond 2014.

Intangible Liabilities

For all acquisitions subsequent to September 12, 2003, the acquisition cost is allocated to land, buildings, paving and equipment and intangible costs. The portion of the purchase price that is allocated to "below-market-value rents" is recorded as a liability on the REIT's balance sheet and is amortized over the related lease. This amount has decreased to \$57.2 million at December 31, 2009 as compared to \$64.3 million as at December 31, 2008 due to the write off for tenants who have vacated, the sale of properties, the change in foreign exchange rates and normal amortization incurred.

The change in this liability in the future will be dependent upon the leases that are in place in future acquisitions and the rent in place as compared to market rents at the time of purchase of the related asset.

Bank Indebtedness

Bank indebtedness decreased by \$99.3 million from \$112.9 million at December 31, 2008 to \$13.6 million at December 31, 2009. The change is primarily a result of the issuance of the 2014 Convertible Debentures, the Non-Convertible Debentures and the 2017 Convertible Debentures which were used to lower bank indebtedness offset by the cash required for properties under development and the cash required for the cancellation of the Fairfax Warrants.

Non-Controlling Interest

During November 2004, as part of the acquisition of substantially all of the 30% interest of the remaining properties in which the REIT acquired an initial 70% interest as part of its 1996 initial public offering the REIT issued 6,974,555 units to its subsidiary H&R Portfolio Limited Partnership ("HRLP"), which was set up to complete this transaction. The participating vendors exchanged their interest in these properties for 5,696,610 Class B units of HRLP as well as subscribing for an additional 1,277,945 Class B units of

HRLP at the same time. These units are now exchangeable on a one for one basis for Stapled Units. During the year ended December 31, 2008, 1,536,990 Class B units were exchanged for Stapled Units.

As clarified by EIC-151, since these Class B units can be transferred without requirement and can be exchanged for Stapled Units, the aggregate outstanding amount at any point in time of the exchangeable Class B units of HRLP shall be recorded as a non-controlling interest on the REIT's financial statements until such time as these Class B units have been exchanged for Stapled Units. As Class B units are exchanged over time into Stapled Units, the conversion will result in a transfer to unitholders' equity and the non-controlling interest will be reduced accordingly.

On November 30, 2009, the REIT and Finance Trust completed a reorganization (the "2009 Reorganization") as part of the steps required to assist the REIT in furthering to qualify for the REIT exemption under the SIFT Rules contained in the Income Tax Act (Canada), as described under "Canadian Federal Income Tax Considerations - SIFT Rules". The 2009 Reorganization involved, among other things, a redemption by the REIT and Finance Trust of the 5,437,565 Stapled Units held by HRLP. In accordance with the respective Declarations of Trust for the REIT and Finance Trust and upon the exercise of discretion by the trustees of the REIT as provided for in the declaration of trust of the REIT, the redemption price for the REIT Units was paid in cash, while Finance Trust delivered U.S. Holdco Notes in payment of the redemption price for the Finance Trust Units redeemed.

Each Class B Limited Participation LP unit of the Partnership ("Class B LP unit") remains entitled to cash distributions from HRLP equal to the cash distributions on a Stapled Unit, and the Class B LP units of HRLP continue to be exchangeable for the same number of Stapled Units post 2009 Reorganization as prior to the 2009 Reorganization (except that such Stapled Units will be issued from treasury at the time of the exchange). The 2009 Reorganization was neutral to the capitalization of the REIT and Finance Trust, as on a fully-diluted basis there is no change to the capitalization of the Trust.

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

The 2009 Reorganization has resulted in a more conventional exchangeable limited partnership structure, comparable to other income funds and investment trusts whereby the underlying equity securities that the limited partnership units are exchangeable into are not outstanding but rather will be issued at the time of the exchange.

USE OF PROCEEDS FROM FINANCING ISSUED

Financing	Disclosed Use of Proceeds	Actual Use of Proceeds
Private offering of \$200 million of non-convertible debentures completed on April 24, 2009.	To fund the development of the Bow. Proceeds intended to fund the Bow not initially used for such purposes were to be used for general trust purposes.	The entire net proceeds were used for general trust purposes and/or invested in short-term instruments.
Public offering of \$150 million of convertible debentures completed on July 30, 2009.	To fund the development of the Bow. Proceeds intended to fund the Bow not initially used for such purposes were to be used for general trust purposes.	The entire net proceeds were used for general trust purposes and/or invested in short-term instruments.
Public offering of \$175 million of convertible debentures completed on December 30, 2009.	For general trust purposes, and to the extent that funds available to the REIT from operations or other sources cannot fully satisfy the aggregate redemption price, for Fairfax warrants pursuant to the Fairfax Agreement, certain of the proceeds may be used to redeem the Fairfax Warrants.	The entire net proceeds were used for general trust purposes and/or invested in short-term instruments.

Bow development expenses were incurred throughout the year, and funded from cash generally available to the REIT. The private offering of \$200 million of non-convertible debentures on April 24, 2009 and the public offering of \$150 million of convertible debentures on July 30, 2009 indirectly increased the amount of cash available to the REIT for such purpose.

EQUITY

Unitholders' Equity

Unitholders' equity decreased by \$138.0 million between December 31, 2008 and December 31, 2009. The decrease is due primarily to the redemption of the Fairfax warrants, distributions paid to unitholders and the change in accumulated other comprehensive income offset by net earnings for the period and the equity component of the convertible debentures.

On December 17, 2009, the REIT announced that it had signed a definitive agreement (the "Fairfax Agreement") that provided the REIT the opportunity to redeem up to 28,571,429 warrants (the "Fairfax Warrants") issued to Fairfax. The warrants were issued simultaneously with the Non-Convertible Debentures in April 2009. On December 29, 2009, the REIT completed the redemption at a cash redemption price of \$6.50 per Fairfax Warrant (representing a fixed reference price of \$13.50 per Stapled Unit less the Fairfax Warrant exercise price of \$7.00). The net amount payable by the REIT to Fairfax was approximately \$185.7 million as all of the Fairfax Warrants were redeemed. See Subsequent Events for a discussion regarding the repurchase of the Non-Convertible Debentures.

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

LIQUIDITY AND CAPITAL RESOURCES

Funds from Operations and Adjusted Funds from Operations

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

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

Funds From Operations (in thousands of dollars except per unit amounts)	Three months ended December 31		Year ended December 31	
	2009	2008	2009	2008
Net earnings	\$29,870	\$45,826	\$86,525	\$97,706
Add (deduct)				
Mortgage interest accruals on non-recourse mortgage defaults	2,425	1,857	10,058	2,540
Depreciation and amortization	34,864	29,653	128,643	122,005
Impairment loss on income properties	268	3,006	14,764	53,237
Loss (gain) on sale of income properties	3,118	(41,160)	(10,649)	(71,420)
Future income taxes	(17,480)	4,940	(9,613)	15,628
Net earnings attributable to non-controlling interest	1,246	1,074	3,670	3,829
Operating income from discontinued operations	(1,439)	(1,841)	(6,200)	(11,327)
Funds from operations – continuing operations	52,872	43,355	217,198	212,198
Funds from operations – discontinued operations	1,585	3,540	7,966	16,143
Funds from operations	\$54,457	\$46,895	\$225,164	\$228,341
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	148,501	146,502	147,946	141,655
Diluted weighted average number of units (in thousands of units) for the calculation of FFO ^{(1) (2)}	173,305	146,502	164,863	142,040
Funds from operations per unit (basic – adjusted for conversion of non-controlling interest)	\$0.37	\$0.32	\$1.52	\$1.61
Funds from operations per unit (diluted) ⁽²⁾	\$0.34	\$0.32	\$1.40	\$1.61

⁽¹⁾ Although the Fairfax warrants were redeemed on December 29, 2009, they are included in the denominator of diluted FFO per unit for the period in which they were outstanding (for the three months and year ended December 31, 2009 13,646,056 units and 12,231,559 units respectively).

⁽²⁾ The 2014 and 2017 Convertible Debentures are dilutive. Debenture interest for the three months and year ended December 31, 2009 of \$3.7 million and \$6.2 million respectively is added to FFO and 10,914,515 units and 4,600,371 units are included in the diluted weighted average number of units outstanding for the respective periods.

Excluding net losses on foreign exchange and swap derivatives, basic FFO per unit would have been \$0.39 for the three months ended December 31, 2009 (Q4 2008 - \$0.39) and \$1.64 for the year ended December 31, 2009 (2008 - \$1.66).

Management believes that AFFO is a more meaningful measure of operating performance as it adjusts FFO for the non-cash items of (i) straight-lining of contractual rent; (ii) rent amortization; (iii) effective interest rate accretion; (iv) unit-based compensation; (v) gains or losses on foreign exchange and swap derivatives and deducts tenant and capital expenditures. The calculation of AFFO is presented on the next page.

Adjusted Funds from Operations (in thousands of dollars except per unit amounts)	Three months ended December 31		Year ended December 31	
	2009	2008	2009	2008
Funds from operations (as calculated on page 26)	\$54,457	\$46,895	\$225,164	\$228,341
Add (deduct)				
Straight-lining of contractual rent	(2,797)	(3,960)	(12,990)	(15,832)
Rent amortization	1,051	3,830	3,931	4,813
Effective interest rate accretion	2,386	597	5,844	1,236
Unit-based compensation	177	66	535	74
Additions to tenant expenditures	(2,119)	(3,199)	(6,044)	(9,659)
Capital expenditures	(5,399)	(328)	(10,090)	(1,794)
Loss on foreign exchange and swap derivatives	3,338	10,915	17,046	7,090
Adjusted funds from operations	\$51,094	\$54,816	\$223,396	\$214,269
Weighted average number of units (in thousands of units adjusted for conversion of non-controlling interest)	148,501	146,502	147,946	141,655
Diluted weighted average number of units (in thousands of units) for the calculation of AFFO ^{(1) (2)}	173,305	146,502	164,863	142,040
Adjusted funds from operations per unit (basic - adjusted for conversion of non-controlling interest)	\$0.34	\$0.37	\$1.51	\$1.51
Adjusted funds from operations per unit (diluted) ⁽²⁾	\$0.31	\$0.37	\$1.38	\$1.51
Cash distributions paid per unit	\$0.18	\$0.36	\$0.72	\$1.44
Cash distributions paid per unit as a % of basic AFFO	52.9%	97.3%	47.7%	95.4%

(1) Although the Fairfax warrants were redeemed on December 29, 2009, they are included in the denominator of diluted AFFO per unit for the period in which they were outstanding (for the three months and year ended December 31, 2009 13,646,056 units and 12,231,559 units respectively).

(2) The 2014 and 2017 Convertible Debentures are dilutive. Contractual debenture interest for the three months and year ended December 31, 2009 of \$2.6 million and \$4.4 million respectively is added to AFFO and 10,914,515 units and 4,600,371 units are included in the diluted weighted average number of units outstanding for the respective periods.

Excluding tenant and capital expenditures, basic AFFO per unit would have been \$0.39 for the three months ended December 31, 2009 (Q4 2008 - \$0.40) and \$1.62 for the year ended December 31, 2009 (2008 - \$1.59).

The primary reasons for the decrease of \$3.7 million in AFFO for the three months ended December 31, 2009 as compared to the three months ended December 31, 2008 are due the following items:

- A decrease of \$2.1 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases;
- A decrease of \$2.6 million in property operating income due to the average U.S./Canadian dollar foreign exchange rate of \$1.05 for Q4 2009 as compared to \$1.22 during Q4 2008;
- Excluding the above two items, a net increase of \$6.3 million in property operating income primarily due to the completion of the Bell Canada Phase III development, rent step ups and additional rent recoverable of \$2.1 million from tenants in accordance with their leases with no corresponding expense for items which were capitalized to building improvements.
- A decrease of \$1.5 million for higher interest expense (net of the mortgage interest accrued on the non-recourse mortgage defaults);
- An increase of \$1.0 million due to higher interest income, lower trust expenses and lower current income taxes;

- A decrease of \$1.2 million from properties sold between October 1, 2008 and December 31, 2009; and
- A decrease of \$4.0 million due to higher capital and tenant expenditures.

The primary reasons for the increase of \$9.1 million in AFFO for the year ended December 31, 2009 as compared to the year ended December 31, 2008 are due the following items:

- A decrease of \$11.6 million in property operating income due to tenants who filed for protection under Chapter 11 of the U.S. Bankruptcy Code and subsequently terminated their leases;
- An increase of \$5.7 million in property operating income due to the average U.S./Canadian foreign exchange rate of \$1.14 in 2009 as compared to \$1.07 in 2008;
- Excluding the above two items, a net increase of \$21.8 million in property operating income primarily due to the completion of the Bell Canada Phase III development, rent step ups and additional rent recoverable of \$5.6 million from tenants in accordance with their leases with no corresponding expense for items which were capitalized to building improvements.
- A decrease of \$0.8 million for higher interest expense (net of the mortgage interest accrued on the non-recourse mortgage defaults) mainly due to the debentures issued in 2009 and 2008;
- An increase of \$6.2 million due to higher interest income, lower trust expenses and lower current income taxes;
- A decrease of \$7.7 million due to properties sold between January 1, 2008 and December 31, 2009; and
- A decrease of \$4.7 million due to higher capital and tenant expenditures.

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

(in thousands of dollars)	Three months ended December 31		Year ended December 31	
	2009	2008	2009	2008
Adjusted funds from operations	\$51,094	\$54,816	\$223,396	\$214,269
Straight-lining of contractual rent	2,797	3,960	12,990	15,832
Additions to tenant expenditures	2,119	3,199	6,044	9,659
Capital expenditures	5,399	328	10,090	1,794
Change in other non-cash operating items	7,612	12,677	(3,499)	(6,065)
Mortgage interest accruals on non-recourse mortgage defaults	(2,425)	(1,857)	(10,058)	(2,540)
Realized gain (loss) on foreign exchange	-	251	(22)	251
Cash provided by operations	\$66,596	\$73,374	\$238,941	\$233,200

Capital Resources

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

(in thousands of dollars)	Three months ended December 31, 2009	Year ended December 31, 2009	Year ended December 31, 2008	Year ended December 31, 2007
Cash provided by operating activities	\$66,596	\$238,941	\$233,200	\$196,589
Net earnings (loss)	29,870	86,525	97,706	(2,193)
Actual cash distributions paid or payable relating to the period	24,376	97,726	161,839	135,678
Excess of cash provided by operating activities over cash distributions paid	42,220	141,215	71,361	60,911
Excess (shortfall) of net earnings over cash distributions paid	\$5,494	(\$11,201)	(\$64,133)	(137,871)

For the three months ended December 31, 2009 and for the years ended December 31, 2009, December 31, 2008 and December 31, 2007, cash provided by operating activities exceeded cash distributions. Management expects this trend to continue.

Cash distributions normally exceed net earnings due to non-cash items which are deducted or added in determining net earnings. Non-cash items such as impairment losses, future income taxes and recoveries, unrealized gains or losses, depreciation and amortization, while deducted from or added to net earnings have no impact on cash available to pay current distributions. For the three months and year ended December 31, 2009, there is an excess of net earnings over cash distributions due to a recovery of future income taxes, which is a non-cash item. Effective January 1, 2009, the distribution on the Stapled Units was reduced from \$1.44 to \$0.72 per Stapled Unit annually.

Subject to market conditions, management expects to be able to meet all of the Trusts' ongoing obligations and to finance short term development commitments through the issue of new securities, as well as by using conventional real estate debt, selling or refinancing other assets, short-term financing from the bank and the Trusts' cash flow from operations. As at December 31, 2009, the REIT is not in default or arrears on any of its obligations including distribution payments, interest or principal payments on debt and any debt covenant with the exception of the non payment of principal and interest for the seven Boscov's Department Stores, the Circuit City distribution warehouse and the two Bruno's Supermarkets mortgages following the Chapter 11 filings of the tenants. The REIT has handed over control of seven of the properties to the respective mortgage companies and is waiting for them to legally release the REIT's subsidiaries from their debt obligations. During Q4 2009, the REIT was legally released from one of the Bruno's Supermarkets mortgages.

Short-term bank financing has been provided by the same chartered bank since the REIT's inception. This general operating facility expires on December 31, 2011 and is secured by income properties. Management believes this facility will continue to be made available in the future as it represents a typical or standard loan facility provided by numerous financial institutions in the industry. At December 31, 2009, approximately \$236.7 million was still available under this facility.

Other than the Bow development which is described in greater detail under "Funding of Future Commitments", the following is a summary of material contractual obligations of the REIT (excluding mortgages related to discontinued operations) including payments due as at December 31, 2009 for the next 5 years and thereafter:

Contractual Obligations (in thousands of dollars)	Payments Due by Period				Total
	2010	2011- 2012	2013- 2014	2015 and thereafter	
Mortgages payable	\$109,196	\$536,396	\$472,318	\$1,551,631	\$2,669,541
2013 Convertible debentures	-	-	115,000	-	115,000
Non-Convertible debentures	-	-	200,000	-	200,000
2014 Convertible debentures	-	-	150,000	-	150,000
2107 Convertible debentures	-	-	-	175,000	175,000
Total Contractual Obligations	\$109,196	\$536,396	\$937,318	\$1,726,631	\$3,309,541

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

As at December 31, 2009, DBRS provided H&R REIT with a credit rating of BBB with a stable trend. This rating was confirmed subsequent to year end upon the issuance of the senior unsecured debentures. A credit rating of BBB by DBRS is generally an indication of adequate credit quality, where protection of interest and principal is considered acceptable. A credit rating of BBB - or higher is an investment grade rating. There can be no assurance that any rating will remain in effect for any given period of time or that any rating will not be withdrawn or revised by DBRS at any time. The credit rating is reviewed periodically with DBRS.

The REIT has no material capital or operating lease obligations.

Funding of Future Commitments

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

(in thousands of dollars)	Costs incurred to date	Remaining Costs	Budget
Land	\$60,804	\$ -	\$60,804
Financing costs	13,880	40,993	54,873
Capitalized interest on the REIT's costs as incurred	67,589	148,133	215,722
Soft costs	111,342	81,263	192,605
Hard costs	493,145	601,639	1,094,784
Recoveries and other income	(27,587)	(85,158)	(112,745)
Contingency	-	40,679	40,679
Cost incurred to date/budget	719,173	827,549	1,546,722
Less capitalized interest on the REIT's costs incurred	(67,589)	(148,133)	(215,722)
Total costs incurred to date/budget less capitalized interest	\$651,584	\$679,416	\$1,331,000

Notwithstanding the current contingency reduction, both the REIT and Altus Group Cost Consulting believe the remaining contingencies to be sufficient at this stage of the project. The decrease of \$13 million in the contingency amount since September 30, 2009 is primarily due to two factors:

- An allowance of \$10 million has been taken for the following potential risks: \$3.1 million due to anticipated cost considerations for projected overtime premiums, possible delay claims related to the man and material hoist and scope change orders projected until the end of the project; \$2.3 million for continued changes to the design of the mechanical systems leading to change in scope; \$1 million for the elevator and escalator costs for acceleration and additional storage costs and \$2.3 million relating to doors and hardware for material cost escalations, allowances for future design changes and other miscellaneous items.
- There is an increase of \$2.5 million due (i) to additional unanticipated costs of \$1.5 million due to the analysis and reforecast of anticipated change orders in the metal requirements; (ii) the budget for crane maintenance was increased by \$0.3 million due to the allowance for the expected purchase of additional spare crane cables; and (iii) there was an increase of \$0.8 million due to the anticipated drywall contractor being unable to perform the work, resulting in a different contractor being awarded the job.

The chart below shows the projected source of funds and the funds required for the 2010-2011 period.

(In millions of dollars)

Construction facility	\$425
Cash retained due to a reduction in distributions	160
Available cash and undrawn credit facilities	346
Collection of mortgage receivable	58
Current anticipated property sales	23
Funds required to complete the Bow	(679)
Annual principal mortgage payments	(195)
Expected mortgage maturity repayments	(6)
Surplus of Funds	\$132

While the REIT has identified projected sources of funds from which it expects to satisfy its anticipated cash flow requirements as described above, there is no assurance that such funds will be available to the REIT as the availability of any such funds will be subject to market conditions and other factors beyond the REIT's control. Please see "Forward-Looking Disclaimer" and "Risks and Uncertainties".

The REIT's capacity to fund future acquisitions, capital expenditures and commitments was in excess of \$2 billion as at December 31, 2009. This represents the amount by which the REIT can increase its debt, subject to market availability, before the REIT reached its maximum debt limitation of 65% of debt to its GBV of assets.

The following summarizes term debt maturities for existing mortgages:

Year	Mortgage Debt due on Maturity (\$000's)	Number of Mortgages	2010 Estimated Property Operating Income (\$000's) ⁽¹⁾	Loan to Value ⁽²⁾
2010	\$13,881	6	\$4,174	27%
2011	70,246	11	16,189	33%
2012	268,697	21	47,481	42%
2013	101,408	10	23,047	33%
2014	182,632	8	26,708	51%
	\$636,864	56	\$117,599	41%

⁽¹⁾ Converting U.S. dollars to Canadian dollars at an exchange rate of 1.05

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

OFF-BALANCE SHEET ITEMS

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

At December 31, 2009, such guarantees amounted to \$43.3 million (December 31, 2008 - \$51.3 million), expiring between 2011 and 2016 and no amount has been provided for in the consolidated financial statements for these items. These amounts arise where the REIT has guaranteed a co-owner's share of the mortgage liability. The REIT, however, customarily guarantees or indemnifies the obligations of its nominee companies which hold separate title to each of its properties owned.

In addition, the REIT continued to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable thereunder until such debts are extinguished or the lenders agree to release the REIT's covenants. At December 31, 2009, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$119.2 million (December 31, 2008 - \$14.3 million) with expiries between 2013 and 2018. There have been no

defaults by the primary obligor for debts on which the REIT has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in the financial statements.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Where appropriate, the REIT also uses forward contracts to lock in lending rates on certain anticipated mortgages. This strategy provides certainty in the rate of interest on borrowings when the REIT is involved in transactions that close further into the future than during the normal timeframe of a transaction. At December 31, 2009, the REIT had no forward contracts in place.

SECTION IV

SUMMARY OF QUARTERLY RESULTS

(unaudited) (in thousands of dollars except per unit amounts)	December 31, 2009	September 30, 2009 ⁽¹⁾	June 30, 2009 ⁽¹⁾	March 31, 2009 ⁽¹⁾
Rentals from income properties	\$151,668	\$148,209	\$148,997	\$156,291
Mortgage interest and other income	1,621	1,602	1,175	1,822
Net property operating income	21,606	23,898	28,413	30,539
Net earnings from continuing operations	31,488	7,643	10,752	20,412
Net earnings per unit from continuing operations				
(basic)	0.22	0.05	0.08	0.14
(diluted)	0.20	0.05	0.08	0.14
Net earnings	29,870	\$15,656	\$18,901	\$22,097
Net earnings per unit				
(basic)	0.21	0.11	0.13	0.16
(diluted)	0.19	0.10	0.13	0.15
	December 31, 2008 ⁽¹⁾	September 30, 2008 ⁽¹⁾	June 30, 2008 ⁽¹⁾	March 31, 2008 ⁽¹⁾
Rentals from income properties	\$151,257	\$146,863	\$148,530	\$145,304
Mortgage interest and other income	1,045	1,015	641	593
Net property operating income	26,507	25,891	27,448	27,417
Net earnings (loss) from continuing operations	5,140	(28,066)	19,865	22,312
Net earnings (loss) per unit from continuing operations				
(basic)	0.04	(0.20)	0.15	0.17
(diluted)	0.03	(0.20)	0.15	0.17
Net earnings (loss)	\$45,826	(\$20,706)	\$32,973	\$39,613
Net earnings (loss) per unit				
(basic)	0.33	(0.15)	0.25	0.31
(diluted)	0.32	(0.15)	0.25	0.31

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

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

SECTION V

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Trusts' financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Estimates are used when accounting for such items as the embedded prepayment and extension options and notes payable. The Trusts' financial statements have been prepared in accordance with Canadian GAAP.

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

Impairment of Assets

The REIT is required to write down to fair value any of its income properties that were determined to have been impaired. The analysis required is dependent upon a review of estimated undiscounted future cash flows from operations over the anticipated holding period. This review involves subjective assumptions of, among other things, estimated occupancy and rental rates, all of which can affect the ultimate value of the property. In the event these factors result in a carrying value that exceeds the sum of future undiscounted cash flows expected to result from the ongoing use and ultimate residual value of the properties, an impairment would be recognized. During 2009, the REIT recorded an impairment loss of \$14.8 million relating to the properties formerly tenanted by Circuit City and Bruno's Supermarkets. During 2008, the REIT recorded an impairment loss of \$53.2 million relating to properties which were formerly leased by Boscov's Department Stores. In addition, upon the expiry of an option to purchase the remaining interest in the Neways office building, an additional \$0.4 million was written off during 2008. This property was sold during 2009.

The REIT also evaluates the fair value of mortgages receivable to determine whether any impairment provisions are required. Impairment is recognized when the carrying value of the mortgage receivable will not be recovered as determined by the economic value of the underlying security and/or the financial covenant of the issuer of the security. No impairments of mortgages receivable were recorded during 2009 or 2008.

Depreciation of Income Properties

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

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

Property Acquisitions

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

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

Income Tax

On June 22, 2007, legislation relating to the federal income taxation of a SIFT, received royal assent (the "SIFT Rules"). A SIFT includes certain publicly listed or traded partnerships and trusts and generally includes an income trust. Management of the REIT believes that the REIT currently meets the definition of a SIFT. Under the SIFT Rules, following a transition period for qualifying

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

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

Pursuant to the terms of the Finance Trust Declaration of Trust, the only properties which Finance Trust is permitted to invest in are U.S. Holdco Notes, and certain cash and cash equivalents, none of which constitutes non-portfolio property for purposes of the Tax Act, provided Finance Trust does not at any time carry on a business in Canada. It follows that Finance Trust will not be a SIFT trust for purposes of the Tax Act and will not be subject to tax under the SIFT Rules.

Tax Consequences to U.S. Holders

Finance Trust qualifies as an investment trust that is classified as a grantor trust for U.S. federal income tax purposes under Treasury Regulation section 301.7701-4(c) (a "Fixed Investment Trust") and section 671 of the Internal Revenue Code (the "Code"). In general, an investment trust will qualify as a Fixed Investment Trust if: (i) the trust has a single class of ownership interests, representing undivided beneficial interests in the assets of the trust; and (ii) there is no power under the trust agreement to vary the investment of the holders. If Finance Trust is a Fixed Investment Trust, then it will generally be disregarded for U.S. federal income tax purposes, with the result that the holders of Finance Trust units will be treated as owning directly their *pro rata* shares of all of the Finance Trust assets (i.e. primarily the U.S. Holdco Notes). Moreover, all payments made on the U.S. Holdco Notes will be treated as payments made directly to the holders of the Finance Trust units in proportion to their interest in Finance Trust.

Provided that Finance Trust qualifies as a Fixed Investment Trust and the U.S. Holdco Notes are respected as debt for U.S. federal income tax purposes, payments of principal and interest on the U.S. Holdco Notes that are attributable to U.S. holders will be treated as payments directly to the U.S. holders. Interest on the U.S. Holdco Notes will generally be taxable to U.S. holders as ordinary income at the time it is paid or accrued and will be subject to U.S. federal taxation at a maximum marginal rate of 35%. If the U.S. Holdco Notes were treated as equity rather than debt for U.S. federal income tax purposes, then the stated interest on the U.S. Holdco Notes would be treated as a distribution with respect to stock.

Additionally, there can be no assurance that the Internal Revenue Service will not challenge the determination that the interest rate on the U.S. Holdco Notes represents an arm's length rate.

CHANGES TO SIGNIFICANT ACCOUNTING POLICIES FOR 2009

Effective January 1, 2009, the Trusts adopted the new recommendation of The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, Goodwill and Intangible Assets, on a retroactive basis by adjusting the prior year. This new section replaces Section 3062, Goodwill and Other Intangible Assets, and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets.

Commencing January 1, 2009, the Trusts no longer defer capital cost expenditures recoverable from its tenants and no longer records the amortization of these deferred expenditures over the period in which revenue is collected from tenants. This change requires the Trusts to capitalize capital expenditures recoverable from its tenants and amortize it over the useful life of the asset. If the capitalization criteria is not met, the Trusts expense the full amount in the period incurred.

The adoption by the Trusts of the new standards require retroactive application to its 2008 quarterly and annual combined financial statements on January 1, 2009 as follows:

Balance sheet	
Impact of restatement as at December 31, 2008	Increase (decrease)
Income properties	\$9,142
Deferred expenses	(19,220)
Assets	(10,078)
Future income tax liability	1,547
	(\$8,531)
Non-controlling interest	(\$430)
Opening accumulated net earnings as at January 1, 2008	(7,277)
Net earnings for the year ended December 31, 2008	(824)
Unitholders' equity	(8,101)
	(\$8,531)

Statement of earnings

Impact of restatement increase/ (decrease)	For the three months ended				For the year ended December 31, 2008
	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008	
Property operating costs	\$633	\$562	\$1,177	\$740	\$3,112
Depreciation and amortization	(430)	(509)	(629)	(501)	(2,069)
Net earnings from discontinued operations	-	138	-	81	219
Net earnings	(203)	85	(548)	(158)	(824)
Net earnings per unit – basic and diluted	-	-	-	-	-

There was no impact on the statement of cash flows as the amounts adjusted only impacts items within cash provided by operations.

In January 2009, the Emerging Issues Committee ("EIC") of the CICA issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which clarifies that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments. EIC-173 is to be applied retrospectively without adjustment of prior periods in interim and annual financial statements for periods ending on or after January 20, 2009. The Trusts adopted this recommendation in their fair value determinations effective January 1, 2009. The adoption of this guidance did not have any material effect on the Trusts' results, financial position or cash flows.

Effective January 1, 2009, The Trusts prospectively adopted the CICA amendments to section 3855, Financial Instruments - Recognition and Measurement. Amendments to this section requires an assessment to determine whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of held-for-trading category. In addition, the amendment prohibits the reclassification of a financial asset out of the held-for trading category when the fair value of the embedded derivative in a combined contract cannot be reasonably measured. The adoption of the amendments to this standard did not have a significant impact on the Trusts' financial statements.

Effective January 1, 2009, the Trusts adopted the CICA amendments to section 3855, Financial Instruments - Recognition and Measurement, in relation to the impairment of financial assets. Amendments to this section have revised the definition of "loans and receivables" and provided that certain conditions have been met, requires or permits reclassification of financial assets from the held-for-trading and available-for-sale categories into the loans and receivables category. The adoption of the amendments to this standard did not have an impact on the Trusts' financial statements.

In May 2009, the CICA amended Section 3862, Financial Instruments - Disclosures, to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These amendments are effective for the REIT on December 31, 2009. The adoption of the amendments to this standard did not have a significant impact on the Trusts' financial statements.

ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Canadian Accounting Standards Board has confirmed that the use of IFRS, as issued by the International Accounting Standards Board ("IASB"), will replace Canadian Accounting Standards effective January 1, 2011. The Trusts are currently implementing a conversion plan to transition financial reporting to IFRS as issued by the International Accounting Standards Board ("IFRS-IASB") but at this time, the Trusts cannot fully quantify the impact that the adoption of IFRS will have on the classification or valuation of the Trusts' combined financial statements.

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. The Trusts did not early adopt these standards on January 1, 2009.

Canadian GAAP will be fully converged with IFRS-IASB through a combination of two methods: first, as current joint-convergence projects of the United States' Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they will be adopted by Canada's Accounting Standards Board and may be introduced in Canada before the publicly accountable enterprises' transition date to IFRS-IASB; and secondly, standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the publicly accountable enterprises' transition date to IFRS-IASB. The IASB currently has projects underway that are expected to result in new pronouncements that continue to evolve.

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

The following provides a summary of the Trusts' IFRS Implementation Plan and Status of our activities:

Initial Assessment Phase

This phase includes the identification of significant differences between existing Canadian GAAP and IFRS-IASB at a high level as relevant to the Trusts. Based upon the current state of IFRS-IASB, this phase identified a number of topics that may possibly impact the REIT's financial results and/or the necessary effort to make the transition to IFRS-IASB. Targeted training and communication activities, leveraging both internal and external resources, are occurring during this phase. The Trusts have finalized their initial assessment phase.

Detailed Assessment Phase

Building upon the assessment performed in the Initial Assessment Phase, this phase will include:

- identification, evaluation and selection of accounting policies necessary for the Trusts to change over to IFRS-IASB;
- identification of the business impacts resulting from the identified accounting differences. Business impacts to be considered in the Trusts' project plan are: business units, control processes, information technology, unitholders, regulatory matters and others as identified during this phase;
- assessment of IFRS 1 elections. This aspect of the project plan will follow the detailed assessment of the financial statement items and will be revisited periodically throughout the project;

- an initial training analysis and information systems impact analysis are also components of this phase, and are currently being documented.

It is expected that this detailed assessment phase will progress throughout 2010. The Trusts have identified those major factors which will impact the financial statements. See Status of Convergence Plan.

Design Phase

The Design Phase will integrate the recommendations from the Detailed Assessment Phase into the Trusts' underlying financial systems and processes that are necessary for the Trusts to change over to IFRS-IASB. In addition, the Trusts will have designed business process changes and developed detailed training programs. Based on current timeline, the Design Phase is expected to be completed during Q4 2010.

Testing & Implementation Phase

It is expected that during 2010, the Trusts will be testing its IFRS-IASB systems, processes, financial statements, notes, policies, internal controls and internal reporting throughout the period in preparation for the Trusts' conversion date of January 1, 2011.

Status of Convergence Plan

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

Where significant impacts of the transition have already been identified, work has commenced on solutions which require a significant amount of time to resolve. These issues include but may not be limited to, the identification of information technology initiative, the possibility of amendments to the Declarations of Trust for both Trusts and components of debt covenants which need to be addressed to ensure these are completed on time.

The Trusts' combined financial performance and financial position as disclosed in the current GAAP financial statements may be significantly different when presented in accordance with IFRS. The significant IFRS differences that will potentially have an impact on the Trusts' financial statements include the following:

- 1) Under Canadian GAAP, issued units of the Trusts are presented as equity in the combined balance sheet. As IFRS is currently drafted and generally interpreted by the Canadian accounting profession, trust units may be regarded under IFRS as a liability rather than equity. This interpretation is influenced by section 9 of the Declaration of Trust of the REIT which indicates that, in each year, the aggregate amount payable by the Trusts for distributions to unitholders shall not be less than the Trusts' taxable income for the year, as calculated in accordance with the Tax Act after all permitted deductions under the Tax Act have been taken. Under IFRS, a liability arises where "financial instruments" contain a "contractual obligation to deliver cash or another financial asset to another equity".

A trust unit is a financial instrument for both Canadian GAAP and IFRS purposes. A mandatory requirement to distribute taxable income or distributable cash may constitute a "contractual requirement to deliver cash", resulting in trust units being considered as a liability for purposes of IFRS. Should this interpretation be correct and applicable to the Trusts, the financial statements of the Trusts would be materially affected upon adoption of IFRS. Accordingly, and as part of the Trusts' transition to IFRS (as required by 2011 with comparatives for 2010), management, subject to approval by unitholders, will amend the Declaration of Trust of the REIT to delete the reference in section 9 that the Trusts must distribute all of its taxable income and leave distributions up to the discretion of the trustees. This amendment will be proposed in the 2010 Management Information Circular. Should any trust units be classified as debt, the distributions on such units would then be classified as interest expense.

- 2) Under Canadian GAAP, the REIT measures its income properties using the historical cost model and recognizes various tangible and intangible components of the income property. Under IFRS, the REIT will have a choice of whether to use the historical cost model or the fair value model. If the fair value model is selected, income properties will be carried on the consolidated balance sheet at their fair values, and changes in fair value each period will be recorded in the consolidated

statement of earnings. If the historical cost model is selected, the REIT will be required to disclose the fair value of income properties in the notes to the consolidated financial statements.

Under IFRS 1 the REIT may choose to adopt either valuation model for its income properties prospectively. In addition, the REIT may also elect under IFRS 1 to use the fair value as the deemed cost of these income properties and upon initial implementation of IFRS regardless of whether it chooses the fair value or cost method in accordance with IAS 40. At conversion the resulting adjustments of this election are recorded directly to unitholders' equity. Though this standard has been analyzed in detail by both the REIT and the Board of Trustees, a decision has not been finalized regarding what policy choice the REIT will adopt.

- 3) Under Canadian GAAP, upon the purchase of a property, all transaction costs (i.e. commissions, land transfer tax, appraisals, etc.), associated with the purchase are capitalized to the cost of the property. Under IFRS, all of these costs would be expensed as part of operations. This may have a material impact on the REIT's AFFO and net earnings.
- 4) Under Canadian GAAP, impairment is recognized for assets, other than financial assets, based on estimated fair value when the undiscounted future cash flows from an asset or group of assets is less than their carrying value. Under IFRS, an entity is required to recognize an impairment charge if the recoverable amount, determined as the higher of the estimated fair value less costs to sell or value-in-use, is less than its carrying value. Value in use is the discontinued present value of estimated future cash flows expected to arise from the current use of an asset and from its disposal at the end of its useful life.

IFRS also requires the reversal of an impairment loss when the recoverable amount is higher than the carrying value (by no more than what the depreciated amount of the asset would have been had the impairment not occurred) unlike Canadian GAAP which does not permit reversals.

- 5) IFRS only allows for the capitalization of carrying costs, including interest, when properties are in active development, which is generally considered to occur when an entity conducts activities that change the condition of the asset. IFRS also prohibits the capitalization of incidental operating income before or during development.

Both Canadian GAAP and IFRS require the cessation of capitalization when a property is completed for its intended use.

- 6) Under Canadian GAAP, the Trusts present a non-classified balance sheet. The Trusts will present a classified balance sheet under IFRS.

First Time Adoption of IFRS

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

- 1) Business Combinations

The Trusts expect to apply the business combination exemption in IFRS (1) to not apply IFRS (3) business combinations retrospectively to past business combinations. Accordingly, the Trusts will not restate business combinations that take place prior to the January 1, 2011 transition date.

- 2) Cumulative Translation Difference

The Trusts expect to elect this exemption where it will set the previous foreign exchange cumulative translation balances to zero at January 1, 2011, with the balance reclassified to retained earnings.

- 3) Borrowing Costs

The Trusts expect to elect to derecognize the carrying amounts of previous capitalized interest to the construction of a qualifying asset. The effect of this would be to show a lower cost on the Bow and a higher interest expense.

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

INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes were made to the design of the Trusts' internal control over financial reporting during the three months ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Trusts' internal control over financial reporting.

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

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

The Trusts have also established adequate disclosure controls and procedures and internal control over financial reporting to provide reasonable assurance regarding their responsibility of the Trusts' financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP. The Trusts' CEO and CFO assessed, or caused an assessment under their direct supervision, of the design and operating effectiveness of the Trusts' disclosure controls and procedures and internal control over financial reporting (as defined in *National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*) as at December 31, 2009. Based on this assessment, it was determined that the Trusts' disclosure controls and procedures and internal control over financial reporting were appropriately designed and are operating effectively as at December 31, 2009.

SECTION VI

RISKS AND UNCERTAINTIES

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

Unit Prices

Publicly traded trust units will not necessarily trade at values determined solely by reference to the underlying value of trust assets. Accordingly, the Stapled Units may trade at a premium or a discount to the underlying value of the assets of the REIT and Finance Trust. Investors in Stapled Units will be subject to all of the risks of an investment in units of Finance Trust and of an investment in units of the REIT. Holders of Stapled Units should consult the Management's Discussion and Analysis of Finance Trust and specifically the risk factors therein. See also "Forward-Looking Disclaimer".

One of the factors that may influence the market price of the Stapled Units is the annual yield on the Stapled Units. Accordingly, an increase in market interest rates may lead investors in Stapled Units to demand a higher annual yield which could adversely affect the market price of Stapled Units. In addition, the market price for Stapled Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of the REIT and/or Finance Trust.

Availability of Cash for Distributions

The Trusts' current distribution policy is to pay a monthly cash distribution such that the aggregate monthly distribution per Stapled Unit is 6 cents. As the monthly cash distribution paid by Finance Trust fluctuates monthly, the monthly cash distribution paid by the REIT will also fluctuate in order to result in an aggregate monthly cash distribution of 6 cents per Stapled Unit. Although the Trusts intend to make distributions of its available cash to unitholders in accordance with its distribution policy, these cash distributions may be reduced or suspended. The actual amount distributed by the REIT will depend on numerous factors including monthly cash distributions paid by Finance Trust, capital market conditions, the financial performance of the properties, the REIT's debt covenants and obligations, its working capital requirements, its future capital requirements, its development commitments and fluctuations in interest rates. On April 22 2009, the REIT secured a construction facility, the terms of which provide, among other things, that distributions (other than certain unit distributions) cannot exceed the lesser of (i) \$0.72 per Stapled Unit and (ii) 60% of funds from operations (as defined for such purpose). Cash available to the REIT for distributions may be reduced from time to time because of

items such as principal repayments on debt, tenant allowances, leasing commissions and capital expenditures. The Trusts may be required to use part of their debt capacity in order to accommodate any or all of the above items. The market value of Stapled Units may decline significantly if the REIT and/or Finance Trust suspends or reduces distributions. The REIT may reduce distributions if the trustees anticipate a cash shortfall and determine that such a reduction would be in the best interests of the REIT.

Development and Financing Risk Relating to the Bow Development

The REIT entered into agreements to develop the Bow consisting of approximately 2.0 million square foot office and retail complex in Calgary. The Bow, budgeted to cost approximately \$1.5 billion (including capitalized interest), is pre-leased to EnCana Corporation for an initial term of approximately 25 years. Construction commenced during the spring of 2007 and is expected to be completed in 2012. The REIT is currently bearing the risk for construction overruns and project delays as the REIT does not have a fixed price contract for the entire project cost. To mitigate this, the REIT has entered into fixed price contracts amounting to approximately 82% of the hard cost budget. Together with costs incurred to date, the REIT has effectively locked in approximately 87% of the total budget before contingencies. The REIT is also at risk for interest rate fluctuations on this project during the construction period. To mitigate this risk, the REIT entered into an interest rate swap which is intended to limit the interest rate to an effective annual rate of 6.9%.

The REIT was able to secure a \$425 million construction facility during April 2009. The initial maturity date of the facility is October 22, 2012. The agreements and indentures governing indebtedness of this construction facility contain certain covenants and conditions applicable to the REIT, including without limitation, those requiring the REIT to maintain, at all times on a combined basis with Finance Trust, the following financial ratios (i) indebtedness to gross asset value of not greater than 0.65:1.0; (ii) debt service coverage of not less than 1.20:1.0 and (iii) unitholders equity of not less than the sum of \$1.35 billion plus 75% of net cash proceeds received in connection with any equity offering after April 24, 2009. In addition, the REIT is required to have not less than \$906 million of cash equity being invested by the REIT and to have in place a committed revolving credit facility of not less than \$300 million (subject to reduction to \$200 million in certain circumstances) with a maturity date of not less than 11 months from the date of the initial borrowing under the facility, and imposing on the REIT certain restrictions including without limitation regarding: the disposition of the Bow project, lands related to the Bow, or any other properties or assets in excess of certain thresholds; the creation of liens or granting of negative pledges; creation or incurrence of debt; the making of distributions; the purchase or redemption of securities; the entering into of any merger or similar transaction with any person; changes of a fundamental nature (including senior management, business objectives, purposes or operations, capital structure, constating documents, and subordinated debt); the cancellation or waiver of material contracts; the making of any investment in excess of certain thresholds; the repayment or repurchase of any subordinated indebtedness; the involvement of other real estate development or construction projects in excess of certain thresholds; and changes to the Bow project budget. Included in the construction facility, the terms of which provide, among other things, that distributions (other than certain unit distributions) cannot exceed the lesser of (i) \$0.72 per Stapled Unit and (ii) 60% of funds from operations (as defined for such purpose). As a result, the REIT is limited by such covenants and restrictions. These conditions have not been satisfied as at December 31, 2009 nor has any amount been drawn upon the credit facility. Please see notes 20 and 27 of the financial statements for further information.

Subsequent to December 31, 2009, the lenders to the credit facility amended certain covenants, including the previous limitation on annual distributions. Going forward, annual distributions will only be limited to 60% of the REIT's funds from operations for the trailing four quarters rather than the lesser of \$0.72 and 60% of FFO for the trailing four quarters excluding the one-time charge for the redemption of the Non-Convertible Debentures. In addition, the debt service coverage ratio was amended to 1.25:1.0 excluding those properties with non-recourse mortgages in which the tenant has filed for protection under Chapter 11 and control of the properties have been returned to the lenders.

Liquidity Risk

Real estate investments are relatively illiquid. This fact will tend to limit the REIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If for whatever reason, liquidation of assets is required, there is a risk that sale proceeds realized might be less than the current book value of the REIT's investments or that market conditions would prevent prompt disposition of assets.

Credit Risk and Tenant Concentration

The REIT is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties (office, industrial and retail) and acquires properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of

tenants, other than investment grade tenants, account for a significant portion of the cash flow. The only tenants which individually account for more than 5% of the rentals from income properties of the REIT are Bell Canada, TransCanada PipeLines Limited, Telus Communications and Bell Mobility. Each of these companies that have a public debt rating is rated with at least an A (low) rating by a recognized rating agency.

Interest Rate and Financing Risk

The REIT is exposed to interest rate risk on its notes payable due to the volatility of variable interest rates. The interest rate on the U.S. Holdco Notes is adjusted monthly and is equal to the then-prevailing ten-year U.S. treasury note rate plus 8% per annum. The floor interest rate of 8% mitigates the effect of a change in short-term market interest rates while the floating component linked to the ten-year U.S. treasury rate results in decreased earnings when the short-term market interest rate increases.

The Trusts are exposed to financing risk on maturing mortgages, bank indebtedness and interest rate risk on its borrowings. It minimizes this risk by obtaining long-term, fixed rate debt to replace short-term floating rate borrowings. At December 31, 2009, the percentage of fixed rate debt to total debt was 99.6% (December 31, 2008 - 96.7%). In addition, the REIT matches the terms to maturity of its mortgages on specific properties to the corresponding lease terms to maturity as closely as possible. At December 31, 2009, the weighted average term to maturity of the mortgages was 8.3 years (December 31, 2008 - 9.3 years) compared to the remaining average lease term of 10.5 years (December 31, 2008 - 11.5 years). Only 4.1% of total mortgage principal will mature before the end of 2010. The REIT also minimizes financing risk by restricting total debt (subject to certain exceptions) to 65% of aggregate assets as well as by obtaining non-recourse debt wherever possible. At December 31, 2009, the debt to GBV ratio (as per the Declaration of Trust) was 52.5% (December 31, 2008 - 54.8%) while the percentage of non-recourse debt to total debt was 44.9% (December 31, 2008 - 51.4%).

Tax Risk

The REIT currently qualifies as a mutual fund trust for Canadian income tax purposes. On June 22, 2007, the SIFT rules received royal assent. A SIFT includes certain publicly-listed or traded partnerships and trusts and generally includes an income trust. Management of the REIT believes that the REIT currently meets the definition of a SIFT. Under the SIFT rules, following a transition period for qualifying SIFTs, certain distributions from a SIFT will no longer be deductible in computing the SIFT's taxable income, and the SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation unless the REIT satisfies the REIT exemption. Distributions paid by a SIFT as returns of capital will not be subject to the tax.

Under the SIFT rules, the new taxation regime will not apply to a REIT that meets prescribed conditions relating to the nature of its income and investments. The REIT does not currently meet certain technical requirements for the REIT exemption. The REIT intends to restructure to qualify for the REIT exemption prior to 2011. However if the REIT is unable to restructure, commencing in 2011, the REIT will become subject to tax on distributions of certain income.

The REIT operates in the United States through U.S.Holdco which is capitalized with equity provided by the REIT and debt owed to Finance Trust. As at December 31, 2009, U.S. Holdco owed \$134.2 million to Finance Trust which is eliminated on the combined financial statements.

After the Plan of Arrangement, Finance Trust now provides debt financing to U.S. Holdco. If the REIT provided debt financing to U.S. Holdco, in determining income for U.S. tax purposes, U.S. Holdco is subject to possible limitations on the deductibility of interest, if any, paid to the REIT. Section 163(j) of the Internal Revenue Code (the "Code") applies to defer U.S. Holdings' deduction of interest paid on debt to the REIT in years that (i) the debt to equity ratio of U.S. Holdings exceeded 1.5:1, and (ii) the net interest expense exceeds an amount equal to 50% of its "adjusted taxable income" (generally, earnings before interest, taxes, depreciation, and amortization). For the year ended December 31, 2009, USD \$0.1 million of USD \$0.1 million interest expense (December 31, 2008 - U.S.D. \$12.5 million of the USD \$16.3 million interest expense) was disallowed by Section 163(j) of the Code, but such disallowance had no cash effect on U.S. Holdco. If this limitation applied to interest paid, depending on the facts and circumstances and the availability of net operating losses to U.S. Holdco (which are subject to normal assessment by the Internal Revenue Service), the U.S. federal income tax liability of U.S. Holdings could increase. In such case, the amount of income available for distribution by the REIT to its unitholders could be reduced.

No statutory, judicial or administrative authority directly addresses the treatment of the Stapled Units or instruments similar to the Stapled Units for U.S. federal income tax purposes. As a result, the U.S. federal income tax consequences of the purchase, ownership and disposition of Stapled Units are unclear.

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

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

Finance Trust intends to qualify as a fixed investment trust for U.S. federal income tax purposes. However, there are limited legal authorities and precedents regarding fixed investment trust and there is no authoritative legal guidance with respect to the qualification of an investment trust with investments and terms similar to Finance Trust as a fixed investment trust. If the IRS or a court were to determine that Finance Trust should be treated instead as a partnership or a corporation, the tax consequences to the holders of Stapled Units could be adversely affected. No statutory, judicial or administrative authority directly addresses the treatment of the Stapled Units or instruments similar to the Stapled Units for U.S. federal income tax purposes. As a result, the U.S. federal income tax consequences of the purchase, ownership and disposition of Stapled Units are unclear.

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

Ability to Access Capital Markets

As the Trusts distribute a substantial portion of their income to unitholders, the Trusts' ability to access the capital markets through equity issues and forms of secured or unsecured debt financing will affect the operations of the Trusts. Such financing may be available only on disadvantageous terms, if at all. If financing is not available on acceptable terms, further acquisitions or ongoing development projects may be curtailed and cash available for distributions or to fund future commitments may be adversely affected.

Dilution

The number of units the Trusts are authorized to issue is unlimited. The Trustees have the discretion to issue additional Units in certain circumstances, including under the Unit Option Plan. Any issuance of Units may have a dilutive effect on the investors of Units.

Lease Rollover Risk

Lease rollover risk arises from the possibility that the REIT may experience difficulty renewing leases as they expire or in re-leasing space vacated by tenants upon lease expiry. Management's strategy is to sign creditworthy tenants to leases that are long-term in nature which assists in the REIT's attempt to fulfill its primary goal of maintaining a predictable cash flow. The REIT has relatively

few short to medium term lease rollovers which is illustrated in the previously disclosed table (see "Overview") showing that leases representing only 17.4% of the REIT's total square footage expires by the end of 2014.

Construction Risks

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

Debentures

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

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

Financing Credit Risk

The REIT is also exposed to credit risk as a lender on the security of real estate in the event that a borrower is unable to make the contracted payments. Such risk is mitigated through credit checks and related due diligence of the borrowers and through careful evaluation of the worth of the underlying assets. Risk is further mitigated by the REIT's investment guideline of only providing construction financing after 70% of the project has been pre-leased.

Currency Risk

The REIT is exposed to foreign exchange fluctuations as a result of ownership of assets in the United States and the rental income earned from these properties. In order to mitigate the risk, the REIT's debt on these properties is also held in U.S. dollars to act as a natural hedge.

The REIT is exposed to foreign exchange fluctuations as a result of the notes payable being denominated in United States dollars.

Environmental Risk

The REIT is subject to various Canadian and U.S. laws, which could cause the REIT, as an owner and operator of real property, to become liable for the costs of removal or remediation of certain hazardous or toxic substances released on or in its properties or

disposed of at other locations. The failure to remediate any environmental issue may affect the REIT's ability to sell or finance the affected asset and could potentially also result in claims against the REIT.

The REIT has formal environmental policies in place to manage any exposure. The REIT's guidelines mandate the carrying out of environmental audits and inspections before a property is purchased. Also, the majority of its leases specify that tenants will conduct their businesses in accordance with environmental regulations and be responsible for liabilities arising out of any infractions. In support thereof, tenants' premises are periodically inspected for environmental issues, among other things, to ensure adherence where applicable. Finally, the REIT carries appropriate insurance coverage to cover any environmental mishaps.

Redemption Right

Unitholders are entitled to have their units redeemed at any time on demand. It is anticipated that this redemption right will not be the primary mechanism for Unitholders to liquidate their investments. The aggregate redemption price payable by the REIT is subject to limitations. The notes which may be distributed *in specie* to Unitholders in connection with a redemption will not be listed on any stock exchange, no established market is expected to develop for such notes and they may be subject to resale restrictions under applicable securities laws.

Unitholder Liability

The Declaration of Trust for both the Trusts provide that unitholders will have no personal liability for actions of the Trust and no recourse will be available to the private property of any Unitholder for satisfaction of any obligation or claims arising out of a contract or obligation of the Trusts. The Declarations of Trust further provides that this lack of unitholder liability, where possible, must be provided for in certain written instruments signed by the Trusts. In addition, legislation has been enacted in the Provinces of Ontario and certain other provinces that is intended to provide unitholders in those provinces with limited liability. However, there remains a risk, which the Trusts consider to be remote in the circumstances, that a unitholder could be held personally liable for the Trusts' obligations to the extent that claims are not satisfied out of the Trusts' assets. It is intended that the Trusts' affairs will be conducted to seek to minimize such risk wherever possible.

RELATED PARTY TRANSACTIONS

H&R Property Management Ltd. (the "Property Manager"), a company partially owned by family members of the Chief Executive Officer, provides property management services for substantially all properties owned by the REIT, including leasing services, for a fee of 2% of gross revenue. The Property Manager also provides support services in connection with the acquisition, disposition and development activities of the REIT and is also entitled to an incentive fee. Acquisitions and development support services are provided for a fee of 2/3 of 1% of total acquisition and development costs, as defined in the agreement and effective January 1, 2007. Effective January 1, 2008, the support services relating to dispositions of income properties are provided for a fee of 10% of the gain on sale of income properties adjusted for the add back of accumulated depreciation and amortization. The current agreement expires on January 1, 2010 and was automatically renewed for a five-year period. There is one additional automatic five-year extension.

During the three months ended December 31, 2009, the REIT recorded fees pursuant to this agreement of \$3.5 million (2008 - \$3.5 million), of which nil (2008 - \$0.04 million) was capitalized to the cost of the income properties acquired, \$0.5 million (2008 - \$0.4 million) was capitalized to properties under development and \$0.8 million (2008 - \$0.2 million) was capitalized to deferred expenses. Approximately 79% of these fees are recoverable from tenants. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the three months ended December 31, 2009, a further amount of \$0.9 million (2008 - \$1.2 million) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager. Of this amount, \$0.9 million (2008 - \$1.2 million) has been waived by the Property Manager and nil (2008 - nil) has been expensed in the consolidated statement of earnings.

During the year ended December 31, 2009, the REIT recorded fees pursuant to this agreement of \$13.8 million (2008 - \$14.5 million), of which nil (2008 - \$0.6 million) was capitalized to the cost of the income properties acquired, \$2.1 million (2008 - \$2.1 million) was capitalized to properties under development and \$2.8 million (2008 - \$2.3 million) was capitalized to deferred expenses. Approximately 71% of these fees are recoverable from tenants. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the year ended December 31, 2009, a further amount of \$3.6 million (2008 - \$3.5 million) has been earned by the Property Manager, pursuant to the above agreement, in accordance with the annual incentive fee, payable to the Property Manager. Of this amount, \$3.6 million (2008 - \$1.5 million) has been waived by the Property Manager and nil (2008 - \$2.0 million) has been expensed in the consolidated statements of earnings

Pursuant to the above agreements, as at December 31, 2009, \$0.9 million (2008 - \$1.0 million) was payable to the Property Manager.

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the three months ended December 31, 2009 is \$0.3 million (2008 - \$0.3 million) and for the year ended December 31, 2009 is \$1.3 million (2008 - \$1.2 million).

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

OUTSTANDING UNIT DATA

The beneficial interests in the Trusts are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders. As at February 25, 2010, there were 143,871,520 trust units issued and outstanding.

As at December 31, 2009, the maximum number of units authorized to be granted under the REIT's unit option plan was 8,800,000. Of this amount, 7,000,000 have been granted and 4,913,566 have been exercised. Subsequent to December 31, 2009, an additional 600,000 options were granted. As at February 25, 2010, there were 2,686,434 options to purchase units outstanding of which 1,086,434 are fully vested.

SUBSEQUENT EVENTS

In January 2010, the REIT sold a 179,000 square foot industrial building located in Mississauga, Ontario for gross proceeds of \$12.3 million.

In February 2010, the REIT issued \$115 million of Series A senior unsecured debentures which will mature on February 3, 2015 and bear interest at a contractual rate of 5.196%. The REIT also issued \$115 million of Series B senior unsecured debentures which will mature on February 3, 2017 and bear interest at a contractual rate of 5.902%.

In February 2010, the REIT repurchased the outstanding Non-Convertible Debentures for a total repurchase price of approximately \$230 million. The repurchase price included accrued interest of approximately \$2.1 million. The REIT will recognize a one-time non-recurring charge to the consolidated statement of earnings of approximately \$39 million, representing the difference between the repurchase price, excluding accrued interest expense, and the approximate carrying value of the Non-Convertible Debentures of \$189 million.

In February 2010, the REIT entered into an agreement to purchase a 93,000 square foot retail property located in Parma, Ohio for gross proceeds of U.S.D. \$18 million.

ADDITIONAL INFORMATION

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