

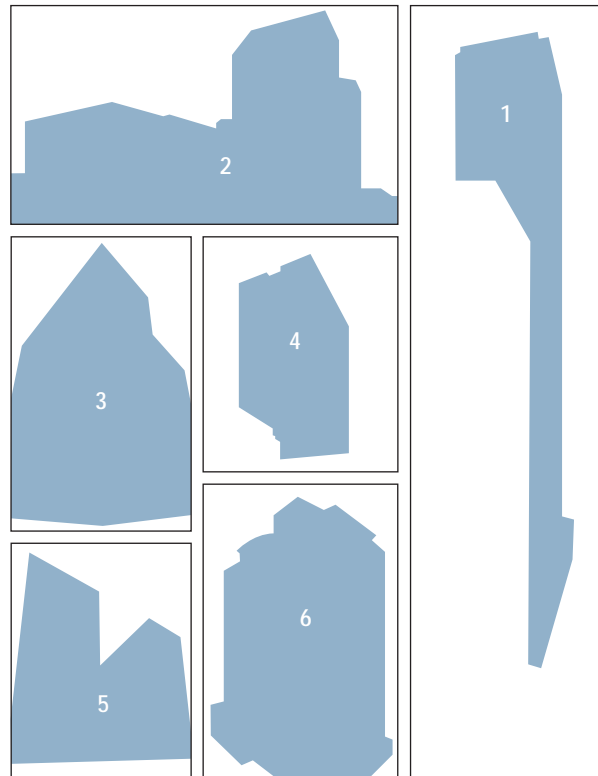


The O&Y Portfolio

BPO Properties significantly expanded its assets under management in 2005 with the acquisition of O&Y Properties and O&Y REIT. This major office portfolio of 11.6 million square feet — 27 office properties and one development site across five cities — was purchased by a consortium comprised of CPP Investment Board, Arca Investments and BPO Properties. We manage the operations of these properties on behalf of our institutional partners.

The O&Y portfolio acquisition has enabled BPO Properties to expand our platform in Toronto and Calgary and establish a solid presence in appealing new markets, Ottawa and Edmonton. The BPO Properties' portfolio currently stands at 27.2 million square feet comprising 43 properties and seven development sites in six cities across Canada.

Core Properties	Leasable Area (000's Sq. Ft.)
1. First Canadian Place, Toronto	2,781
2. Gulf Canada Square, Calgary	1,145
3. Place de Ville I, Ottawa	1,089
4. Place de Ville II, Ottawa	1,043
5. Jean Edmonds Towers, Ottawa	646
6. 2 Queen Street E., Toronto	545



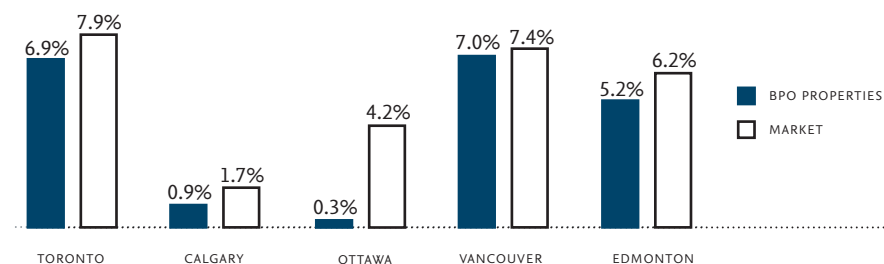
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Financial Highlights

All amounts expressed in Canadian dollars

(Millions, except per share information)	2005	2004	2003
Portfolio of commercial properties			
Book value	\$ 1,700.9	\$ 1,003.9	\$ 1,039.7
Leaseable area (sq. ft.)	27.2	14.1	14.4
Results of operations			
Net income			
Excluding property disposition gains	\$ 68.2	\$ 58.2	\$ 91.0
Including property disposition gains	68.2	63.0	93.9
Funds from operations			
Excluding property disposition gains	104.4	96.2	128.9
Including property disposition gains	104.4	102.2	132.5
Financial position			
Total assets	\$ 2,026.3	\$ 1,562.4	\$ 2,022.2
Shareholders' equity			
Preferred equity	381.7	381.7	381.7
Common equity	517.7	479.3	872.3
Per common share			
Net income			
Excluding property disposition gains	\$ 1.98	\$ 1.66	\$ 2.74
Including property disposition gains	1.98	1.83	2.84
Funds from operations			
Excluding property disposition gains	3.25	2.99	4.07
Including property disposition gains	3.25	3.20	4.20

BPO Properties vs. Market Vacancy (%)



Dear Shareholders,

We are pleased to report that 2005 was a year of great achievement for BPO Properties. Our solid financial results included generating net income of \$68.2 million or \$1.98 per share, an increase of 8% compared to \$63.0 million or \$1.83 per share in 2004. Funds from operations totaled \$104.4 million or \$3.25 per share compared to \$102.2 million or \$3.20 per share in 2004. The 2004 results included a property disposition gain of \$6.0 million or \$0.21 per share. Additionally, we completed the acquisition of O&Y Properties and O&Y REIT, which significantly expanded our platform, adding 11.6 million square feet of office properties to our premiere portfolio. We expanded our presence in two existing markets, Toronto and Calgary, and we have added two new markets, Ottawa and Edmonton.

2005 Accomplishments

Our team worked hard during the year to accomplish the major goals that we established, enabling us to meet our financial and operating targets for 2005. A year ago I outlined in my letter to shareholders our three-part strategic plan: provide progressive tenant services and infrastructure to maintain the quality of our portfolio and our tenant base; surface value from our properties through pro-active leasing; and prudently manage the company's capital. We made meaningful progress in all three areas.

We leased 1.5 million square feet of space during the year, approximately three times the amount contractually expiring.

In doing so, we increased overall occupancy rate to 96.1%, compared to a Canadian national average of 91.8%.

We invested a substantial amount of our liquidity, approximately \$200 million, alongside two institutional partners with the acquisition of the O&Y portfolio. This \$2 billion acquisition, one of the largest real estate deals in Canadian history, adds 27 office properties and one development site to our roster. We have diversified our already-strong tenant base with the addition of governmental and other high-quality tenants such as Public Works, Bank of Montreal and Manulife. BPO Properties serves as property and asset manager for the portfolio, and we expect to realize attractive incremental returns from this acquisition through fee income.

These fees represent an important area of growth for BPO Properties, as the company's returns will be leveraged through asset management and performance fees which typically include a stable base fee for providing regular on-going services as well as performance fees that are earned when certain pre-determined benchmarks are exceeded. In addition, we earn transaction fees for investment and leasing activities conducted on these properties.

In terms of development opportunities, we positioned our two major development sites, Bay Adelaide Centre in Toronto and Bankers Court in Calgary, for near-term activation. Given



Toronto skyline, left to right: 1. First Canadian Place 2. Exchange Tower 3. 2 Queen Street E

the rapidly decreasing vacancy rates in these markets, we are working diligently to secure anchor tenants for our sites while advancing design, planning and permitting processes. We acquired the remaining 50% interest in the Bay Adelaide development site, providing us with full flexibility to realize long-term value in the ownership of this 2.5 million square foot project which spans two city blocks in the heart of downtown Toronto. We also have a development site in Ottawa, the third phase of our Place de Ville project, which we are actively planning in order to commence development in the near-term in this supply-constrained market.

Outlook

Our markets are in full recovery across the board owing to general economic improvement, steady job growth and no overbuilding during the last cycle. With single-digit vacancy, high occupancies and rising rents, we are well-positioned to achieve additional growth. Our strategy includes selling interests in and repositioning a number of our properties while investor demand for well-leased, high-quality office properties such as ours remains strong.

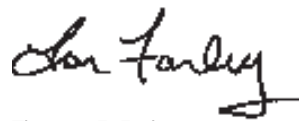
As the resource-based Alberta economy continues to be positively impacted by the surge in world energy prices and record-setting oil and gas prices, we are witnessing a very tight office market in Calgary. We plan to take advantage of the current conditions by selling some of the non-core assets we acquired with the O&Y portfolio before new office

product is delivered to the market in the next five years.

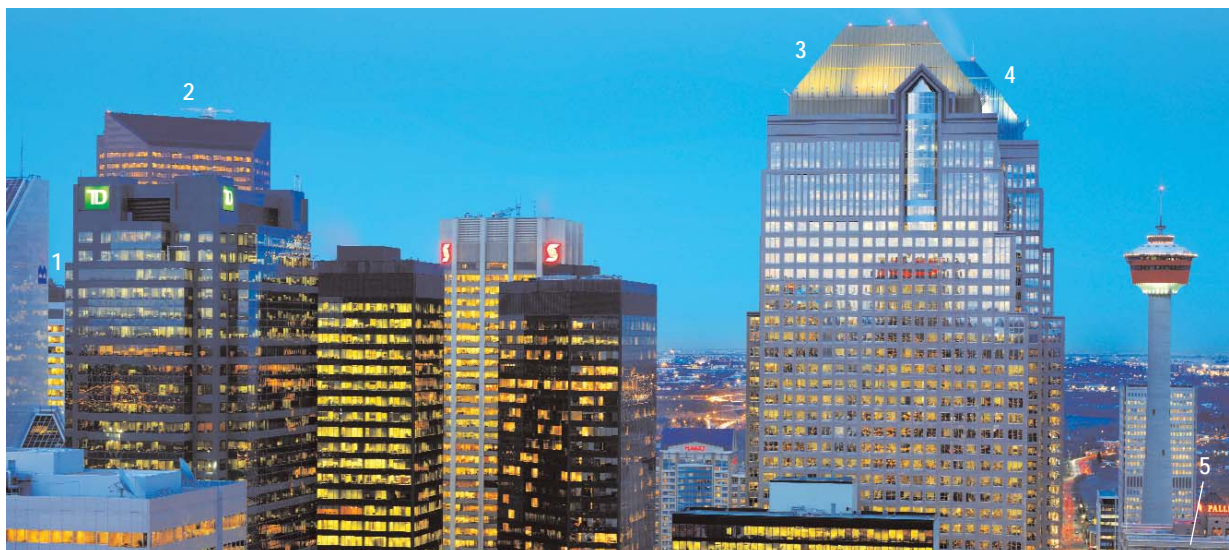
For 2006, we will maintain our disciplined, focussed strategy to property management and investing. Our most important priority continues to be maintaining high occupancy by pro-actively managing our assets. We will continue to lease in advance of maturities to reduce our rollover exposure over the next three to four years. Our average lease maturity at eight years is considerably longer than our peer average, ensuring a stable cash flow. In addition, we plan to commence one or two of our office development projects this year.

There is ample reason to be optimistic about the future. We are in an excellent position to capitalize on strong market conditions during this time of economic rebound. I would like to thank all of our investors, tenants and business partners for their continued support of BPO Properties.

On behalf of the Board,



Thomas F. Farley
President and Chief Executive Officer
February 15, 2006



Calgary skyline, left to right: 1. Fifth Avenue Place 2. Petro Canada Centre 3. Bankers Hall, East Tower 4. Bankers Hall, West Tower 5. Gulf Canada Square

Portfolio by City

BPO Properties Ltd., one of North America's largest commercial real estate companies, owns, develops and manages premier office properties. BPO Properties' portfolio comprises 43 commercial properties totaling 22.9 million square feet and seven development sites totaling 4.3 million square feet in the downtown cores of Toronto, Calgary and Ottawa. Landmark properties include the First Canadian Place in Toronto and Bankers Hall in Calgary.

	Number of Properties	Leased %	Office 000's Sq. Ft.	Retail/Other 000's Sq. Ft.	Leasable Area 000's Sq. Ft.	Effective Ownership Interest %	BPO's Effective Interest 000's Sq. Ft.
Toronto, Ontario							
First Canadian Place	1	94.7%	2,409	372	2,781	25%	695
Atrium on Bay	1	89.4%	914	327	1,241	50%	621
Exchange Tower	2	91.9%	963	198	1,161	50%	580
Hudson's Bay Centre	1	87.4%	535	557	1,092	25%	273
2 Queen St. E.	1	91.5%	448	97	545	25%	136
Queens Quay Terminal	1	97.5%	428	75	503	100%	503
151 Yonge St.	1	100.0%	289	82	371	25%	93
2 St. Clair Ave. W.	1	90.6%	210	90	300	25%	75
18 King St. E.	1	87.9%	219	33	252	25%	63
105 Adelaide St. W.	1	100.0%	173	59	232	100%	232
HSBC Building	1	100.0%	188	37	225	100%	225
40 St. Clair Ave. W.	1	93.4%	117	32	149	25%	37
20-22 Front St.	1	99.2%	137	8	145	100%	145
Developments							
Bay Adelaide Centre	3	—	2,500	—	2,500	100%	2,500
BCE Place III	1	—	800	—	800	65%	520
	17	93.1%	10,330	1,967	12,297		6,698
Ottawa, Ontario							
Place de Ville I	2	100.0%	558	531	1,089	25%	272
Place de Ville II	2	99.3%	577	466	1,043	25%	261
Jean Edmonds Towers	2	99.9%	528	117	646	25%	162
2204 Walkley	1	100.0%	104	—	103	25%	26
2200 Walkley	1	100.0%	54	—	54	25%	13
Development							
Place de Ville III	1	—	500	—	500	25%	125
	9	99.7%	2,321	1,114	3,435		859
Calgary, Alberta							
Bankers Hall	3	99.5%	1,943	750	2,693	50%	1,347
Petro Canada Centre	2	99.9%	1,707	245	1,952	50%	976
5th Avenue Place	2	99.9%	1,428	255	1,683	50%	842
Gulf Canada Square	1	97.4%	1,052	93	1,145	25%	286
Altius Centre	1	99.5%	303	75	378	25%	95
840 - 7th Ave S.W.	1	97.7%	250	37	287	25%	72
McFarlane Tower	1	99.3%	233	44	277	25%	69
Franklin Atrium	1	88.0%	143	102	245	25%	61
Altalink Place	1	100.0%	77	28	105	25%	26
Franklin Building	1	100.0%	51	38	89	25%	22
Mount Royal Place	1	96.0%	54	28	82	25%	20
Developments							
Bankers Court	2	—	500	—	500	50%	250
	17	99.1%	7,741	1,695	9,436		4,066
Edmonton, Alberta							
Canadian Western Bank	1	93.3%	372	124	496	25%	124
Enbridge Tower	1	98.3%	178	34	212	25%	53
	2	94.8%	550	158	708		177
Vancouver, B.C.							
Royal Centre, Vancouver	1	93.0%	493	360	853	100%	853
Other							
330 St. Mary Avenue, Winnipeg	1	89.3%	143	34	177	25%	44
175 Hargrave Street, Winnipeg	1	71.0%	70	5	75	25%	19
4342 Queen Street, Niagara Falls	1	91.2%	149	60	209	25%	52
Other	1	100.0%	—	3	3	100%	3
	4	90.5%	361	102	463		118
Total portfolio	50	96.1%	21,796	5,396	27,192		12,771

Management’s Discussion and Analysis of Financial Results

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FORWARD-LOOKING STATEMENTS

This annual report to shareholders, particularly the “Outlook” section, contains forward-looking statements and information within the meaning of applicable securities legislation. Although BPO Properties believes that the anticipated future results, performance or achievements expressed or implied by the forward-looking statements and information are based upon reasonable assumptions and expectations, the reader should not place undue reliance on forward-looking statements and information because they involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the company to differ materially from anticipated future results, performance or achievement expressed or implied by such forward-looking statements and information. Factors that could cause actual results to differ materially from those set forth in the forward-looking statements and information include general economic conditions; local real estate conditions, including the development of properties in close proximity to the company’s properties; timely leasing of newly-developed properties and re-leasing of occupied square footage upon expiration; dependence on tenants’ financial condition; the uncertainties of real estate development and acquisition activity; the ability to effectively integrate acquisitions; interest rates; availability of equity and debt financing; the impact of newly-adopted accounting principles on the company’s accounting policies and on period-to-period comparisons of financial results; and other risks and factors described from time to time in the documents filed by the company with the securities regulators in Canada including in the Annual Information Form under the heading “Business of BPO Properties – Company and Real Estate Industry Risks.” The company undertakes no obligation to publicly update or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise.

Management's Discussion and Analysis of Financial Results

February 15, 2006

PART I – OBJECTIVES AND FINANCIAL HIGHLIGHTS

BASIS OF PRESENTATION

Financial data included in Management's Discussion and Analysis ("MD&A") has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") with non-GAAP measures such as net operating income and funds from operations ("FFO") being reconciled to appropriate Canadian GAAP measures. All dollar references, unless otherwise stated, are in millions of Canadian dollars except per share amounts. Amounts in U.S. dollars are identified as "US\$".

The following discussion and analysis are intended to provide readers with an assessment of the performance of BPO Properties Ltd. ("BPO Properties") over the past three years as well as our financial position and future prospects. It should be read in conjunction with the audited consolidated financial statements and appended notes which begin on page 33 of this report. In our discussion of operating performance, we refer to net operating income and FFO on a total and per share basis. Net operating income is defined as income from property operations after operating expenses have been deducted, but prior to deducting financing, administration and income tax expenses. FFO is defined as net income prior to extraordinary items, non-cash items and depreciation and amortization. We use net operating income and FFO to assess our operating results, as net operating income is an important measure in assessing operating performance and FFO is a relevant measure in analyzing real estate, as commercial properties generally appreciate rather than depreciate. We provide the components of net operating income on page 21 and a full reconciliation from net income to FFO on page 21. Net operating income and FFO are both non-GAAP measures which do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by non-real estate companies.

Additional information, including our Annual Information Form, is available on our Web site at www.bpoproperties.com, or on www.sedar.com.

FINANCIAL HIGHLIGHTS

BPO Properties' financial results are as follows:

(Millions, except per share amounts)	2005	2004	2003
Results of operations			
Net income			
Excluding property disposition gains ⁽¹⁾	\$ 68.2	\$ 58.2	\$ 91.0
Including property disposition gains	68.2	63.0	93.9
Net income per common share	1.98	1.83	2.84
Common share dividends per common share	0.60	0.60 ⁽²⁾	0.30
Funds from operations			
Excluding property disposition gains ⁽¹⁾	\$ 104.4	\$ 96.2	\$ 128.9
Including property disposition gains	104.4	102.2	132.5
Funds from operations per common share			
Excluding property disposition gains ⁽¹⁾	\$ 3.25	\$ 2.99	\$ 4.07
Including property disposition gains	3.25	3.20	4.20
Balance sheet data			
Total assets	\$ 2,026.3	\$ 1,562.4	\$ 2,022.2
Commercial properties	1,700.9	1,003.9	1,039.7
Shareholders' equity	899.4	861.0	1,254.0

⁽¹⁾ Exclusion of property disposition gains from these results is a non-GAAP measure which we believe provides readers with a supplemental basis for evaluating our on-going operations since property disposition gains are the result of unpredictable and opportunistic events. The 2004 and 2003 results included \$6.0 million and \$3.6 million, respectively, of property disposition gains (or \$0.21 and \$0.13 per share, respectively). There were no property disposition gains in 2005

⁽²⁾ Excludes the special common share dividend of \$15 per share

OVERVIEW OF THE BUSINESS

BPO Properties is a publicly-traded Canadian commercial real estate company listed on the Toronto stock exchange under the symbol BPP. We own, develop and manage premier commercial office properties in select cities in Canada. At December 31, 2005, the book value of BPO Properties' assets was \$2.0 billion. We generated \$68.2 million of net income (\$1.98 per common share) and \$104.4 million of FFO (\$3.25 per common share) in 2005.

COMMERCIAL PROPERTY OPERATIONS

Our strategy of owning, pro-actively managing and developing premier properties in supply-constrained, barrier-to-entry, high-growth markets has created one of Canada's most distinguished portfolios of office properties. Our portfolio consists of 43 commercial properties totaling 22.9 million square feet and seven development sites totaling 4.3 million square feet. Our primary markets are the financial, energy and government-centre cities of Toronto, Ottawa, Calgary, Edmonton and Vancouver. We intend to continue our strategy of concentrating operations within a select number of supply-constrained markets with attractive tenant bases in order to maintain a meaningful presence and build on the strength of our tenant relationships within these markets.

We remain focused on the following strategic priorities:

- Surfacing value from our properties through pro-active leasing and select redevelopment initiatives;
- Prudent capital management including the refinancing of mature properties and investing in joint venture opportunities with institutional partners who seek to benefit from the depth of our expertise; and
- Monetizing development assets as the economy rebounds and continued supply constraints create opportunities.

The following table summarizes our investment by market:

Region	Number of Properties	Leasable Area (000's Sq. Ft.)	BPO Properties			Debt (Millions)	Net Book Equity (Millions)
			Owned Interest (000's Sq. Ft.)	Book Value (Millions)			
Toronto, Ontario	13	8,997	3,678	\$ 604.5	\$ 335.4	\$ 269.1	
Ottawa, Ontario	8	2,935	734	115.0	57.8	57.2	
Calgary, Alberta	15	8,936	3,816	658.3	474.0	184.3	
Edmonton, Alberta	2	708	177	17.6	10.6	7.0	
Vancouver, B.C.	1	853	853	108.1	51.2	56.9	
Winnipeg, Manitoba and other	4	463	118	7.5	6.5	1.0	
	43	22,892	9,376	\$ 1,511.0	\$ 935.5	\$ 575.5	
Office development sites	7	4,300	3,395	189.9	11.0	178.9	
Total	50	27,192	12,771	\$ 1,700.9	\$ 946.5	\$ 754.4	

An important characteristic of our portfolio is the strong credit quality of our tenants. We direct special attention to credit quality in order to ensure the long-term sustainability of rental revenues through economic cycles. Major tenants with over 500,000 square feet of space in the portfolio include Government of Canada, Bank of Montreal, Petro-Canada, CIBC, Imperial Oil and Talisman Energy. A detailed list of major tenants is included in Part III of this MD&A which deals with "Risks and Uncertainties" commencing on page 25.

Our strategy is to sign long-term leases in order to mitigate risk and reduce our overall retensing costs. We typically commence discussions with tenants regarding their space requirements well in advance of the contractual expiration, and while each market is different, the majority of our leases, when signed, extend between 10 and 20-year terms. As a result of this strategy, approximately 7.9% of our leases mature annually.

Following is the breakdown of lease maturities by market with associated in-place rental rates:

Year of Expiry	Total Portfolio			Toronto, Ontario			Ottawa, Ontario			Calgary, Alberta		
	000's Sq. Ft.	Net Rate per Sq. Ft.-\$		000's Sq. Ft.	Net Rate per Sq. Ft.-\$		000's Sq. Ft.	Net Rate per Sq. Ft.-\$		000's Sq. Ft.	Net Rate per Sq. Ft.-\$	
Currently available	742	3.9		544	6.9		5	0.3		71	0.9	
2006	833	4.4	\$ 20	390	5.0	\$ 17	118	6.2	\$ 11	201	2.6	\$ 18
2007	1,003	5.3	18	499	6.3	22	66	3.5	13	290	3.8	17
2008	2,101	11.1	24	630	8.0	22	1,005	52.7	12	408	5.4	19
2009	1,235	6.5	22	667	8.5	17	135	7.1	12	299	3.9	19
2010	1,942	10.3	17	608	7.7	24	2	0.1	38	1,129	14.8	24
2011	2,044	10.8	25	343	4.4	25	—	—	—	1,614	21.2	20
2012	1,333	7.0	20	624	7.9	24	2	0.1	26	632	8.3	23
2013 & beyond	11,659	40.7	23	4,692	45.3	23	1,602	30.0	13	4,292	39.1	23
	22,892	100.0	\$ 20	8,997	100.0	\$ 22	2,935	100.0	\$ 12	8,936	100.0	\$ 21
Weighted average market net rent			\$ 26			\$ 27			\$ 17			\$ 30

Year of Expiry	Edmonton, Alberta			Vancouver, B.C.			Winnipeg and Other		
	000's Sq. Ft.	Net Rate per Sq. Ft.-\$		000's Sq. Ft.	Net Rate per Sq. Ft.-\$		000's Sq. Ft.	Net Rate per Sq. Ft.-\$	
Currently available	31	5.2		41	7.0		50	13.4	
2006	24	4.1	\$ 7	51	8.7	\$ 17	49	13.1	\$ 6
2007	28	4.8	8	53	9.0	19	67	17.9	10
2008	23	3.9	8	8	1.4	21	27	7.2	11
2009	42	7.2	9	36	6.1	20	56	15.0	10
2010	102	17.4	10	52	8.8	18	49	13.1	11
2011	58	9.9	10	29	4.9	20	—	—	—
2012	22	3.7	5	24	4.1	20	29	7.8	13
2013 & beyond	378	43.8	13	559	50.0	12	136	12.5	12
	708	100.0	\$ 11	853	100.0	\$ 15	463	100.0	\$ 10
Weighted average market net rent			\$ 14			\$ 25			\$ 11

Commercial Development

We hold interests in 4.3 million square feet of high-quality, centrally-located development sites at various stages of planning and construction. We will seek to monetize these sites through development only when our risk-adjusted return hurdles are met and when significant pre-leasing targets with one or more lead tenants have been achieved. As the economy rebounds, continued supply constraints should create opportunities for us to enhance value through the development of these assets.

The following table summarizes our commercial development projects at December 31, 2005:

Location	Number of Sites	Ownership	Buildable Sq. Ft.
Toronto, Ontario			
Bay-Adelaide Centre	3	100%	2,500,000
BCE Place III	1	65%	800,000
Calgary, Alberta			
Bankers Court	2	50%	500,000
Ottawa, Ontario			
300 Queen Street	1	25%	500,000
	7		4,300,000

PERFORMANCE MEASUREMENT

The key indicators by which we measure our performance are:

- Net income per share;
- Net operating income;
- FFO per share;
- Overall indebtedness level;
- Weighted average cost of debt; and
- Occupancy levels.

While we monitor and analyze our financial performance using a number of indicators, our primary business objective of generating reliable and growing cashflow is monitored and analyzed using net income, net operating income and FFO. While net income is calculated in accordance with GAAP, net operating income and FFO are both non-GAAP financial measures which do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. We provide the components of net operating income on page 21 and a full reconciliation from net income to FFO on page 21 of this MD&A.

Net Income

Net income is calculated in accordance with GAAP. Net income is used as a key indicator in assessing our profitability.

Net Operating Income

Net operating income is defined as income from property operations after operating expenses have been deducted, but prior to deducting financing, administration and income tax expenses. Net operating income is used as a key indicator of performance as it represents a measure over which management has control. We measure the performance of management by comparing the performance of the property portfolio adjusted for the effect of current and prior year sales and acquisitions.

Funds From Operations

FFO is defined as net income prior to extraordinary items, non-cash items and depreciation and amortization. While we believe that FFO is the most relevant measure to analyze real estate as commercial properties generally appreciate rather than depreciate, we believe that both FFO and net income are relevant measures. We compute FFO substantially in accordance with the definition provided by the Real Property Association of Canada ("RealPac"). Under this definition, FFO does not represent cash or approximate cash generated from operating activities determined in accordance with Canadian GAAP, and should not be considered as an alternative to GAAP measures. Accordingly, we provide a reconciliation of FFO to net income, consistent with the definition provided by RealPac as set out above. A reconciliation is not provided to cashflow from operating activities, as it is often subject to fluctuations based on the timing of working capital payments.

KEY PERFORMANCE DRIVERS

In addition to monitoring and analyzing performance in terms of net operating income and FFO, we consider the following items to be important drivers of our current and anticipated financial performance:

- Increases in occupancies by leasing up vacant space;
- Increases in rental rates as market conditions permit; and
- Reduction in occupancy costs through achieving economies of scale and diligently managing contracts.

We also believe that the key external performance drivers are:

- The availability of new property acquisitions which fit into our strategic plan;
- The availability of equity capital at a reasonable cost; and
- The availability of debt capital at a cost and on terms conducive to our goals.

SIGNIFICANT EVENTS

During the fourth quarter, we completed the acquisition of a 25% joint-venture interest in O&Y Properties Corporation and O&Y Real Estate Investment Trust (collectively, "O&Y"). The O&Y portfolio consists of 27 office properties and one development site totaling 11.6 million square feet in Toronto, Calgary, Ottawa, Edmonton, Winnipeg and Niagara Falls. Included in the portfolio is First Canadian Place, which is directly connected to the Exchange Tower in Toronto.

We serve as property and asset manager for the entire portfolio. The following is a summary of our investment in the portfolio:

Region	Number of Properties	Leasable Area (000's Sq. Ft.)	BPO Properties Owned Interest (000's Sq. Ft.)	Purchase Price Book Value (Millions)
Toronto, Ontario	6	4,398	1,099	\$ 314.9
Calgary, Alberta	8	2,608	651	130.6
Ottawa, Ontario	8	2,935	734	115.1
Edmonton, Alberta	2	708	177	17.5
Winnipeg, Manitoba	2	251	63	3.8
Niagara Falls, Ontario	1	209	52	2.7
	27	11,109	2,776	\$ 584.6
Office development site	1	500	125	4.0
Total commercial and development properties	28	11,609	2,901	\$ 588.6
Accounts receivable and other assets				17.0
Intangible assets				66.5
Accounts payable and other liabilities assumed				(16.8)
Intangible liabilities				(115.2)
Future income tax liabilities assumed				(31.3)
Commercial property debt assumed				(163.0)
Purchase price before acquisition financing				345.8
Acquisition financing				(129.5)
Total purchase price				\$ 216.3

PART II – FINANCIAL STATEMENT ANALYSIS

ASSET PROFILE

Our total assets were \$2.0 billion at December 31, 2005, an increase of \$463.9 million from 2004. The increase in total assets is primarily attributable to the acquisition of the O&Y portfolio and the acquisition of the remaining 50% interest in Bay-Adelaide Centre development site. The following is a summary of our assets over the past three years:

(Millions)	2005	2004	2003
Assets			
Commercial properties	\$ 1,511.0	\$ 881.8	\$ 923.7
Development properties	189.9	122.1	116.0
Loans receivable	100.1	91.7	50.4
Marketable securities and other investments	66.7	377.9	349.6
Cash and cash equivalents	24.2	11.2	491.1
Other assets	54.0	28.5	31.9
Intangible assets	63.9	—	—
Future income taxes	16.5	49.2	59.5
Total	\$ 2,026.3	\$ 1,562.4	\$ 2,022.2

COMMERCIAL PROPERTIES

Our acquisition of the O&Y portfolio accounts for the majority of the increase in book value of commercial properties from December 31, 2004. Our 25% joint-venture interest in the O&Y portfolio was purchased in the fourth quarter of 2005 for approximately \$216.3 million, after the assumption of debt and acquisition financing, and comprises 11.6 million square feet in Toronto, Calgary, Ottawa, Edmonton, Winnipeg and Niagara Falls.

The consolidated carrying value of our office properties is approximately \$161 per square foot, significantly less than the estimated replacement cost of these assets. Hudson's Bay Centre was reclassified to commercial properties in 2005. A breakdown of our commercial properties by region is as follows:

Region	Leasable Area (000's Sq. Ft.)	BPO Properties		2005	2004	2003
		Owned Interest (000's Sq. Ft.)	Book Value (Millions)	Book Value (Millions)	Book Value (Millions)	
Toronto, Ontario	8,997	3,678	\$ 604.5	\$ 240.9	\$ 243.9	
Ottawa, Ontario	2,935	734	115.0	—	—	
Calgary, Alberta	8,936	3,816	658.3	536.0	581.5	
Edmonton, Alberta	708	177	17.6	—	—	
Vancouver, B.C.	853	853	108.1	104.9	98.3	
Winnipeg, Manitoba and other	463	118	7.5	—	—	
	22,892	9,376	\$ 1,511.0	\$ 881.8	\$ 923.7	
Office development sites	4,300	3,395	189.9	122.1	116.0	
Total	27,192	12,771	\$ 1,700.9	\$ 1,003.9	\$ 1,039.7	

TENANT INSTALLATION COSTS AND CAPITAL EXPENDITURES

Upon the signing of the majority of our leases, we provide tenant improvements for leased space in order to accommodate the specific space requirements of the tenant. In addition to this capital, leasing commissions are paid to third-party brokers representing tenants in lease negotiations. Tenant improvements and leasing commissions are capitalized in the year incurred, amortized over the term of the lease and recovered through rental payments. Expenditures for tenant improvements in 2005 totaled \$15.1 million, compared with \$10.7 million expended in 2004. The increase was a result of tenant improvements incurred on the lease-up of space in Calgary and Vancouver. On an annual basis, one to two million square feet of leases expire on average with a cost to replace these tenancies approximating \$15 to \$25 per square foot, with each region of operation varying in actual cost per square foot. The average expenditure on tenant inducements across the portfolio over the last three years was \$9 per square foot. Tenant installation costs are summarized as follows:

(Millions)	2005	2004	2003
Leasing commissions	\$ 3.4	\$ 2.0	\$ 1.9
Tenant improvements	11.7	8.7	6.8
Total	\$ 15.1	\$ 10.7	\$ 8.7

We also invest in on-going maintenance and capital improvement projects to sustain the high quality of the infrastructure and tenant service amenities in our properties. Due to the relatively recent construction and major renovation of our core properties as well as high-quality construction standards, our recurring capital maintenance expenditures are lower than industry norms. Capital maintenance expenditures totaled \$11.9 million in 2005, compared with \$13.5 million in 2004. These expenditures exclude repairs and maintenance costs which are recovered through contractual tenant cost-recovery payments.

Capital expenditures include revenue-enhancing capital expenditures which represent improvements to an asset or reconfiguration of space to increase rentable area or increase current rental rates, and non-revenue enhancing expenditures, which are those required to extend the service life of an asset. The details of our capital expenditures are summarized as follows:

(Millions)	2005	2004	2003
Revenue enhancing	\$ 6.8	\$ 7.0	\$ 5.7
Non-revenue enhancing	5.1	6.5	4.8
Total	\$ 11.9	\$ 13.5	\$ 10.5

DEVELOPMENT PROPERTIES

Development properties consist of commercial property development sites, density rights and related infrastructure. The total book value of this development land was \$189.9 million at December 31, 2005, an increase of \$67.8 million from \$122.1 million in 2004. The increase relates to the acquisition of the remaining 50% interest in the Bay-Adelaide Centre in Toronto, offset by the reclassification of Hudson's Bay Centre to commercial properties.

The details of the commercial development property portfolio are as follows:

	Buildable Sq. Ft.	2005 Book Value (Millions)	2004 Book Value (Millions)	2003 Book Value (Millions)
Bay-Adelaide Centre, Toronto	2,500,000	\$ 184.7	\$ 86.0	\$ 82.6
Hudson's Bay Centre, Toronto ⁽¹⁾	—	—	34.9	33.5
Other:				
BCE Place III, Toronto	800,000			
Bankers Court, Calgary	500,000			
300 Queen Street, Ottawa	500,000			
	1,800,000	5.2	1.2	1.0
	4,300,000	\$ 189.9	\$ 122.1	\$ 117.1

⁽¹⁾ Reclassified to commercial properties in 2005

Although we are not a speculative developer, we are a full-service real estate company with development expertise. With approximately 4.3 million square feet of high-quality, centrally-located development properties in Toronto, Calgary and Ottawa, we will undertake development only when our risk-adjusted returns are adequate and significant pre-leasing of space has been achieved.

In the fourth quarter of 2005, we increased our ownership in the Bay-Adelaide Centre development to 100% by acquiring the remaining 50% interest at a price of \$105 million, payable with \$80 million cash and a \$25 million vendor take-back mortgage. The terms of the vendor take-back mortgage provide that the amount is permanently reduced by \$12.5 million if construction does not commence within the three-year term. This project has in place full below-grade infrastructure to service 2.5 million square feet of office and residential space. A fully operational underground parking facility is currently generating revenue.

We also own expansion rights for a third office tower at BCE Place, adjacent to our 20-22 Front Street property, which includes approximately 800,000 square feet of density. We have similar rights to develop 500,000 square feet of office space at Bankers Court, adjacent to Bankers Hall in Calgary. With the acquisition of the O&Y portfolio, we have added 500,000 square feet of development density at 300 Queen Street, the third phase of Place de Ville in Ottawa.

The details of our development and redevelopment expenditures on commercial and development properties are as follows:

(Millions)	2005	2004	2003
Construction costs	\$ 2.4	\$ 1.7	\$ 3.3
Interest capitalized	4.6	2.9	3.5
Property taxes and other	2.5	0.5	0.6
Total	\$ 9.5	\$ 5.1	\$ 7.4

LOANS RECEIVABLE

Loans receivable increased to \$100.1 million from \$91.7 million primarily due to an increase in accrued interest. The components of loans receivable are as follows:

(Millions)	2005	2004	2003
Loans receivable	\$ 87.1	\$ 88.9	\$ 51.0
Provisions	—	(6.0)	(6.0)
Accrued interest	13.0	8.8	5.4
Total	\$ 100.1	\$ 91.7	\$ 50.4

MARKETABLE SECURITIES AND OTHER INVESTMENTS

We endeavor to maintain high levels of liquidity to ensure that we can react quickly to potential investment opportunities. This liquidity consists of cash and marketable securities which contribute investment returns, as well as committed lines of credit. To ensure we maximize our returns, cash balances are generally carried at a modest level and excess cash is invested in short-term marketable securities. Marketable securities consist of a portfolio of fixed-rate corporate bonds which are carried at amortized cost with a fair value which approximates their book value at an average yield of 2.6%. The bond portfolio matures over the next two years.

As at December 31, 2005, marketable securities decreased to \$66.7 million from \$377.9 million at December 31, 2004, as these funds were used to purchase our interest in the O&Y portfolio and the remaining 50% interest in Bay-Adelaide Centre.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents increased to \$24.2 million from \$11.2 million in 2004. The increase is primarily related to additional cash balances in the O&Y portfolio.

OTHER ASSETS

Other assets increased to \$54.0 million from \$28.5 million primarily due to the additional working capital acquired from the O&Y portfolio. The components of other assets are as follows:

(Millions)	2005	2004	2003
Tenant and other receivables	\$ 32.8	\$ 23.7	\$ 25.9
Prepaid expenses and other assets	21.2	4.8	6.0
Total	\$ 54.0	\$ 28.5	\$ 31.9

INTANGIBLE ASSETS

In September 2003, the CICA issued EIC 140 "Accounting for Operating Leases Acquired in either an Asset Acquisition or a Business Combination" in which the Emerging Issues Committee of the CICA concluded that an enterprise that acquires real estate should allocate a portion of the purchase price to in-place operating leases, based on their fair value that the enterprise acquires in connection with the real estate property. With the acquisition of the O&Y portfolio, we assessed the fair value of acquired intangible assets, including tenant improvements, above-market leases, lease origination costs, tenant relationships and other identified intangible assets and have allocated \$66.5 million (2004 - nil) to intangible assets accordingly. The components of intangible assets are as follows:

(Millions)	2005	2004	2003
Lease origination costs	\$ 54.4	—	—
Tenant relationships	9.5	—	—
Above-market leases	2.6	—	—
	66.5	—	—
Accumulated amortization	(2.6)	—	—
Total	\$ 63.9	—	—

FUTURE INCOME TAXES

At December 31, 2005, we had a future income tax asset of \$16.5 million compared to \$49.2 million at December 31, 2004, a decrease of \$32.7 million, primarily reflecting the utilization of tax losses during 2005 and the assumption of future income tax liabilities with the acquisition of the O&Y portfolio.

(Millions)	2005	2004	2003
Future income tax assets related to non-capital losses and capital losses	\$ 52.6	\$ 38.1	\$ 27.3
Future income tax assets (liabilities) related to difference in tax and book basis, net	(36.1)	11.1	32.2
Total	\$ 16.5	\$ 49.2	\$ 59.5

UTILIZATION OF CASH RESOURCES

The following table illustrates the utilization of cashflow generated by our operating activities, financing initiatives and our investing initiatives:

(Millions)	2005	2004	Total
Cashflow from operating activities	\$ 63.7	\$ 64.5	\$ 128.2
Financing			
Borrowings, net of repayments	116.0	(26.9)	89.1
Net repurchase of common shares	(0.9)	—	(0.9)
Shareholder distributions	(28.9)	(456.0)	(484.9)
	86.2	(482.9)	(396.7)
Investing			
Marketable securities	311.2	(28.3)	282.9
Loans receivable	—	(35.9)	(35.9)
Acquisitions of real estate, net	(426.7)	—	(426.7)
Dispositions of real estate, net	—	21.3	21.3
Development and redevelopment	(9.5)	(5.1)	(14.6)
Capital expenditures	(11.9)	(13.5)	(25.4)
	(136.9)	(61.5)	(198.4)
Increase (decrease) in cash	\$ 13.0	\$ (479.9)	\$ (466.9)

Cashflow from operating activities represents the primary source of liquidity to service debt, to fund deferred maintenance and leasing costs and to fund distributions on shares. Cashflow from operating activities is dependent upon occupancy levels of properties owned, rental rates achieved and timing of the collection of receivables and payment of payables.

LIABILITIES AND SHAREHOLDERS' EQUITY

Our asset base of \$2.0 billion is financed with a combination of debt, preferred shares and common equity. The components of our liabilities and shareholders' equity over the past three years are as follows:

(Millions)	2005	2004	2003
Liabilities			
Commercial property debt	\$ 946.5	\$ 655.8	\$ 703.5
Accounts payable and other liabilities	66.9	45.6	64.7
Intangible liabilities	113.5	—	—
Shareholders' equity			
Preferred shares	381.7	381.7	381.7
Common shares	78.9	78.9	78.9
Retained earnings	438.8	400.4	793.4
Total	\$ 2,026.3	\$ 1,562.4	\$ 2,022.2

COMMERCIAL PROPERTY DEBT

Commercial property debt totaled \$946.5 million at December 31, 2005, compared with \$655.8 million at December 31, 2004 and \$703.5 million at December 31, 2003. The increase during 2005 is due to the acquisition of the O&Y portfolio, offset by principal amortization. Commercial property debt at December 31, 2005 had an average interest rate of 6.6% and an average term to maturity of seven years. All of our commercial property debt is recourse only to specific properties, thereby reducing our overall financial risk.

Our financing targets and results are set out in the following table:

Objective	Three Year	Annual Results		
	Average	2005	2004	2003
Maintain debt to total market capitalization of 50% or less	33%	36%	30%	33%
Move towards long-term goal of 100% non-recourse debt	99%	100%	100%	98%
Maintain interest expense coverage of 3.2x or greater	3.5x	3.4x	3.2x	3.9x

In addition, we attempt to match the maturity of our commercial property debt portfolio with the average lease term of our properties. At December 31, 2005, both the average term to maturity of our commercial property debt and our average lease term was seven years.

With the acquisition of the O&Y portfolio, we assumed \$163.0 million of existing debt and added \$129.5 million of bridge financing while we position the properties for permanent financing. During 2005, we also refinanced \$40 million of commercial property debt at Atrium on Bay with a one-year floating rate mortgage. The details are as follows:

	Financed / Refinanced	
	Mortgage (Millions)	Weighted Average Interest Rate %
Assumed debt on the acquisition of the O&Y portfolio	\$ 163.0	6.5%
Financing on the acquisition of the O&Y portfolio	129.5	CDOR + (75 bps to 195 bps)
Atrium on Bay, Toronto	40.0	CDOR + (95 bps to 115 bps)
Total	\$ 332.5	

The details of commercial property debt at December 31, 2005 are as follows:

Commercial Property	Location	Interest Rate %	Maturity Date	BPO Properties'	
				Proportionate Share (Millions)	Mortgage Details
O&Y Acquisition Facility	Various	4.46	2006/2008	\$ 129.5	Non-recourse, floating rate
Atrium on Bay	Toronto, Ontario	4.30	2006	40.0	Non-recourse, floating rate
330 St. Mary	Winnipeg	5.98	2006	1.6	Non-recourse, fixed rate
105 Adelaide	Toronto, Ontario	5.77	2007	24.4	Non-recourse, fixed rate
Queens Quay Terminal	Toronto, Ontario	6.50	2007	6.9	Non-recourse, fixed rate
Petro-Canada Centre	Calgary, Alberta	6.43	2008	130.1	Non-recourse, fixed rate
Bay Adelaide VTB	Toronto, Ontario	—	2008	11.0	—
22 Front Street	Toronto, Ontario	11.88	2008	7.0	Non-recourse, fixed rate
First Canadian Place	Toronto, Ontario	8.06	2009	66.5	Non-recourse, fixed rate
Place de Ville I	Ottawa	7.81	2009	7.4	Non-recourse, fixed rate
Enbridge Tower	Edmonton	6.72	2009	2.6	Non-recourse, fixed rate
18 King Street E	Toronto	6.08	2010	4.6	Non-recourse, fixed rate
Fifth Avenue Place	Calgary	7.59	2011	76.7	Non-recourse, fixed rate
Queen's Quay Terminal	Toronto	7.26	2011	36.7	Non-recourse, fixed rate
Gulf Canada Square	Calgary	5.47	2011	31.7	Non-recourse, fixed rate
Exchange Tower	Toronto	6.83	2012	65.7	Non-recourse, fixed rate
HSBC Building	Toronto	8.19	2012	24.6	Non-recourse, fixed rate
151 Yonge Street	Toronto	6.01	2012	11.9	Non-recourse, fixed rate
Bankers Hall	Calgary	7.20	2013	168.0	Non-recourse, fixed rate
Bankers Hall	Calgary	6.69	2013	12.2	Non-recourse, fixed rate
840 - 7th Ave SW	Calgary	6.60	2013	5.6	Non-recourse, fixed rate
4342 Queen St.	Niagara Falls	6.15	2013	1.4	Non-recourse, fixed rate
Jean Edmonds Tower	Ottawa	5.55	2014	2.0	Non-recourse, fixed rate
Royal Centre	Vancouver	8.00	2022	26.0	Non-recourse, fixed rate
Royal Centre	Vancouver	6.25	2022	25.2	Non-recourse, fixed rate
Jean Edmonds Tower	Ottawa	6.79	2024	15.6	Non-recourse, fixed rate
Mark-to-market (O&Y debt)	Various	—	—	11.6	—
Total		6.60		\$ 946.5	

Commercial property debt maturities for the next five years and thereafter are as follows:

(Millions) Year	Scheduled		Total	Weighted Average Interest Rate at Dec. 31, 2005 (%)
	Amortization	Maturities		
2006	\$ 19.3	\$ 124.2	\$ 143.5	4.2
2007	18.1	30.7	48.8	5.9
2008	15.0	185.2	200.2	6.3
2009	15.5	65.5	81.0	8.0
2010	13.8	4.3	18.1	6.1
2011 and thereafter	95.0	359.9	454.9	7.1
Total	\$ 176.7	\$ 769.8	\$ 946.5	6.6

The most significant maturities in the next five years are the floating-rate bridge financing facilities put in place on the acquisition of the O&Y portfolio. We expect to refinance these facilities in the future with long-term, fixed-rate debt.

CONTRACTUAL OBLIGATIONS

The following table presents our contractual obligations over the next five years:

(Millions)	Total	Payments Due By Period		
		1 - 3 Years	4 - 5 Years	After 5 Years
Commercial property debt	\$ 946.5	\$ 392.5	\$ 99.1	\$ 454.9
Interest expense ⁽¹⁾ - Commercial property debt	324.4	163.8	71.1	89.5

⁽¹⁾ Represents aggregate interest expense expected to be paid over the term of the debt, on an undiscounted basis, based on current interest rates.

Additionally we have properties situated on land held under leases or other agreements largely expiring on or before the year 2069. Minimum rental payments on land leases are approximately \$4.9 million annually for the next five years and \$49.2 million in total on an undiscounted basis.

Credit Ratings

We are currently rated by two credit rating agencies, Dominion Bond Rating Service ("DBRS") and Standard & Poors ("S&P"). We are committed to arranging our affairs to maintain these ratings as well as to improve them further over time. Our credit ratings at December 31, 2005 and at the date of this report were as follows:

	DBRS	S&P
Corporate rating	BBB	BBB-
Preferred shares	Pfd-3	P-3

Credit ratings are intended to provide investors with an independent measure of the credit quality of an issue of securities. The credit ratings presented are not recommendations to purchase, hold or sell the company's common or preferred shares in as much as such ratings do not comment as to market price or suitability for a particular investor. There is no assurance that any rating will remain in effect for any given period of time or that any rating will not be revised or withdrawn entirely by a rating agency in the future if, in its judgment, circumstances so warrant.

Corporate Guarantees and Contingent Obligations

We conduct our operations through entities that are fully or proportionately consolidated in the financial statements, except for our 25% investment in a residential development project in Toronto which is equity accounted.

We may be contingently liable with respect to litigation and claims that arise in the normal course of business. In addition, we may execute agreements that provide for indemnifications and guarantees to third parties. Disclosure of commitments, guarantees and contingencies can be found in note 17 to the consolidated financial statements.

ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities totaled \$66.9 million in 2005, compared with \$45.6 million in 2004. The increase is due to the acquisition of the O&Y portfolio.

A summary of the components of accounts payable and other liabilities is as follows:

(Millions)	2005	2004	2003
Accounts payable and other liabilities	\$ 61.3	\$ 41.6	\$ 59.6
Accrued interest	5.6	4.0	5.1
Total	\$ 66.9	\$ 45.6	\$ 64.7

INTANGIBLE LIABILITIES

With the acquisition of the O&Y portfolio, we assessed the fair value of acquired intangible liabilities including in-place leases and other identified intangible liabilities and have allocated \$115.2 million (2004 - nil) to intangible liabilities accordingly. The components of intangible liabilities are as follows:

(Millions)	2005	2004	2003
Below-market leases	\$ 65.2	—	—
Above-market ground leases	50.0	—	—
	115.2	—	—
Accumulated amortization	(1.7)	—	—
Total	\$ 113.5	—	—

PREFERRED SHARES

At December 31, 2005 we had \$381.7 million of preferred equity outstanding. These preferred shares represent low-cost capital to us, without dilution to our common equity base. Dividends paid on these preferred shares are accounted for as capital distributions. The following preferred shares were outstanding at December 31:

(Millions except share information)	Shares Outstanding	Cumulative Dividend Rate	2005	2004	2003
Series G	1,805,489	70% of bank prime	\$ 45.1	\$ 45.1	\$ 45.1
Series J	3,816,527	70% of bank prime	95.4	95.4	95.4
Series K	300	30-day BA + 0.4%	150.0	150.0	150.0
Series M	2,847,711	70% of bank prime	71.2	71.2	71.2
Series N	800,000	30-day BA + 0.4%	20.0	20.0	20.0
Total			\$ 381.7	\$ 381.7	\$ 381.7

The redemption terms of the preferred shares issued by BPO Properties are as follows:

(i) Series G preferred shares are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate. The company may, at its option, redeem the shares at a price of \$25 per share plus arrears on any accrued and unpaid dividends.

(ii) Series J and M preferred shares are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate for the previous quarter. The company may, at its option, redeem the shares at a price of \$25 per share plus arrears on any accrued and unpaid dividends.

(iii) Series K preferred shares are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at a price of \$500,000 per share plus an amount equal to all accrued and unpaid dividends.

(iv) Series N preferred shares are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at \$25 per share plus arrears on any accrued and unpaid dividends.

During 2005, we paid preferred dividends of \$11.8 million compared with \$10.9 million in year 2004 due to increase in interest rate.

COMMON EQUITY

As at December 31, 2005, we had 28.5 million issued and outstanding common shares, which included 21.7 million non-voting equity shares, consistent with the amounts issued and outstanding at December 31, 2004 and 2003.

The book value per common share at December 31, 2005 was \$18.16 compared with \$16.82 at December 31, 2004. During the year ended December 31, 2005, we repurchased 25,600 common shares under our normal course issuer bid at an average price of \$37.01 per share.

At December 31, 2005, the book value of our common equity was \$517.7 million, compared with a market equity capitalization of approximately \$1.1 billion, calculated as total common shares outstanding multiplied by \$39.70, the closing price per common share on the Toronto Stock Exchange on December 30, 2005.

CAPITAL RESOURCES AND LIQUIDITY

We employ a broad range of financing strategies to facilitate growth and manage financial risk, with particular emphasis on the overall reduction of the weighted average cost of capital, in order to enhance returns for common shareholders.

Contractual rent is the primary driver of cashflow from operating activities which represents the primary source of liquidity to fund debt service, dividend payments and recurring capital and leasing costs in our commercial property portfolio. Sufficient cashflows are generated by our properties to service these obligations. We seek to increase income from our existing properties by maintaining quality standards which promote high occupancy rates and permit increases in rental rates while reducing tenant turnover and controlling operating expenses. Other sources of revenue include third-party fees generated by our real estate management, leasing and development businesses. In addition, our tax status as a corporation and substantial tax loss pools allow us to reinvest and retain cash generated by our operations without incurring cash taxes.

Our commercial property debt is primarily fixed-rate and non-recourse. These investment-grade financings are typically structured up to 70% loan-to-appraised value basis. In addition, in certain circumstances when a building is leased almost exclusively to a high-credit quality tenant, a higher loan-to-value financing, based on the tenant's credit quality, is put in place at rates commensurate with the cost of funds for the tenant. This reduces our equity requirements to finance commercial property, and enhances equity returns.

COST OF CAPITAL

We continually strive to reduce our weighted average cost of capital and improve common shareholders' equity returns through value-enhancement initiatives and the consistent monitoring of the balance between debt and equity financing.

As at December 31, 2005, our weighted average cost of capital, assuming a 12% return on equity, was 7.7% (2004 – 8.1%). Our cost of capital is lower than many of our peers because of the greater amount of investment-grade financing which can be placed on our assets, a function of the high-quality nature of both the assets and the tenant base which comprise our portfolio. The decrease over the prior year is due to the addition of the O&Y portfolio.

The following schedule details our capitalization at the end of 2005 and 2004 and the related costs thereof:

(Millions)	Cost of Capital ⁽¹⁾		Underlying Value ⁽²⁾	
	2005	2004	2005	2004
Liabilities				
Commercial property debt	6.6%	7.1%	\$ 997.5	\$ 702.1
Shareholders' equity				
Preferred shares	3.6%	3.0%	381.7	381.7
Common shares	12.0%	12.0%	1,132.8	1,112.9
Total⁽³⁾	7.7%	8.1%	\$ 2,512.0	\$ 2,196.7

⁽¹⁾ As a percentage of average book value

⁽²⁾ Underlying value of liabilities represents the cost to retire on maturity. Underlying value of common equity is based on the closing stock price of BPO Properties' common shares

⁽³⁾ In calculating the weighted average cost of capital, the cost of debt has been tax-effected

OPERATING RESULTS

NET INCOME

Our net income for the year ended December 31, 2005 was \$68.2 million (\$1.98 per common share) compared to \$63.0 million (\$1.83 per common share) in 2004 and \$93.9 million (\$2.84 per common share) in 2003. The net increase is largely a result of:

- \$4.3 million of growth (\$0.10 per share) from the acquisition of the O&Y portfolio, offset by \$1.7 million of increase in interest expense (\$0.04 per share) on additional acquisition financing and debt assumed on the O&Y portfolio; and
- A decrease of \$8.8 million in future income tax expense (\$0.31 per share) primarily due to the recognition of a previously unrecognized tax assets in connection with a strategic tax review undertaken and determination of the necessary plans to realize such assets, offset by a decrease in property disposition gain of \$6.0 million (\$0.17 per share) recognized in 2004 related to the sale of Gulf Canada Square in Calgary.

Set out below is a summary of the various components of our net income and funds from operations. Discussion of each of these components is provided on the following pages.

(Millions, except per share amounts)	2005	2004	2003
Total revenue and gains	\$ 266.6	\$ 259.0	\$ 291.5
Net operating income			
Commercial property operations			
Operating income from commercial properties	\$ 121.8	\$ 113.2	\$ 110.2
Property disposition gains	—	6.0	3.6
Total commercial property operations	121.8	119.2	113.8
Loans and investment income	34.6	35.0	71.5
	156.4	154.2	185.3
Expenses			
Interest	43.1	43.9	43.7
Administrative and large corporation tax	8.9	8.1	9.1
Funds from operations and gains	104.4	102.2	132.5
Depreciation and amortization	34.7	28.9	23.2
Future income taxes	1.5	10.3	15.4
Net income	\$ 68.2	\$ 63.0	\$ 93.9
Net income per common share			
Prior to property disposition gains	\$ 1.98	\$ 1.66	\$ 2.74
Property disposition gains	—	0.17	0.10
	\$ 1.98	\$ 1.83	\$ 2.84
Funds from operations per common share			
Prior to disposition gains	\$ 3.25	\$ 2.99	\$ 4.07
Property disposition gains	—	0.21	0.13
	\$ 3.25	\$ 3.20	\$ 4.20

It should be noted that challenges of comparability of net income exist among various real estate companies, as those entities structured as corporations, such as BPO Properties, are required to charge their earnings with tax expense, despite the presence of tax losses which reduce the cash tax obligation. This differs from those entities which operate as real estate investment trusts (“REITs”), as REITs are not subject to taxation, provided they remain in compliance with specific tax codes.

Our net income per share and weighted average common shares outstanding are calculated as follows:

(Millions, except per share amounts)	2005	2004	2003
Net income	\$ 68.2	\$ 63.0	\$ 93.9
Preferred share dividends	(11.8)	(10.9)	(12.9)
Net income available to common shareholders	\$ 56.4	\$ 52.1	\$ 81.0
Weighted average shares outstanding	28.5	28.5	28.5
Net income per common share	\$ 1.98	\$ 1.83	\$ 2.84

RECONCILIATION OF NET INCOME TO FUNDS FROM OPERATIONS

(Millions)	2005	2004	2003
Net income	\$ 68.2	\$ 63.0	\$ 93.9
Add:			
Depreciation and amortization	34.7	28.9	23.2
Future income taxes and other provisions	1.5	10.3	15.4
Funds from operations and gains	104.4	102.2	132.5
Less:			
Property disposition gains	—	(6.0)	(3.6)
Funds from operations	\$ 104.4	\$ 96.2	\$ 128.9

After providing for preferred share dividends, our FFO per common share excluding property disposition gains is calculated as follows:

(Millions, except per share amounts)	2005	2004	2003
Funds from operations	\$ 104.4	\$ 96.2	\$ 128.9
Preferred share dividends	(11.8)	(10.9)	(12.9)
	\$ 92.6	\$ 85.3	\$ 116.0
Weighted average shares outstanding	28.5	28.5	28.5
FFO per common share	\$ 3.25	\$ 2.99	\$ 4.07

Excluding property disposition gains, funds from our operations increased 9% to \$3.25 per share during year 2005 compared with \$2.99 per share in 2004. The increase is primarily related to the acquisition of the O&Y portfolio.

The components of revenue and gains are as follows:

(Millions)	2005	2004	2003
Revenue from commercial property operations	\$ 232.0	\$ 218.0	\$ 216.4
Property disposition gains	—	6.0	3.6
Total commercial property revenue	232.0	224.0	220.0
Loans and investment income	34.6	35.0	71.5
Total	\$ 266.6	\$ 259.0	\$ 291.5

COMMERCIAL PROPERTY OPERATIONS

Commercial property net operating income including property disposition gains contributed \$121.8 million compared with \$119.2 million in 2004 and \$113.8 million in 2003.

The components of commercial property net operating income are as follows:

(Millions)	2005	2004	2003
Rental revenue	\$ 232.0	\$ 218.0	\$ 216.4
Property operating costs	(110.2)	(104.8)	(106.2)
Net operating income	121.8	113.2	110.2
Property disposition gains	—	6.0	3.6
Net operating income including property disposition gains	\$ 121.8	\$ 119.2	\$ 113.8

The growth in net operating income in each of the past two years is as follows:

(Millions)	2005	2004
Net operating income, prior year	\$ 113.2	\$ 106.3
(a) Contractual rent increases and straight-line rental income, net	(0.4)	9.0
(b) Leasing activity	2.7	0.3
(c) Acquisitions, net of dispositions	3.6	(4.5)
Net operating income from current properties	119.1	111.1
(d) Non-recurring and other income	2.7	2.1
Total	\$ 121.8	\$ 113.2

(a) Contractual rent increases and straight-line rental income, net

Our leases generally have clauses which provide for the collection of rental revenues in amounts that increase every five years, with these increases negotiated at the signing of the lease. The large number of high-credit quality of tenants in our portfolio lowers the risk of not realizing these increases. During the year ended December 31, 2005, net operating income decreased by \$0.4 million primarily due to the decrease in straight-line rental income. As a result of adopting CICA Handbook section 1100, "Generally Accepted Accounting Principles," commencing January 1, 2004, we recognized an additional \$6.4 million of straight-line rental income in 2004. This straight-line rental income decreased to \$4.2 million in 2005.

(b) Leasing activity

During 2005, the increase of rental rates on the re-leasing of space in our portfolio (prior to the addition of the O&Y portfolio) and the lease up of vacancies contributed to an increase of net operating income by \$2.7 million compared with \$0.3 million of additional net operating income for the year ended December 31, 2004. At December 31, 2005, average in-place net rents throughout the portfolio was \$18 per square foot compared to \$20 per square foot at December 31, 2004. The decrease is primarily related to non-core assets in the O&Y portfolio acquired.

The following table shows the average in-place rents and estimated current market rents for similar space in each of our markets as at December 31, 2005:

	Gross Leasable Area (000's Sq. Ft.)	Avg. Lease Term (Years)	Avg. In-Place Net Rent (\$ per Sq. Ft.)	Avg. Market Net Rent (\$ per Sq. Ft.)
Toronto, Ontario	8,997	7	\$ 20	\$ 27
Ottawa, Ontario	2,935	5	12	17
Calgary, Alberta	8,936	7	19	30
Edmonton, Alberta	708	7	9	14
Vancouver, British Columbia	853	11	14	25
Winnipeg, Manitoba and other	463	4	10	11
Total ⁽¹⁾	22,892	7	\$ 18	\$ 26

⁽¹⁾ Excludes developments

Our occupancy rate increased by 130 basis points to 96.1% at December 31, 2005 compared with 94.8% at December 31, 2004 with the acquisition of the O&Y portfolio and the continuing lease-up of Royal Centre in Vancouver and our Calgary portfolio. As occupancy increased, net operating income increased by \$1.8 million during the 2005 year and \$0.1 million during the 2004 year. The contribution to net operating income from vacancy lease-ups is expected to continue to increase in the future as properties acquired or developed with vacancies are leased up.

A summary of current and historical occupancy levels at December 31 for the past three years is as follows:

(Thousands of square feet)	2005		2004		2003	
	Total Square Feet	% Leased	Total Square Feet	% Leased	Total Square Feet	% Leased
Toronto, Ontario ⁽²⁾	8,997	93.1	4,601	90.5	4,601	89.1
Ottawa, Ontario	2,935	99.7	—	—	—	—
Calgary, Alberta	8,936	99.1	6,331	98.4	7,472	97.6
Edmonton, Alberta	708	94.8	—	—	—	—
Vancouver, British Columbia	853	93.0	853	89.8	853	85.7
Winnipeg, Manitoba and other	463	90.5	—	—	—	—
Total ⁽¹⁾⁽²⁾	22,892	96.1	11,785	94.8	12,926	94.3

⁽¹⁾ Excludes developments

⁽²⁾ The 2003 to 2004 occupancy numbers have been restated to include Hudson's Bay Centre which was transferred to commercial properties in the first quarter of 2005

During 2005, we leased 1.5 million square feet of space, approximately three times the amount of space contractually expiring. This includes 805,000 square feet of new leases and 650,000 square feet of renewals.

The details of our leasing activity for 2005 are as follows:

(Thousands of sq. ft.)	December 31, 2004		2005 Activities						December 31, 2005	
	GLA ⁽¹⁾	Leased	Expiries	Accelerated Expiries	Expiring Net Rent	Leasing	Leasing Net Rent	Acq. (Disp.)	GLA ⁽¹⁾	Leased
Toronto, Ontario	4,601	4,231	(392)	(329)	\$ 19	747	\$ 19	4,196	8,997	8,453
Ottawa, Ontario	—	—	—	—	—	—	—	2,930	2,935	2,930
Calgary, Alberta	6,331	6,246	(39)	(480)	20	600	26	2,538	8,936	8,865
Edmonton, Alberta	—	—	(1)	(24)	7	34	11	668	708	677
Vancouver, B.C.	853	792	(1)	(11)	22	32	20	—	853	812
Winnipeg, Man. & other	—	—	(1)	(40)	32	42	32	412	463	413
Total	11,785	11,269	(434)	(884)	\$ 19	1,455	\$ 21	10,744	22,892	22,150

⁽¹⁾ Excludes developments

(c) Acquisitions, net of dispositions

The value created in our mature commercial properties provides us with the opportunity to generate additional gains and capital available to reinvest in other assets at higher returns. The acquisition of the O&Y portfolio contributed an additional \$4.3 million of net operating income in 2005, offset by the decrease in income of \$0.7 million from the disposition of Gulf Canada Square in Calgary. During the year ended December 31, 2004, the disposition of properties reduced net operating income by \$4.5 million.

(d) Non-recurring and other income

During 2005, we received \$2.7 million of non-recurring items consisting of prior-period recoveries and tenant termination payments while the 2004 results included \$2.1 million of tenant termination payments.

COMMERCIAL PROPERTY OPERATING COSTS

Commercial property operating costs which include real estate taxes, utilities, insurance, repairs and maintenance, cleaning and other property-related expenses increased to \$110.2 million from \$104.8 million in 2004. The primary reason for the increase was a result of the O&Y acquisition. The balance of the change is a result of inflationary pressures. As a result of world events over the past few years, premiums for insurance have increased substantially for all property owners and utility costs have generally increased by 10% due to the increased gas, water and electricity costs. Substantially all of our leases are net leases in which the lessee is required to pay all of their proportionate share of property operating expenses such as utilities, repairs, insurance and taxes.

LOANS AND INVESTMENT INCOME

Loans and investment income include interest charged on loans receivable, interest received on cash balances and transactional gains and losses realized on the disposal of non-core assets. Loans and investment income decreased to \$34.6 million in 2005 from \$35.0 million earned in 2004 as cash deposits and marketable securities were sold to purchase the O&Y portfolio.

INTEREST EXPENSE

Interest expense was \$43.1 million in 2005 compared with \$43.9 million in 2004. This decrease relates to additional interest capitalized on our acquisition of the remaining 50% interest in the Bay-Adelaide Centre development site, offset by additional interest carry on the O&Y portfolio.

ADMINISTRATIVE AND LARGE CORPORATION TAX

Administrative and large corporation tax costs during the year ended 2005 increased to \$8.9 million from \$8.1 million in 2004 due to the acquisition of the O&Y portfolio in the fourth quarter of 2005 and inflationary and competitive pressures on various general and administrative costs. With the O&Y portfolio acquisition, we expect these expenses to increase further due to increased property management and leasing staff requirements resulting from significant portfolio growth and commensurate staffing requirements in accounting, information systems, human resources, acquisitions and business analysis, as well as overall compensation increases.

DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation for the year ended December 31, 2005 increased to \$34.7 million from \$28.9 million in 2004. The majority of this increase was due to the addition of the O&Y portfolio in the fourth quarter of 2005 as well as the reclassification of Hudson's Bay Centre from development properties.

QUARTERLY RESULTS

The 2005 and 2004 results by quarter are as follows:

(Millions, except per share amounts)	2005				2004			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total revenue	\$ 74.8	\$ 63.4	\$ 63.7	\$ 64.7	\$ 64.5	\$ 59.8	\$ 60.9	\$ 73.8
Net operating income								
Commercial property operations								
Operating income from commercial properties	36.7	27.8	28.3	29.0	30.5	27.7	27.5	27.5
Property disposition gains	—	—	—	—	—	—	—	6.0
Total commercial property operations	36.7	27.8	28.3	29.0	30.5	27.7	27.5	33.5
Interest and other	6.0	9.0	9.6	10.0	7.0	7.1	7.9	13.0
	42.7	36.8	37.9	39.0	37.5	34.8	35.4	46.5
Expenses								
Interest	10.8	10.8	10.7	10.8	10.8	10.9	10.8	11.4
Administrative and large corporation tax	3.1	1.9	1.9	2.0	1.9	2.0	2.1	2.1
	28.8	24.1	25.3	26.2	24.8	21.9	22.5	33.0
Depreciation and amortization	11.9	7.6	7.4	7.8	8.8	6.8	6.6	6.7
Future income taxes and other provisions	5.1	6.6	(7.3)	(2.9)	0.5	1.0	3.3	5.5
Net income	\$ 11.8	\$ 9.9	\$ 25.2	\$ 21.3	\$ 15.5	\$ 14.1	\$ 12.6	\$ 20.8
Net income per common share								
Prior to property disposition gains	\$ 0.31	\$ 0.24	\$ 0.78	\$ 0.65	\$ 0.45	\$ 0.41	\$ 0.35	\$ 0.45
Property disposition gains	—	—	—	—	—	—	—	0.17
	\$ 0.31	\$ 0.24	\$ 0.78	\$ 0.65	\$ 0.45	\$ 0.41	\$ 0.35	\$ 0.62
Funds from operations per common share								
Prior to property disposition gains	\$ 0.91	\$ 0.74	\$ 0.78	\$ 0.82	\$ 0.77	\$ 0.68	\$ 0.70	\$ 0.84
Property disposition gains	—	—	—	—	—	—	—	0.21
	\$ 0.91	\$ 0.74	\$ 0.78	\$ 0.82	\$ 0.77	\$ 0.68	\$ 0.70	\$ 1.05

Operating income from current properties in the fourth quarter of 2005 increased as compared with previous quarters in 2005 due to the acquisition of the O&Y portfolio.

The gain realized in the first quarter of 2004 of \$6.0 million relates to the sale of our 20% interest in Gulf Canada Square in Calgary.

During the fourth quarter of 2005, loans and investment income decreased as cash on deposits and marketable securities were cashed to purchase the O&Y portfolio.

During the fourth quarter of 2005, interest, administrative and large corporation tax, depreciation and amortization and future income tax expenses increased as a result of the addition of the O&Y portfolio. Net income also increased in the fourth quarter of 2005 compared to the fourth quarter of 2004 due to the acquisition of the O&Y portfolio.

PART III – RISKS AND UNCERTAINTIES

In evaluating BPO Properties and its business, the following is a brief review of the potential impact different risks and uncertainties may have on our operations.

INTEREST RATE AND FINANCING RISK

We attempt to stagger the maturities of our mortgage portfolio evenly over a 10-year time horizon. We believe that this strategy will most effectively manage interest rate risk.

As outlined under “Capital Resources and Liquidity” on page 19 of this MD&A, we have an ongoing requirement to access debt markets to refinance maturing debt as it comes due. There is a risk that lenders will not refinance such maturing debt on terms and conditions acceptable to us, or on any terms at all. Our strategy to stagger the maturities of our mortgage portfolio attempts to mitigate our exposure to excessive amounts of debt maturing in any one year.

We have identified a target level of indebtedness of 55% of gross book value. It is our view that such level of indebtedness is conservative given the lending parameters currently existing in the real estate marketplace (generally up to 70% of current market value) and based on this, we believe that all debts will be financed or refinanced as they come due in the foreseeable future.

CREDIT RISK

As we invest in mortgages from time to time, further credit risks arise in the event that borrowers default on the repayment of their mortgages to us. We endeavor to ensure that adequate security has been provided in support of such mortgages.

Credit risk arises from the possibility that tenants may be unable to fulfill their lease commitments. We mitigate this risk by ensuring that our tenant mix is diversified and by limiting our exposure to any one tenant. We also maintain a portfolio that is diversified by property type so that exposure to a business sector is lessened. Currently, no one tenant represents more than 9% of total leasable area.

We attempt to mitigate our credit risk by signing long-term leases with tenants who have investment-grade ratings. Additional discussion of this strategy is included on page 8.

The following list shows the largest tenants by leasable area in our portfolio and their respective lease commitments:

Tenant	Location	Year of Expiry ⁽¹⁾	000's Sq.Ft. ⁽²⁾	% of Sq. Ft. ⁽²⁾	Credit Rating ⁽³⁾
Rated					
Government of Canada	Toronto, Ottawa, Edmonton	2010	2,008	8.8%	AAA
Bank of Montreal/Nesbitt Burns	Toronto, Ottawa, Calgary	2018	1,092	4.8%	AA-
Petro-Canada	Calgary	2013	871	3.8%	BBB
CIBC	Toronto, Calgary	2023	645	2.8%	A+
Imperial Oil	Calgary	2011	633	2.8%	AAA
Talisman Energy	Calgary	2015	527	2.3%	BBB+
RBC Financial Group	Various	2022	490	2.1%	AA-
CP Rail	Calgary	2013	452	2.0%	BBB
ConocoPhillips	Calgary	2010	445	1.9%	A-
Enbridge Inc.	Calgary, Edmonton	2016	355	1.6%	A-
Canadian Natural Resources	Calgary	2011	277	1.2%	BBB+
EnCana Corporation	Calgary	2014	256	1.1%	A-
Anadarko Canada Corp.	Calgary	2011	235	1.0%	BBB+
Amdocs Canada Inc	Toronto	2010	220	1.0%	BBB-
Bell Canada/Bell West Inc.	Calgary	2012	199	0.9%	A
Manufacturers Life Insurance	Toronto	2013	169	0.7%	AA+
CIT Financial Ltd.	Toronto	2009	147	0.6%	A
Lombard Insurance	Toronto	2011	134	0.6%	BBB
Westcoast Energy	Calgary, Vancouver	2012	132	0.6%	BBB
HSBC of Canada	Toronto, Winnipeg	2011	110	0.5%	A+
State Street Trust Company	Toronto	2008	92	0.4%	AA-
National Bank of Canada	Toronto, Ottawa	2013	89	0.4%	A
Falconbridge	Toronto	2013	81	0.4%	BBB-
Other investment grade	Various	Various	498	2.2%	BBB- or higher
			10,157	44.5%	
Unrated					
Osler, Hoskin & Harcourt	Toronto	2015	254	1.1%	—
The Hudson's Bay Company	Toronto	2009	209	0.9%	—
CI Investments Inc.	Toronto	2012	195	0.9%	—
Bennett Jones	Toronto, Calgary	2010	185	0.8%	—
Toronto Stock Exchange	Toronto	2018	179	0.8%	—
Ministry of the Environment	Toronto	2018	178	0.8%	—
Gowlings Canada Inc.	Toronto	2020	170	0.7%	—
Uniking Holdings Limited	Toronto	2010	138	0.6%	—
Precision Drilling Corp.	Calgary	2011	112	0.5%	—
DWPV Management Limited	Toronto	2008	100	0.4%	—
Fraser Milner	Toronto, Calgary	2008	84	0.4%	—
Other government agencies	Various	Various	503	2.2%	—
Total			12,464	54.6%	

⁽¹⁾ Weighted average based on square feet

⁽²⁾ Prior to considering partnership interests in partially-owned properties

⁽³⁾ From Standard & Poors, Moody's or Dominion Bond Rating Service

LEASE ROLL-OVER RISK

Lease roll-over risk arises from the possibility that we may experience difficulty renewing leases as they expire or in releasing space vacated by tenants upon early lease expiry.

We attempt to stagger the lease expiry profile so that we are not faced with disproportionate amounts of space expiring in any one year. We further mitigate this risk by maintaining a diversified portfolio mix by geographic location and by proactively leasing space in advance of its contractual expiry. Additional discussion of this strategy to manage lease roll-over risk can be found on page 8 of this MD&A.

The following table sets out lease expiries, by square footage, for our portfolio at December 31, 2005:

December 31, 2005 (000's Sq. Ft.)	Currently Available	2006	2007	2008	2009	2010	2011	2012	2013 & Beyond	Total
Toronto, Ontario	544	390	499	630	667	608	343	624	4,692	8,997
Ottawa, Ontario	5	118	66	1,005	135	2	—	2	1,602	2,935
Calgary, Alberta	71	201	290	408	299	1,129	1,614	632	4,292	8,936
Edmonton, Alberta	31	24	28	23	42	102	58	22	378	708
Vancouver, B.C.	41	51	53	8	36	52	29	24	559	853
Other	50	49	67	27	56	49	—	29	136	463
Total	742	833	1,003	2,101	1,235	1,942	2,044	1,333	11,659	22,892
% of total	3.9%	4.4%	5.3%	11.1%	6.5%	10.3%	10.8%	7.0%	40.7%	100.0%

ENVIRONMENTAL RISKS

As an owner of real property, we are subject to various federal, provincial and municipal laws relating to environmental matters. Such laws provide that we could be liable for the costs of removing certain hazardous substances and remediating certain hazardous locations. The failure to remove or remediate such substances or locations, if any, could adversely affect our ability to sell such real estate or to borrow using such real estate as collateral and could potentially result in claims against us. We are not aware of any material non-compliance with environmental laws at any of our properties nor are we aware of any pending or threatened investigations or actions by environmental regulatory authorities in connection with any of our properties or any pending or threatened claims relating to environmental conditions at our properties.

We will continue to make the necessary capital and operating expenditures to ensure that we are compliant with environmental laws and regulations. Although there can be no assurances, we do not believe that costs relating to environmental matters will have a materially adverse effect on our business, financial condition or results of operation. However, environmental laws and regulations can change and we may become subject to more stringent environmental laws and regulations in the future, which could have an adverse effect on our financial condition or results of operation.

OTHER RISKS AND UNCERTAINTIES

Real estate investments are generally subject to varying degrees of risk depending on the nature of the property. These risks include changes in general economic conditions (such as the availability and cost of mortgage funds), local conditions (such as an oversupply of space or a reduction in demand for real estate in the markets in which we operate), the attractiveness of the properties to tenants, competition from others with available space and the ability of the owner to provide adequate maintenance at an economical cost.

Certain significant expenditures, including property taxes, maintenance costs, mortgage payments, insurance costs and related charges must be made regardless of whether or not a property is producing sufficient income to service these expenses. Our commercial properties are subject to mortgages, which require significant debt service payments. If we are unable or unwilling to meet mortgage payments on any property, losses could be sustained as a result of the mortgagee's exercise of its rights of foreclosure or sale.

Real estate is relatively illiquid. Such illiquidity may limit our ability to vary our portfolio promptly in response to changing economic or investment conditions. Also, financial difficulties of other property owners resulting in distressed sales could depress real estate values in the markets in which we operate.

Our commercial properties generate a relatively stable source of income from contractual tenant rent payments. Continued growth of rental income is dependent on strong leasing markets to ensure expiring leases are renewed and new tenants are found promptly to fill vacancies.

While the outlook for commercial office rents is positive in the long term, 2006 may not provide the same level of increases in rental rates on renewal as compared to previous years. We are, however, substantially protected against short-term market conditions, as most of our leases are long-term in nature with an average term of seven years. A protracted disruption in the economy, such as the onset of a severe recession, could place downward pressure on overall occupancy levels and net effective rents.

Our commercial properties operations have insurance covering certain acts of terrorism for up to US\$500 million of damage and business interruption costs. We continue to seek additional coverage equal to the full replacement cost of our assets. However, until this type of coverage becomes commercially available on an economically reasonable basis, any damage or business interruption costs as a result of uninsured acts of terrorism could result in a material cost to us.

DERIVATIVE FINANCIAL INSTRUMENTS

We utilize derivative financial instruments primarily to manage financial risks, including interest rate, commodity and foreign exchange risks. Hedge accounting is applied where the derivative is designated as a hedge of a specific exposure and there is reasonable assurance the hedge will be effective. Realized and unrealized gains and losses on forward exchange contracts designated as hedges of currency risks are included in the cumulative translation account. Otherwise, realized and unrealized gains and losses on derivative financial instruments designated as hedges of financial risks are included in income as an offset to the hedged item in the period the underlying asset, liability or anticipated transaction to which they relate.

Financial instruments that are not designated as hedges are carried at estimated fair values, and gains and losses arising from changes in fair values are recognized in income as a component of interest and other income in the period the changes occur. The use of non-hedging derivative contracts is governed by documented risk management policies and approved limits.

During 2005, our use of derivative financial instruments was limited to foreign exchange contracts. Unrealized gains and losses, representing the fair value of such contracts, are determined in reference to the appropriate forward exchange rate for each contract at December 31, 2005 and are reflected in receivables and other assets or accounts payable and other liabilities, as appropriate, on the balance sheet.

At December 31, 2005, we had foreign exchange contracts to sell a notional amount of US\$77.5 million maturing in January 2006, which have not been designated as hedges for financial reporting purposes. The aggregate fair value of these contracts at December 31, 2005 was a gain of \$0.4 million which is reflected in loans and investment income in the consolidated statement of income with a corresponding asset in marketable securities and other investments in the consolidated balance sheet.

The primary risks associated with our use of derivatives are credit risk and price risk. Credit risk is the risk that losses will be incurred from the default of the counterparty on its contractual obligations. The use of derivative contracts is governed by documented risk management policies and approved limits, which includes an evaluation of the creditworthiness of counterparties, as well as managing the size, diversification and maturity of the portfolio. Price risk is the risk that we will incur losses from derivatives from adverse changes in foreign exchange rates. We mitigate price risk by entering only into derivative transactions where we have determined a significant offset exists between changes in the fair value of, or the cashflows attributable to, the hedged item and the hedging item.

PART IV – CRITICAL ACCOUNTING POLICIES AND ESTIMATES

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2005, we adopted the following new accounting policies, none of which individually or collectively had a material impact on our consolidated financial statements, unless otherwise noted. These changes were the result of changes to the Canadian Institute of Chartered Accountants (“CICA”) Handbook, Accounting Guidelines (“AcG”) and Emerging Issues Committee Abstracts (“EIC”).

Consolidation of Variable Interest Entities, CICA AcG 15

Effective January 1, 2005, we adopted CICA Accounting Guideline 15, “Consolidation of Variable Interest Entities” (AcG 15). This guideline provides guidance for applying the principles in section 1590, “Subsidiaries,” to those entities defined as Variable Interest Entities (VIEs) and more commonly referred to as Special Purpose Entities (SPEs), in which either the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack either voting control, an obligation to absorb expected losses, or the right to relieve expected residual returns. AcG 15 requires consolidation of VIEs by the Primary Beneficiary. The Primary Beneficiary is defined as the party who has exposure to the majority of a VIE’s expected losses and/or expected residual returns. The adoption of this standard did not have a material impact on our financial results.

FUTURE ACCOUNTING POLICY CHANGES

The following future accounting policy changes may have an impact on the company, although the impact, if any, has not been determined at this time.

(i) Comprehensive Income, CICA Handbook Section 1530

In January 2005, the CICA issued Handbook Section 1530, “Comprehensive Income,” which is effective for our 2007 fiscal year. As a result of adopting this standard, a new statement, Comprehensive Income, will be included in our financial statements. Major components for this statement will include unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation amounts, net of hedging, arising from self-sustaining foreign operations, and changes in the fair value of the effective position of cashflow hedging instruments.

(ii) Financial Instruments – Recognition and Measurement, CICA Handbook Section 3855

In January 2005, the CICA issued Handbook Section 3855, “Financial Instruments – Recognition and Measurement,” which is effective for our 2007 fiscal year. Under this new standard, all financial instruments will be classified as one of the following: Held-to-maturity, Loans and Receivables, Held-for-trading or Available-for-sale. Financial assets and liabilities held-for-trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, will be measured at amortized cost. Available-for-sale instruments will be measured at fair value with unrealized gains and losses recognized in other comprehensive income. The standard also permits designation of any financial instrument as held-for-trading upon initial recognition.

(iii) Hedges, CICA Handbook Section 3865

In January 2005, the CICA issued Handbook Section 3865, “Hedges,” which is effective for our 2007 fiscal year. This new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting can be executed for each of the permitted hedging strategies: fair value hedges and cashflow hedges. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk and recognized in net income. This change in fair value of the hedged item, to the extent that the hedging relationship is effective, is offset by changes in the fair value of the derivative. In a cashflow hedging relationship, the effective portion of the change in the fair value of the hedging derivative will be recognized in other comprehensive income. The ineffective portion will be recognized in net income. The amounts recognized in accumulated other comprehensive income will be reclassified to net income in the periods in which net income is affected by the variability in the cashflows of the hedged item.

(iv) Implicit Variable Interests, Emerging Issues Committee Abstract 157

In October 2005, the Emerging Issues Committee issued Abstract No. 157, “Implicit Variable Interests Under AcG 15” (“EIC 157”). This EIC clarifies that implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity’s net assets exclusive of variable interests which is effective for our 2006 fiscal year. An implicit variable interest is similar to an explicit variable interest except that it involves absorbing and/or receiving variability indirectly from the entity. The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances. The implication of this EIC is not expected to have a material impact on our financial results.

(v) Conditional Asset Retirement Obligations, Emerging Issues Committee Abstract 159

In December 2005, the Emerging Issues Committee issued Abstract No. 159, "Conditional Asset Retirement Obligations" ("EIC 159"). This EIC requires an entity to recognize the fair value of a legal obligation to perform asset retirement activities, even though the timing and/or method of settlement may be uncertain. The implication of this EIC is not expected to have a material impact on our financial results.

USE OF ESTIMATES

The preparation of our financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The result of our ongoing evaluation of these estimates forms the basis for making judgments about the carrying values of assets and liabilities and the reported amounts of revenues and expenses that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions.

Our critical accounting policies are those that we believe are the most important in portraying our financial condition and results, and require the most subjective judgment and estimates on the part of management. A summary of our significant accounting policies, including the critical accounting policies discussed below, is set forth in note 1 to our consolidated financial statements.

Property Acquisitions

Upon acquisition of rental properties, we determine the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, above- and below-market leases and origination costs related to acquired in-place leases, other identified intangible assets and assumed liabilities and allocate the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at depreciated replacement cost. We assess and consider fair values based on estimated cashflow projections that utilize appropriate discount rates, as well as available market information. Estimates of future cashflows are based on a number of factors including the historical operating results, known and anticipated trends and market conditions. We also consider an allocation of purchase price to other acquired intangibles, including acquired in-place leases that may have a customer relationship intangible value, including (but not limited to) the nature and extent of the existing relationship with the tenant, the tenant's credit quality and expectations of renewals. We record acquired "above and below" market leases at their fair value, using a discount rate which reflects the risks associated with the leases acquired, equal to the difference between: (1) the contractual amounts to be paid pursuant to each in-place lease; and (2) management's estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the leases for above-market leases and the initial term plus the term of any below-market fixed rate renewal options for below-market leases. Recorded amounts for in-place lease origination values are based on our evaluation of the specific characteristics of each tenant's lease. Factors to be considered include estimates of carrying costs during expected lease-up periods considering current market conditions, and costs to execute similar leases. Building is stated at a depreciated replacement cost.

The cost of buildings and improvements includes the purchase price of property, legal fees and other acquisition costs.

Depreciation and amortization on rental properties is based on the allocation of the acquisition cost to land, building, tenant improvements and intangibles and their estimated useful lives, based on management's estimates. The allocation of the acquisition cost and the determination of the estimated useful lives of the components significantly impact the computation of depreciation and amortization recorded over future periods and, accordingly, net income.

Depreciation

We apply the straight-line method of depreciation. Under this method, depreciation is charged to income on a straight-line basis over the remaining estimated useful life of the property. A significant portion of the acquisition cost of each property is allocated to building. The allocation of the acquisition cost to building and the determination of the useful life are based upon management's estimates. In the event the allocation to building is inappropriate or the estimated useful life of buildings proves incorrect, the computation of depreciation will not be appropriately reflected over future periods.

Impairment of Assets

We review the long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates a potential impairment in value. An asset is considered impaired when the undiscounted future cashflows are not sufficient to recover the asset's carrying value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The evaluation of anticipated cashflows is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods.

The fair value of mortgages receivable depends upon the financial stability of the issuer and the economic value of the underlying security. There were no impairments recorded for the years ended December 31, 2005 or 2004.

Revenue Recognition

Base rental revenue is reported on a straight-line basis over the terms of each lease. In accordance with EIC-140, we recognize rental revenue of acquired in-place “above and below” market leases at their fair value over the terms of the respective leases. Free rent receivable represents rental income recognized in excess of rent payments actually received pursuant to the terms of the individual lease agreements. An allowance for doubtful accounts is recorded, if necessary, for estimated losses resulting from the inability of tenants to make required rent payments. The computation of this allowance is based on the tenants’ payment history and current credit status, as well as certain industry or geographic-specific credit considerations.

Recoveries from tenants, consisting of amounts due for common area maintenance, real estate taxes and other recoverable costs, are recognized as revenue in the period the expenses are incurred. Tenant reimbursements are recognized and presented in accordance with EIC Abstract No. 123 “Reporting Revenue Gross as a Principal versus Net as an Agent,” which requires that these reimbursements be recorded on a gross basis, as we are generally the primary obligor with respect to purchasing goods and services from third-party suppliers, having discretion in selecting suppliers and taking credit risk.

Fair Value of Financial Instruments

The fair values of mortgage debt notes payable and unsecured senior notes are calculated based on the discount spread between the future contractual interest payments and future interest payments on mortgage debt based on a current market rate. In determining the current market rate, market spread is added to the quoted yields on federal government bonds with similar maturity dates to debt in place. Because valuations of the financial instruments are based on these types of estimates, the fair values of financial instruments may change if the estimates do not prove to be accurate.

Tax

In accordance with Canadian GAAP, we use the liability method of accounting for future income taxes and provide for future income taxes for all significant income tax temporary differences.

Preparation of the financial statements requires an estimate of income taxes in the jurisdictions in which we operate. The process involves an estimate of our actual current tax exposure and an assessment of temporary differences resulting from differing treatment of items, such as depreciation and amortization, for tax and accounting purposes. These differences result in future tax assets and liabilities which are included in our balance sheet. An assessment must also be made to determine the likelihood that our future tax assets will be recovered from future taxable income. To the extent that recovery is not considered more likely than not, a valuation allowance must be provided.

Judgment is required in determining the provision for income taxes, future income tax assets and liabilities and any related valuation allowance. To the extent a valuation allowance is created or revised, current period earnings will be affected. Judgment is required to assess tax interpretations, regulations and legislation, which are continually changing to ensure liabilities are complete and to ensure assets net of valuation allowances are realizable. The impact of different interpretations and applications could potentially be material.

During the year, we released approximately \$13.0 million (2004 - \$14.2 million) of tax valuation allowances following the completion of certain reviews by taxation authorities, and recorded \$9.8 million (2004 – nil) in previously unrecognized tax assets in connection with a strategic tax review undertaken and determination of the necessary plans to realize such assets. Both these changes are reflected our income tax provision.

RELATED-PARTY TRANSACTIONS

In the normal course of operations, we enter into various transactions on market terms with related parties which have been measured at exchange value and are recognized in the consolidated financial statements. We retained the services of a subsidiary of Brookfield Properties Corporation (“BPC”), our principal shareholder, for the property management of some of our office properties on contracts based on fair market value of services provided. The fees paid for these property management services totaled \$5.4 million in 2005 (2004 - \$5.4 million). We also has an agreement with BPC to provide asset management services for our property portfolio. The fees paid for these services, determined on a cost-recovery basis, totalled \$4.6 million (2004 - \$4.6 million). Interest earned on related party deposits for the year ended December 31, 2005 was nil (2004 - \$6.0 million). These amounts have been recorded at the exchange amount.

PART V - BUSINESS ENVIRONMENT AND OUTLOOK

COMMERCIAL OPERATIONS

In the office property markets where we have a presence, the markets appear to have stabilized and are now recovering. While the pace of recovery has been slow, absorption rates have become positive in most markets. The most significant improvement has taken place in Calgary.

The lack of development, especially in central business districts, has created some stability and the erosion in rental rates experienced over the past two years appears to have stabilized. Office vacancy rates are generally expected to decline gradually over the near term, with the pace of absorption potentially accelerating during 2006. As a result, rental rates are expected to begin to move upward this year, with leasing costs and landlord incentives expected to decline at the same time. However, any significant slow-down in the economy could have a dampening effect on the recovery of office markets.

The investment market continues to remain competitive with acquisition prices increasing. The strength in acquisition activity is due to a great demand from investors for high quality office product with limited supply of assets for sale. In addition, the current low interest rate environment has allowed investors to acquire real estate at lower yields.

DISCLOSURE CONTROLS AND PROCEDURES

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in the Canadian Securities Administrators Multilateral Instrument 52-109). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that such disclosure controls and procedures were effective as of December 31, 2005 in providing reasonable assurance that material information relating to the company and our consolidated subsidiaries would be made known to us by others within those entities.

OUTLOOK

Our markets are in full recovery with low vacancies, high occupancies and rising rents. To take advantage of these positive economic conditions, we are actively working to secure anchor tenants in order to commence one or two of our office development projects in the near term. Having significantly expanded our premier portfolio with the O&Y acquisition, we will now look to sell interests in and reposition a number of our properties while investor demand for well-leased, high-quality office properties such as ours remains strong.

This past year was very successful for BPO Properties on many fronts, and we anticipate 2006 to be active and rewarding from an operational and financial perspective as well.



Craig J. Laurie
Senior Vice President and Chief Financial Officer

February 15, 2006

DISTRIBUTIONS

Distributions paid by the company during the year ended December 31, 2005 and in the past three fiscal years are as follows:

	2005	2004	2003
Common shares	\$ 0.60	\$ 0.60 ⁽¹⁾	\$ 0.30
Series G preferred shares	0.73	0.73	0.82
Series J preferred shares	0.74	0.71	0.82
Series K preferred shares	15,646.94	13,490.21	16,760.82
Series M preferred shares	0.74	0.71	0.82
Series N preferred shares	0.78	0.67	0.84

⁽¹⁾ Excludes the special common share dividend of \$15 per share

Management's Responsibility for the Financial Statements

The consolidated financial statements and management's financial analysis and review contained in this annual report are the responsibility of the management of the company. To fulfill this responsibility, the company maintains a system of internal controls to ensure that its reporting practices and accounting and administrative procedures are appropriate, and provide assurance that relevant and reliable financial information is produced. The consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based on management's best judgment in the circumstances. The financial information presented throughout this annual report is consistent with the information contained in the consolidated financial statements.

Deloitte & Touche LLP, the independent auditors appointed by the shareholders, have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the shareholders their opinion on the consolidated financial statements. Their report as auditors is set out below.

The consolidated financial statements have been further examined by the Board of Directors and by its Audit Committee, which meets with the auditors and management to review the activities of each and reports to the Board of Directors. The auditors have direct and full access to the Audit Committee and meet with the committee both with and without management present. The Board of Directors, directly and through its Audit Committee, oversees management responsibilities and is responsible for reviewing and approving the financial statements.



Thomas F. Farley
President and Chief Executive Officer



Craig J. Laurie
Senior Vice President and Chief Financial Officer

February 15, 2006

Auditors' Report

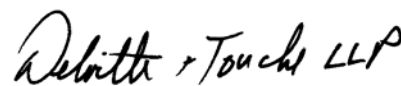
To the Shareholders,

We have audited the consolidated balance sheets of BPO Properties Ltd. as at December 31, 2005 and 2004 and the consolidated statements of income, retained earnings and cashflow for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and 2004 and the results of its operations and its cashflow for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
February 15, 2006



Chartered Accountants

Consolidated Balance Sheets

December 31 (Millions)	Note	2005	2004
Assets			
Commercial properties	5	\$ 1,511.0	\$ 881.8
Development properties	6	189.9	122.1
Loans receivable	7	100.1	91.7
Marketable securities and other investments	8	66.7	377.9
Cash and cash equivalents	9	24.2	11.2
Other assets	10	54.0	28.5
Intangible assets	11	63.9	—
Future income taxes	12	16.5	49.2
		\$ 2,026.3	\$ 1,562.4
Liabilities			
Commercial property debt	13	\$ 946.5	\$ 655.8
Accounts payable and other liabilities	14	66.9	45.6
Intangible liabilities	15	113.5	—
Shareholders' equity			
Preferred shares	16	381.7	381.7
Common shares		78.9	78.9
Retained earnings		438.8	400.4
		\$ 2,026.3	\$ 1,562.4

See accompanying notes to the consolidated financial statements

On behalf of the Board,



Robert J. Harding
Chairman



Thomas F. Farley
President and Chief Executive Officer

Consolidated Statements of Income

December 31 (Millions except per share amounts)	Note	2005	2004
Commercial properties			
Revenue		\$ 232.0	\$ 218.0
Expenses		110.2	104.8
		121.8	113.2
Loans and investment income		34.6	35.0
		156.4	148.2
Expenses			
Interest expense		43.1	43.9
Administrative expenses and large corporation tax		8.9	8.1
		104.4	96.2
Gain on disposition of properties		—	6.0
		104.4	102.2
Depreciation and amortization		34.7	28.9
Future income taxes	12	1.5	10.3
Net income		\$ 68.2	\$ 63.0
Net income per common share	16	\$ 1.98	\$ 1.83

See accompanying notes to the consolidated financial statements

Consolidated Statements of Retained Earnings

December 31 (Millions)	Note	2005	2004
Retained earnings, beginning of year		\$ 400.4	\$ 793.4
Net income		68.2	63.0
Preferred share dividends	16	(11.8)	(10.9)
Common share dividends	16	(17.1)	(445.1)
Share repurchases	16	(0.9)	—
Retained earnings, end of year		\$ 438.8	\$ 400.4

See accompanying notes to the consolidated financial statements

Consolidated Statements of Cashflow

December 31 (Millions)	Note	2005	2004
Operating Activities			
Net income		\$ 68.2	\$ 63.0
Add (deduct):			
Depreciation and amortization		34.7	28.9
Future income taxes		1.5	10.3
Gain on disposition of properties		—	(6.0)
Tenant installation costs		(15.1)	(10.7)
Other working capital		(25.6)	(21.0)
Cashflow from operating activities		63.7	64.5
Investing Activities			
Development and redevelopment expenditures		(9.5)	(5.1)
Capital expenditures		(11.9)	(13.5)
Acquisition of properties, net	20	(426.7)	—
Dispositions of properties, net	20	—	21.3
Loans receivable		—	(35.9)
Marketable securities and other investments		311.2	(28.3)
Cashflow used in investing activities		(136.9)	(61.5)
Financing Activities			
Commercial property debt repayments		(53.4)	(26.9)
Commercial property debt arranged		169.4	—
Repurchase of common shares		(0.9)	—
Common share dividends paid		(17.1)	(445.1)
Preferred share dividends paid		(11.8)	(10.9)
Cashflow provided by (used in) financing activities		86.2	(482.9)
Increase (decrease) in cash and cash equivalents		13.0	(479.9)
Cash and cash equivalents, beginning of year		11.2	491.1
Cash and cash equivalents, end of year		\$ 24.2	\$ 11.2

See accompanying notes to the consolidated financial statements

Notes to the Consolidated Financial Statements

NOTE 1: SUMMARY OF ACCOUNTING POLICIES

(a) General

The consolidated financial statements of BPO Properties Ltd. (the “company”) are prepared in accordance with generally accepted accounting principles as prescribed by the Canadian Institute of Chartered Accountants (“CICA”).

(b) Principles of consolidation

The consolidated financial statements include the accounts of all of the company’s subsidiaries and its proportionate share of assets, liabilities, revenues and expenses of joint ventures.

(c) Properties

(i) *Commercial properties and intangible assets*

Commercial properties held for investment are carried at cost less accumulated depreciation. Upon acquisition, the company allocates the purchase price to the components of the commercial properties acquired: the amount allocated to land is based on its estimated fair value; buildings and existing tenant improvements are recorded at depreciated replacement cost; above- and below-market in-place operating leases are determined based on the present value of the difference between the rents payable under the contractual terms of the leases and estimated market rents; lease origination costs for in-place operating leases are determined based on the estimated costs that would be incurred to put the existing leases in place under the same terms and conditions; and tenant relationships are measured based on the present value of the estimated avoided net costs if a tenant were to renew its lease at expiry, discounted by the probability of such renewal.

Depreciation on buildings is provided on a straight-line basis over the useful lives of the properties to a maximum of 60 years. Depreciation is determined with reference to each rental property’s carried value, remaining estimated useful life and residual value. Acquired tenant improvements, above and below market in-place operating leases and lease origination costs are amortized on a straight-line basis over the remaining terms of the leases. The value associated with tenant relationships is amortized on a straight-line basis over the expected term of the relationships. All other tenant improvements and re-leasing costs are deferred and amortized on a straight-line basis over the terms of the leases to which they relate. Depreciation on buildings and amortization of deferred leasing costs and tenant improvements that are determined to be assets of the company are recorded in depreciation and amortization expense. All other amounts are amortized to revenue.

Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. For commercial properties, an impairment loss is recognized when a property’s carrying value exceeds its undiscounted future net cashflow. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cashflow take into account the specific business plan for each property and management’s best estimate of the most probable set of economic conditions anticipated to prevail in the market.

(ii) *Commercial development properties*

Commercial properties under development consist of properties for which a major repositioning program is being conducted and properties which are under construction. These properties are recorded at cost, including pre-development expenditures. For development properties, an impairment loss is recognized when a property’s carrying value exceeds its undiscounted future net cashflow. Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cashflow take into account the specific business plan for each property and management’s best estimate of the most probable set of economic conditions anticipated to prevail in the market.

(d) Capitalized costs

Costs capitalized to commercial properties which are under development include all direct and directly attributable expenditures incurred in connection with the acquisition, development, construction and initial predetermined leasing period. Costs directly attributable to development projects include interest and salaries and benefits of employees directly associated with the development projects, such as architects, engineers, designers and development project managers. Ancillary income relating specifically to such properties during the development period is treated as a reduction of costs.

(e) Deferred financing costs

Financing costs are deferred and amortized to amortization expense on a straight-line basis over the terms of the debt to which they relate.

(f) Revenue recognition

The company has retained substantially all of the risks and benefits of ownership of its commercial properties and therefore accounts for leases with its tenants as operating leases. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease; a straight-line or free rent receivable, as applicable, is recorded for the difference between the rental revenue recorded and the contractual amount received. Rental revenue includes percentage participating rents and recoveries of operating expenses, including property, capital and Canadian large corporation taxes. Percentage participating rents are recognized when tenants' specified sales targets have been met. Operating expense recoveries are recognized in the period that recoverable costs are chargeable to tenants.

Revenue from a commercial property is recognized upon the earlier of attaining a break-even point in cashflow after debt servicing or the expiration of a reasonable period of time, subject to the time limitation determined when the project is approved, but no later than one year following substantial completion. Prior to this, the property is categorized as a property under development, and related revenue is applied to reduce development costs.

(g) Income taxes

The company accounts for income taxes under the liability method. Under this method, future income tax assets and liabilities are calculated based on: (i) the temporary differences between the carrying values and the tax bases of assets and liabilities, and (ii) unused income tax losses, measured using substantively enacted income tax rates and laws that are expected to apply in the future as temporary differences reverse and income tax losses are used.

(h) Reporting currency and foreign currency translation

The consolidated financial statements have been presented in Canadian dollars as the company's principal investments and cashflow are influenced primarily by the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate in effect at the balance sheet date. Revenues and expenses are translated at the weighted average rate in effect for the period presented.

(i) Marketable securities

Marketable securities are carried at the lower of amortized cost and their estimated net realizable value. During periods where the "fair value" or the "quoted market value" may be less than cost, the company reviews the relevant security to determine if it will recover its carrying value within a reasonable period of time and adjusts it, if necessary. The company also considers the degree to which estimation is incorporated into valuations and any potential impairment relative to the magnitude of the related portfolio.

In determining fair values, quoted market prices are generally used when available and, when not available, management estimates the amounts which could be recovered over time or through a transaction with knowledgeable and willing third parties under no compulsion to act.

(j) Use of estimates

The preparation of financial statements, in conformity with Canadian generally accepted accounting principles, requires estimates and assumptions that affect the carried amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates. Significant estimates are required in the determination of future cashflows and probabilities in assessing net recoverable amounts and net realizable value, the allocation of the purchase price to components of commercial properties and businesses acquired, depreciation and amortization, the company's ability to utilize tax losses, hedge effectiveness, and fair value for disclosure purposes.

(k) Derivative financial instruments

The company utilizes derivative financial instruments primarily to manage financial risks, including interest rate, commodity and foreign exchange risks. The use of derivative contracts is governed by documented risk management policies and approved limits. During 2005, the company's use of derivative financial instruments was limited to foreign exchange contracts.

Hedge accounting is applied where the derivative is designated as a hedge of a specific exposure and there is reasonable assurance the hedge will be effective. Realized and unrealized gains and losses on forward exchange contracts designated as hedges of currency risks are included in the cumulative translation account. Otherwise, realized and unrealized gains and losses on derivative financial instruments designated as hedges of financial risks are included in income as an offset to the hedged item in the period the underlying asset, liability or anticipated transaction to which they relate.

Financial instruments that are not designated as hedges are carried at estimated fair values, and gains and losses arising from changes in fair values are recognized in income as a component of loans and investment income in the period the changes occur. The use of non-hedging derivative contracts is governed by documented risk management policies and approved limits.

(l) Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with original maturities of three months or less.

(m) Comparative figures

Certain comparative figures have been reclassified to conform with the current year's presentation.

NOTE 2: CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2005, the company adopted the following new accounting policies, none of which individually or collectively had a material impact on the consolidated financial statements of the company, unless otherwise noted. These changes were the result of changes to the Canadian Institute of Chartered Accountants ("CICA") Handbook, Accounting Guidelines ("AcG") and Emerging Issues Committee Abstracts ("EIC").

Consolidation of Variable Interest Entities, CICA AcG 15

Effective January 1, 2005, the company adopted CICA Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG 15). This guideline provides guidance for applying the principles in section 1590, "Subsidiaries," to those entities defined as Variable Interest Entities (VIEs) and more commonly referred to as Special Purpose Entities (SPEs), in which either the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack either voting control, an obligation to absorb expected losses, or the right to receive expected residual returns. AcG 15 requires consolidation of VIEs by the Primary Beneficiary. The Primary Beneficiary is defined as the party who has exposure to the majority of a VIE's expected losses and/or expected residual returns. The adoption of this standard did not have a material impact on the company.

NOTE 3: FUTURE ACCOUNTING POLICY CHANGES

The following future accounting policy changes may have an impact on the company, although the impact, if any, has not been determined at this time.

(i) Comprehensive Income, CICA Handbook Section 1530

In January 2005, the CICA issued Handbook Section 1530, "Comprehensive Income," which is effective for the company's 2007 fiscal year. As a result of adopting this standard, a new statement, Comprehensive Income, will be included in the company's financial statements. Major components for this statement will include unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation amounts, net of hedging, arising from self-sustaining foreign operations and changes in the fair value of the effective position of cashflow hedging instruments.

(ii) Financial Instruments – Recognition and Measurement, CICA Handbook Section 3855

In January 2005, the CICA issued Handbook Section 3855, "Financial Instruments – Recognition and Measurement," which is effective for the company's 2007 fiscal year. Under this new standard, all financial instruments will be classified as one of the following: Held-to-maturity; Loans and Receivables; Held-for-trading; or Available-for-sale. Financial assets and liabilities held-for-trading will be measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, will be measured at amortized cost. Available-for-sale instruments will be measured at fair value with unrealized gains and losses recognized in other comprehensive income. The standard also permits designation of any financial instrument as held-for-trading upon initial recognition.

(iii) Hedges, CICA Handbook Section 3865

In January 2005, the CICA issued Handbook Section 3865, "Hedges," which is effective for the company's 2007 fiscal year. This new standard specifies the criteria under which hedge accounting can be applied and how hedge accounting can be executed for each of the permitted hedging strategies: fair value hedges and cashflow hedges. In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk and recognized in net income. This change in fair value of the hedged item, to the extent that the hedging relationship is effective, is offset by changes in the fair value of the derivative. In a cashflow hedging relationship, the effective portion of the change in the fair value of the hedging derivative will be recognized in other comprehensive income. The ineffective portion will be recognized in net income. The amounts recognized in accumulated other comprehensive income will be reclassified to net income in the periods in which net income is affected by the variability in the cashflows of the hedged item.

(iv) Implicit Variable Interests, Emerging Issues Committee Abstract 157

In October 2005, the Emerging Issues Committee issued Abstract No. 157, "Implicit Variable Interests Under AcG 15" ("EIC 157"), which is effective for the company's 2006 fiscal year. This EIC clarifies that implicit variable interests are implied financial interests in an entity that changes with changes in the fair value of the entity's net assets exclusive of variable interests. An implicit variable interest is similar to an explicit variable interest except that it involves absorbing and/or receiving variability indirectly from the entity. The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances.

(v) Conditional Asset Retirement Obligations, Emerging Issues Committee Abstract 159

In December 2005, the Emerging Issues Committee issued Abstract No. 159, "Conditional Asset Retirement Obligations" ("EIC 159"), which is effective for the company's 2006 fiscal year. The accounting treatment in this Abstract will be applied retroactively, with restatement of prior periods. This EIC requires an entity to recognize the fair value of a legal obligation to perform asset retirement activities, even though the timing and/or method of settlement may be uncertain.

NOTE 4: PROPERTY ACQUISITIONS

During the fourth quarter, the company completed the acquisition of a 25% joint-venture interest in O&Y Properties Corporation and O&Y Real Estate Investment Trust (collectively, "O&Y"). The O&Y portfolio consists of 27 office properties and one development site totaling 11.6 million square feet in Toronto, Calgary, Ottawa, Edmonton, Winnipeg and Niagara Falls. Included in the portfolio is First Canadian Place, which is directly connected to BPO Properties' Exchange Tower in Toronto. The company will serve as property and asset manager for the portfolio.

The following is a summary of the amounts assigned to each major class of asset and liability of O&Y at the date of acquisition:

	Purchase Price Book Value (Millions)
Commercial and development properties	\$ 588.6
Accounts receivable and other assets	17.0
Intangible assets ⁽¹⁾	66.5
Accounts payable and other liabilities assumed	(16.8)
Intangible liabilities ⁽¹⁾	(115.2)
Future income tax liabilities assumed	(31.3)
Commercial property debt assumed	(163.0)
Purchase price before acquisition financing	345.8
Acquisition financing	(129.5)
Total purchase price	\$ 216.3

⁽¹⁾ All intangibles are subject to amortization

The earnings from the company's interest in the O&Y portfolio are included in the consolidated statement of income commencing from October 21, 2005. The assets, liabilities and earnings from the company's interest in the O&Y portfolio have been proportionately consolidated in the company's consolidated financial statements.

Also during the fourth quarter of 2005, the company acquired the remaining 50% in Bay-Adelaide Centre development site for \$105 million, payable with \$80 million cash and a \$25 million vendor take-back mortgage. The terms of the vendor take-back mortgage provide that the amount is permanently reduced by \$12.5 million if construction does not commence within the three-year term.

NOTE 5: COMMERCIAL PROPERTIES

A breakdown of commercial properties is as follows:

(Millions)	2005	2004
Commercial properties	\$ 1,652.0	\$ 991.1
Less: Accumulated depreciation	(141.0)	(109.3)
Total	\$ 1,511.0	\$ 881.8

Minimum amounts payable over the next five years, and in the aggregate thereafter in respect of ground leases related to commercial real estate properties, which have an aggregate net book value of \$468 million, are as follows: 2006 - \$4.9 million; 2007 - \$4.9 million; 2008 - \$4.9 million; 2009 - \$4.9 million; 2010 - \$4.9 million and thereafter \$24.7 million. Amounts payable under ground leases ranging from seven to 886 years are included in the above amounts for ten years.

The following amounts represent the company's proportionate interest in incorporated and unincorporated joint ventures and partnerships, reflected in the company's commercial and development properties:

(Millions)	2005	2004
Assets	\$ 1,391.0	\$ 822.8
Liabilities	974.6	520.9
Operating revenues	170.8	164.1
Operating expenses	82.4	77.1
Net income	30.6	36.0
Cashflow from operating activities	52.0	60.9
Cashflow used in financing activities	120.5	(7.9)
Cashflow (used in) from investing activities	(365.0)	16.1

NOTE 6: DEVELOPMENT PROPERTIES

Commercial developments include commercial land which represent developable land and construction costs. During 2005, the company capitalized construction costs, property taxes and other related costs of \$3.6 million (2004 - \$2.2 million) and \$4.6 million (2004 - \$2.9 million) of interest to its commercial development sites.

NOTE 7: LOANS RECEIVABLE

(Millions)	2005	2004
Loans receivable	\$ 87.1	\$ 88.9
Accrued interest	13.0	8.8
Provisions	—	(6.0)
Total	\$ 100.1	\$ 91.7

The loans receivable bear interest at a range of 4.0% to 11.2% and mature from 2007 to 2011.

NOTE 8: MARKETABLE SECURITIES AND OTHER INVESTMENTS

Marketable securities consists of a portfolio of US-dollar fixed-rate corporate bonds with a book value exceeding fair value by \$1.6 million (2004 – nil). The portfolio has an average yield of 2.6% with maturities from May 2006 to January 2007.

NOTE 9: CASH AND CASH EQUIVALENTS

Cash and cash equivalents include \$22.5 million (2004 - \$11.2 million) of cash and \$1.7 million (2004 – \$nil) of cash equivalents.

NOTE 10: OTHER ASSETS

The components of other assets are as follows:

(Millions)	2005	2004
Tenant and other receivables	\$ 32.8	\$ 23.8
Prepaid expenses and other assets	21.2	4.7
Total	\$ 54.0	\$ 28.5

NOTE 11: INTANGIBLE ASSETS

The components of intangible assets are as follows:

(Millions)	2005	2004
Lease origination costs	\$ 54.4	—
Tenant relationships	9.5	—
Above-market leases	2.6	—
	66.5	—
Accumulated amortization	(2.6)	—
Total	\$ 63.9	—

NOTE 12: FUTURE INCOME TAXES

The future income tax asset as at December 31 is comprised of the following:

(Millions)	2005	2004
Future tax asset relating to operating and capital losses	\$ 52.6	\$ 38.1
Future tax (liability) asset relating to differences between tax and book basis	(36.1)	11.1
Total	\$ 16.5	\$ 49.2

At December 31, 2005, the company had non-capital income tax losses of approximately \$212.0 million (2004 – \$188.5 million) which are available to reduce taxable income of future years. The losses will expire over a ten year period up to the year 2015. The benefit of the tax losses, net of a valuation allowance, has been reflected in the future income tax asset.

In connection with the O&Y acquisition as discussed in note 4, a future income tax liability of \$31.3 million was recorded to reflect assets and liabilities acquired at amounts lower than their tax values.

The amount of non-capital losses and deductible temporary differences, for which no future income tax assets have been recognized, is \$153.4 million (2004 - \$192.3 million). Future income tax expense consists of the following:

(Millions)	2005	2004
Future income tax expense at combined Canadian federal and provincial income tax rate of 34% (2004 – 35%)	\$ 24.3	\$ 26.0
Recognition of tax assets previously not recognized	(22.8)	(14.2)
Non-taxable portion of capital gains and other income	—	(1.5)
Future income tax expense	\$ 1.5	\$ 10.3

Large corporation tax of \$1.7 million was paid during the year (2004 – \$2.5 million) and is included in administrative expenses and large corporation tax.

NOTE 13: COMMERCIAL PROPERTY DEBT

All of the commercial property mortgages are secured by individual properties without recourse to the company. Approximately 85% of the company's commercial property debt is due after 2006.

(Millions)	Weighted Average Interest Rate at Dec. 31, 2005	Principal Repayments							
		2006	2007	2008	2009	2010	2011 & Beyond	2005 Total	2004 Total
Commercial property debt	6.6%	\$ 143.5	\$ 48.8	\$ 200.2	\$ 81.0	\$ 18.1	\$ 454.9	\$ 946.5	\$ 655.8

The weighted average interest rate at December 31, 2005 was 6.6% (2004 - 7.1%). With the acquisition of the O&Y portfolio, the company assumed \$163.0 million of existing debt and added \$129.5 million of bridge financing.

NOTE 14: ACCOUNTS PAYABLE AND OTHER LIABILITIES

The components of the company's accounts payable and other liabilities are as follows:

(Millions)	2005	2004
Accounts payable and other liabilities	\$ 61.3	\$ 41.6
Accrued interest	5.6	4.0
Total	\$ 66.9	\$ 45.6

NOTE 15: INTANGIBLE LIABILITIES

The components of the company's intangible liabilities are as follows:

(Millions)	2005	2004
Below-market leases	\$ 65.2	—
Above-market ground leases	50.0	—
	115.2	—
Accumulated amortization	(1.7)	—
Total	\$ 113.5	—

NOTE 16: SHAREHOLDERS' EQUITY:

The consolidated statement of changes in shareholders' equity are as follows:

(Millions)	2005				2004			
	Preferred Shares	Common Shares	Retained Earnings	Total	Preferred Shares	Common Shares	Retained Earnings	Total
Balance, beginning of period	\$ 381.7	\$ 78.9	\$ 400.4	\$ 861.0	\$ 381.7	\$ 78.9	\$ 793.4	\$ 1,254.0
Net income	—	—	68.2	68.2	—	—	63.0	63.0
Common share dividends paid	—	—	(17.1)	(17.1)	—	—	(445.1)	(445.1)
Preferred share dividends paid	—	—	(11.8)	(11.8)	—	—	(10.9)	(10.9)
Share repurchases	—	—	(0.9)	(0.9)	—	—	—	—
Balance, end of period	\$ 381.7	\$ 78.9	\$ 438.8	\$ 899.4	\$ 381.7	\$ 78.9	\$ 400.4	\$ 861.0

(a) Total common shares issued and outstanding at December 31, 2005 totaled 28.5 million (2004 – 28.5 million) shares, which included 21.7 million (2004 – 21.7 million) non-voting equity shares.

(b) Net income per common share has been calculated after the payment of preferred share dividends of \$11.8 million (2004 – \$10.9 million) using weighted average shares outstanding of 28.5 million (2004 – 28.5 million). There were no dilutive instruments outstanding.

Authorized share capital consists of 300,000 senior preferred shares, unlimited priority preferred shares, unlimited preferred shares issuable in series, unlimited common shares and unlimited non-voting equity shares. No senior preferred shares or priority preferred shares were issued and outstanding.

Details of the preferred shares issued by the company are as follows:

(Millions, except share information)	Shares Outstanding	Cumulative Dividend Rate	2005	2004
Series G	1,805,489	70% of bank prime	\$ 45.1	\$ 45.1
Series J	3,816,527	70% of bank prime	95.4	95.4
Series K	300	30-day BA + 0.4%	150.0	150.0
Series M	2,847,711	70% of bank prime	71.2	71.2
Series N	800,000	30-day BA + 0.4%	20.0	20.0
Total			\$ 381.7	\$ 381.7

Series G preferred shareholders are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate. The company may, at its option, redeem the shares at a price of \$25 per share plus arrears on any accrued and unpaid dividends.

Series J and M preferred shareholders are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate for the previous quarter. The company may, at its option, redeem the shares at a price of \$25 per share plus arrears on any accrued and unpaid dividends.

Series K preferred shareholders are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at a price of \$500,000 per share plus an amount equal to all accrued and unpaid dividends.

Series N preferred shareholders are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at \$25 per share plus arrears on any accrued and unpaid dividends

Preferred share dividends totaling \$11.8 million were paid in 2005 (2004 - \$10.9 million).

(c) Earnings per share

Net income per share and weighted average common shares outstanding are calculated as follows:

(Millions, except per share amounts)	2005	2004
Net income	\$ 68.2	\$ 63.0
Preferred share dividends	(11.8)	(10.9)
Net income available to common shareholders	\$ 56.4	\$ 52.1
Weighted average shares outstanding	28.5	28.5
Net income per share	\$ 1.98	\$ 1.83

NOTE 17: GUARANTEES, CONTINGENCIES AND OTHER

(a) In the normal course of operations, the company and its consolidated subsidiaries execute agreements that provide for indemnification and guarantees to third parties in transactions such as business dispositions, business acquisitions, sales of assets, sales of services, securitization agreements and underwriting and agency agreements. In particular, the company provided income guarantees to the co-owners in connection with the sale of certain properties in prior years. These guarantees are based on a specified level of contractual occupancy until July 2007. The company's maximum potential loss is \$4 million, however, based on estimated levels of occupancy, the company does not expect to make any payments.

The company has also agreed to indemnify its directors and certain of its officers and employees. The nature of substantially all of the indemnification undertakings prevent the company from making a reasonable estimate of the maximum potential amount that could be required to pay third parties as the agreements do not specify a maximum amount and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, neither the company nor its consolidated subsidiaries have made significant payments nor do they expect to make any significant payments under such indemnification agreements.

The company does not conduct its operations, other than equity-accounted investments, through entities that are not fully or proportionately consolidated in its consolidated financial statements, and has not guaranteed or otherwise contractually committed to support any material financial obligations not reflected in its consolidated financial statements.

(b) The company and its operating subsidiaries are contingently liable with respect to litigation and claims that arise from time to time in the normal course of business. In the opinion of management, any liability which may arise from such contingencies would not have a material adverse effect on the consolidated financial statements of the company.

(c) The company has insurance covering certain acts of terrorism for up to US\$500 million (C\$580 million) of damage and business interruption costs. The company continues to seek additional coverage equal to the full replacement cost of its assets; however, until this type of coverage becomes commercially available on an economically reasonable basis, any damage or business interruption costs as a result of uninsured acts of terrorism could result in a material cost to the company. The company believes it is in compliance with all of its loan covenants, despite not being able to acquire terrorism coverage for the full replacement cost of all of the company's properties.

NOTE 18: SEGMENTED INFORMATION

During 2003, the company completed its strategy of exiting the retail market. As a result, commencing in the year 2004, the company has only one business segment as a pure-play office owner, manager and developer.

NOTE 19: RELATED PARTY TRANSACTIONS

The company retains the services of a subsidiary of Brookfield Properties Corporation ("BPC"), the company's principal shareholder, for the property management of some of its office properties on contracts based on fair market value of services provided. The fees paid for these property management services totaled \$5.4 million in 2005 (2004 - \$5.4 million). The company has an agreement with BPC to provide asset management services for the company's property portfolio. The fees paid for these services, determined on a cost-recovery basis, totalled \$4.6 million (2004 - \$4.6 million). Interest earned on related party deposits for the year ended December 31, 2005 was nil (2004 - \$6.0 million).

NOTE 20: OTHER INFORMATION

(a) At December 31, 2005, the company had foreign exchange contracts to sell a notional amount of US\$77.5 million at a weighted average exchange rate of US\$1.00 = C\$1.16, maturing in January 2006, which have not been designated as hedges for financial reporting purposes. The aggregate fair value of these contracts at December 31, 2005 was a gain of \$0.4 million which is reflected in loans and

investment income in the consolidated statement of income with a corresponding asset in marketable securities and other investments in the consolidated balance sheet.

(b) Supplemental cashflow information

Years ended December 31 (Millions)	2005	2004
Acquisitions of real estate	\$ (601.4)	—
Mortgages and other balances assumed on acquisition ⁽¹⁾	174.7	—
Net acquisitions	\$ (426.7)	—
Dispositions of real estate	—	\$ 42.0
Mortgages disposed	—	(20.7)
Net dispositions	—	\$ 21.3
Capitalized interest	\$ 4.6	\$ 2.9
Cash interest paid	\$ 46.1	\$ 45.7

⁽¹⁾ Refer to note 4 for further details

(c) At December 31, 2005, the fair value of mortgages receivable exceeded their book value by \$0.8 million (2004 - \$1.4 million). The fair value of mortgages and loans payable is determined by references to current market rates for debt with similar terms and risks. As at December 31, 2005, the fair value of advances, commercial property debt and other loans payable exceeds the book value of these obligations by \$51.0 million (2004 - \$46.3 million).

(d) At December 31, 2005, the company's floating-rate liabilities, including \$381.7 million of floating rate preferred shares, exceeded floating rate assets by \$526.9 million (2004 - \$370.1 million).

(e) The assets and liabilities of certain of the company's subsidiaries are neither available to pay debts of, nor constitute legal obligations of the parent or other subsidiaries, respectively.

(f) In 2005, the company recorded amortization of deferred financing costs of \$1.0 million (2004 - \$1.0 million) in depreciation and amortization expense.

NOTE 21: SUBSEQUENT EVENTS

Subsequent to the year-end, the company acquired a land lease held under one of its properties in Toronto, Ontario for approximately \$3.5 million.

Selected Financial Information

December 31 (Millions, except per share information)	2005	2004	2003	2002	2001
Financial results					
Commercial property net operating income	\$ 121.8	\$ 113.2	\$ 110.2	\$ 114.0	\$ 152.9
Funds from operations and gains	104.4	102.2	132.5	220.0	172.4
Net income	68.2	63.0	93.9	167.0	106.9
Total assets	2,026.3	1,562.4	2,022.2	1,976.0	2,000.1
Shareholders' equity	899.4	861.0	1,254.0	1,182.0	1,026.0
Per common share					
Shares outstanding	28.5	28.5	28.5	28.5	28.5
Funds from operations and gains	\$ 3.25	\$ 3.20	\$ 4.20	\$ 7.34	\$ 5.42
Funds from operations excluding straight line rent, property disposition gains	3.10	2.77	4.07	3.98	3.68
Net income	1.98	1.83	2.84	5.47	3.12
Dividends paid	0.60	0.60 ⁽¹⁾	0.30	—	—
Shareholders' equity – book value	31.56	30.21	44.00	41.47	36.00
Common share price at year end	39.70	39.00	34.50	25.50	20.00
Operating data—Commercial properties					
Number of properties	50	17	18	16	18
Rentable area (millions of sq. ft.)	27.2	14.1	14.4	14.6	14.0
Effective interest (millions of sq. ft.)	12.8	7.8	7.6	7.8	10.4
Occupancy (%) ⁽²⁾	96.1	94.8	94.4	94.3	94.3

⁽¹⁾ Excludes the special common share dividend of \$15 per share

⁽²⁾ The 2001 to 2004 occupancy numbers have been restated to include Hudson's Bay Centre which was transferred to commercial properties in the first quarter of 2005

Board of Directors

Robert J. Harding, F.C.A.
Chairman, BPO Properties Ltd. and
Chairman, Brookfield Asset Management Inc.

Richard B. Clark
President and CEO
Brookfield Properties Corporation

Thomas F. Farley
President and Chief Executive Officer
BPO Properties Ltd.

The Hon. William G. Davis, P.C., C.C., Q.C.
Counsel, Torys LLP

Robert J. McGavin
Corporate Director

Michael F.B. Nesbitt
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Brett M. Fox
Vice President and Assistant Secretary

Deborah R. Rogers
Vice President, Legal and Secretary

T. Nga Trinh
Vice President and Controller

BPO Properties Corporate Information

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Stock Exchange Listings

	Stock Symbol	Exchange	Record Date	Payment Date
Common shares	BPP	TSX	First day of March, June, September and December	Last business day of March, June, September and December
Series G	BPP.PR.G	TSX	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series J	BPP.PR.J	TSX	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series K	Not listed	TSX	First business day preceding payment date	The day after the third Wednesday of every month
Series M	BPP.PR.M	TSX	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series N	Not listed	TSX	Six business days preceding payment date	The day after the third Wednesday of every month

Shareholder Information

BPO Properties welcomes inquiries from shareholders, analysts, media representatives and other interested parties. Questions relating to investor relations or media inquiries can be directed to Melissa Coley, Vice President, Investor Relations at 416.359.8593 or via e-mail at mcoley@bpoproperties.com. Inquiries regarding financial results should be directed to Craig Laurie, Senior Vice President and Chief Financial Officer at 416.956.5170 or via e-mail at claurie@bpoproperties.com.

Shareholder questions relating to dividends, address changes and share certificates should be directed to the company's Transfer Agent, CIBC Mellon Trust, as listed above.

Annual General Meeting

The Annual General Meeting of shareholders will be held in Toronto, Ontario, at the Hockey Hall of Fame, BCE Place, 181 Bay Street, at 1:30 p.m. on May 1, 2006. Shareholders may also participate in the meeting by webcast through BPO Properties' Web site at www.bpoproperties.com.

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