Management's Discussion and Analysis of Financial Results

FORWARD-LOOKING STATEMENTS

This annual report to shareholders, particularly the "Business Environment and Outlook" section, contains forward-looking statements and information within the meaning of applicable securities legislation. These forward-looking statements reflect management's current beliefs and are based on assumptions and information currently available to the management of BPO Properties. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "forecast", "outlook", "potential", "continue", "should", "likely", or the negative of these terms or other comparable terminology. Although management 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 assumptions, known and unknown risks, uncertainties, and other factors that may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance, or achievements 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

March 7, 2008

PART I – OBJECTIVES AND FINANCIAL HIGHLIGHTS

BASIS OF PRESENTATION

Financial data included in Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2007, includes material information up to March 7, 2008. Financial data provided 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 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 is intended to provide readers with an assessment of the performance of BPO Properties Ltd. ("BPO Properties" or "the Company") over the past two years as well as our financial position and future prospects. It should be read in conjunction with the consolidated financial statements and appended notes, which begin on page 38 of this report. In our discussion of operating performance, we refer to net operating income and funds from operations 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, depreciation and amortization, and income tax expenses. Funds from operations is defined as net income prior to extraordinary items, noncash items, and depreciation and amortization. We use net operating income and funds from operations to assess the operating results of the Company. Net operating income is an important measure in assessing operating performance and funds from operations is a relevant measure in analyzing real estate, as commercial properties generally appreciate rather than depreciate. We provide the components of net operating income and a full reconciliation from net income to funds from operations on page 24. Net operating income and funds from operations are both non-GAAP measures that do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other companies.

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

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, 2007, the book value of BPO Properties' total assets was $2,235.7 million. During 2007, we generated $138.8 million of net income ($4.23 per share) and $159.3 million of funds from operations ($4.95 per common share).

FINANCIAL HIGHLIGHTS

BPO Properties' financial results are as follows:

(Millions, except per-share amounts)	**2007**	2006	2005
Results of operations			
Net income	**$ 138.8**	$ 72.7	$ 68.2
Net income per share	**4.23**	1.99	1.98
Common share dividends paid per share	**0.60**	0.60	0.60
Funds from operations	**$ 159.3**	$ 155.0	$ 104.4
Funds from operations per share	**4.95**	4.88	3.25
Balance sheet data			
Total assets	**$ 2,235.7**	$ 2,098.6	$ 2,026.3
Commercial properties	**1,351.6**	1,370.5	1,351.8
Commercial and development property debt	**965.5**	887.2	804.0
Shareholders' equity	**1,040.5**	939.0	899.4

COMMERCIAL PROPERTY OPERATIONS

Our strategy of owning, proactively managing, and developing premier properties in high-growth, and in many instances supply-constrained markets with high barriers to entry has created one of Canada's most distinguished portfolios of office properties. Our commercial property portfolio consists of interests in 28 properties totaling 18.3 million square feet, including 3.3 million square feet of parking. Our development portfolio comprises five development sites totaling 5.7 million square feet. Our primary markets are the financial, energy, and government center 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 proactive 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;
- Monetizing development assets as the economy rebounds and continued supply constraints create opportunities; and
- Expanding our asset-management platform through the establishment of new funds.

The following table summarizes our investment by market:

Region	Number of Properties	Leasable Area (000's Sq. Ft.)	BPO Properties' Owned Interest (000's Sq. Ft.)	Book Value (Millions)	Debt[2] (Millions)	Net Book Equity (Millions)
Toronto, Ontario	9	7,054	3,701	$ 603.9	$ 328.9	$ 275.0
Ottawa, Ontario	6	2,780	695	101.7	25.7	76.0
Calgary, Alberta	8	6,704	3,259	519.6	370.9	148.7
Edmonton, Alberta	2	710	177	17.6	2.4	15.2
Vancouver, B.C.	1	853	853	106.9	132.0	(25.1)
Other	1	3	3	1.9	—	1.9
Continuing operations	27	18,104	8,688	1,351.6	859.9	491.7
Discontinued operations[1]	1	209	52	3.2	—	3.2
	28	18,313	8,740	1,354.8	859.9	494.9
Office developments	8	5,677	4,714	452.5	114.4	338.1
Total	36	23,990	13,454	$ 1,807.3	$ 974.3	$ 833.0

(1) *4342 Queen in Niagara Falls has been classified as discontinued operations.*
(2) *Excludes $8.8 million of deferred financing costs that have been reclassified from other assets to commercial and development property debt.*

We have historically explored property-level joint-venture opportunities with strategic institutional partners. Although we plan to continue with this endeavor, we are also pursuing the acquisition of individual assets and portfolios through joint venture fund vehicles. In 2005, we formed our Canadian Office Fund to acquire the O&Y portfolio. Of our 28 properties, seven are wholly owned, eight are held in property-level joint ventures or co-tenancies, and 13 were acquired through the O&Y portfolio. Our Canadian Office Fund consists of a consortium of institutional investors, which we lead and manage. Affiliates of the consortium members own direct interests in property-level joint ventures and have entered into several agreements relating to property management, fees, transfer rights, and other material issues related to the operation of the properties. We proportionately consolidate our interest in this Fund.

We believe that investing our liquidity with these partners in fund formats, enables us to enhance returns. The Funds and associated asset-management fees represent an important area of growth as we expand our assets under management. Purchasing properties or portfolios of properties in fund formats allows us to earn the following categories of fees:

- Asset Management — Stable base fee for providing regular, ongoing services.
- Transaction — Development, redevelopment, and leasing activities conducted on behalf of these funds.
- Performance — Earned when certain predetermined benchmarks are exceeded. Performance fees, which can add considerably to fee revenue, typically arise later in a fund's life cycle and are therefore not fully reflected in current results.

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/Nesbitt Burns, Petro-Canada, Imperial Oil, and Talisman Energy. A detailed list of major tenants is included in Part III ("Risks and Uncertainties") of this MD&A, beginning on page 28.

Our strategy is to sign long-term leases in order to mitigate risk and reduce our overall retenanting costs. We typically commence discussions with tenants regarding their space requirements well in advance of the contractual expiration, and although each market is different, the majority of our leases, when signed, extend between five and 10-year terms. As a result of this strategy, approximately 7.8% of our leases mature annually over the next five years.

The following is a breakdown of lease maturities by region with associated in-place net rental rates:

	Total Portfolio			Toronto, Ontario			Ottawa, Ontario			Calgary, Alberta		
Year of Expiry	000's Sq. Ft.	%	Net Rent per Sq. Ft.[1]	000's Sq. Ft.	%	Net Rent per Sq. Ft.[1]	000's Sq. Ft.	%	Net Rent per Sq. Ft.[1]	000's Sq. Ft.	%	Net Rent per Sq. Ft.[1]
Currently available	246	1.6		153	2.5		11	0.6		14	0.2	
2008	573	3.8	$ 19	334	5.4	$ 23	91	5.2	$ 14	127	2.2	$ 20
2009	907	6.1	21	502	8.1	17	36	2.1	16	304	5.4	24
2010	1,114	7.4	19	489	7.9	26	2	0.1	40	421	7.4	25
2011	1,819	12.1	23	286	4.6	27	—	—	—	1,383	24.3	21
2012	1,407	9.4	21	802	12.9	25	6	0.3	31	497	8.7	30
2013	3,685	24.6	26	1,205	19.4	28	1,055	60.3	19	1,337	23.5	26
2014	239	1.6	24	110	1.8	29	9	0.5	25	98	1.7	40
2015 & beyond	4,996	33.4	22	2,344	37.4	22	540	30.9	15	1,500	26.6	29
Parking	3,327	—	—	829	—	—	1,030	—	—	1,023	—	—
	18,313	100.0		7,054	100.0		2,780	100.0		6,704	100.0	
Average market net rent			$ 28			$ 27			$ 19			$ 35

	Edmonton, Alberta			Vancouver, B.C.			Other		
Year of Expiry	000s Sq. Ft.	%	Net Rent per Sq. Ft.[1]	000s Sq. Ft.	%	Net Rent per Sq. Ft.[1]	000s Sq. Ft.	%	Net Rent per Sq. Ft.[1]
Currently available	5	0.9		15	2.6		48	31.4	
2008	9	1.5	$ 17	11	1.9	$ 24	1	0.7	$ 32
2009	38	6.5	9	23	26.0	19	4	2.6	6
2010	125	21.2	13	43	7.3	19	34	22.4	10
2011	71	12.1	12	73	12.4	24	6	3.9	9
2012	30	5.1	9	61	10.4	22	11	7.2	11
2013	7	1.2	19	80	13.6	21	1	0.7	32
2014	17	2.9	13	5	0.8	27	—	—	—
2015 & beyond	287	48.6	14	278	25.0	13	47	31.1	10
Parking	121	—	—	264	—	—	60	—	—
	710	100.0		853	100.0		212	100.0	
Average market net rent			$ 21			$ 27			$ 9

[1] *Net rent at expiration of lease.*

COMMERCIAL DEVELOPMENT

We hold interests in 5.7 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 preleasing targets with one or more lead tenants have been achieved. We currently have two projects under development, which are outlined on page 12 of this MD&A.

The following table summarizes our commercial development projects at December 31, 2007:

	Location	Number of Properties	Number of Sites	Ownership	Total Sq. Ft.
Toronto, Ontario					
Bay Adelaide Centre	Bay and Adelaide Streets	3	1	100%	2,600,000
Brookfield Place III	Third phase of Brookfield Place project	1	1	65%	800,000
Ottawa, Ontario					
Place de Ville III	Third phase of Place de Ville project	1	1	25%	577,000
Calgary, Alberta					
Herald Block	1st Street and 7th Avenue, within one block from our existing Calgary assets	1	1	100%	1,200,000
Bankers Court	East and West Parkades adjacent to Bankers Hall	2	1	50%	500,000
		8	5		5,677,000

PERFORMANCE MEASUREMENT

The key indicators by which we measure our performance are:

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

Although we monitor and analyze our financial performance using a number of indicators, our primary business objective of generating reliable and growing cash flow is monitored and analyzed using net income, net operating income, and funds from operations. While net income is calculated in accordance with generally accepted accounting principles ("GAAP'), net operating income and funds from operations are both non-GAAP financial measures that 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 23 and a full reconciliation from net income to funds from operations on page 24 of this MD&A.

Net Income

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

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, depreciation and amortization, 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

Funds from operations is defined as net income prior to extraordinary items, one-time transaction costs, depreciation and amortization, income taxes, and certain other noncash items. While we believe that funds from operations is the most relevant measure to analyze real estate as commercial properties generally appreciate rather than depreciate, we believe that funds from operations, net operating income, and net income are all relevant measures. We compute funds from operations substantially in accordance with the definition provided by the Real Property Association of Canada ("Real Pac"). Under this definition, funds from operations does not represent or approximate cash generated from operating activities determined in accordance with Canadian GAAP and should not be considered an alternative to GAAP measures. Accordingly, we provide a reconciliation of funds from operations to net income, consistent with the definition as set out above. A reconciliation is not provided to cash flow 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 income, net operating income, and funds from operations, we consider the following items to be important drivers of our current and anticipated financial performance:

- Increases in occupancies by leasing 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 that fit into our strategic plan; and
- The availability of capital at a cost and on terms conducive to our goals.

PART II – FINANCIAL STATEMENT ANALYSIS

ASSET PROFILE

Our total asset book value was $2,235.7 million at December 31, 2007, compared with $2,098.6 million at December 31, 2006. The following is a summary of our assets:

(Millions)	**December 31, 2007**	December 31, 2006
Commercial properties	**$ 1,351.6**	$ 1,370.5
Commercial developments	**452.5**	312.8
Loans receivable	**283.5**	100.2
Intangible assets	**40.2**	51.7
Tenant receivables and other assets	**66.0**	57.5
Cash	**37.7**	27.7
Assets related to discontinued operations	**4.2**	178.2
Total	**$ 2,235.7**	$ 2,098.6

COMMERCIAL PROPERTIES

The book value of our commercial properties from continued operations was $1,351.6 million as of December 31, 2007, compared with $1,370.5 million at December 31, 2006. The decrease in commercial properties is primarily attributable to depreciation and amortization during the year ended December 31, 2007. The decrease in discontinued operations resulted from the sale of Atrium on Bay in Toronto and 2200 and 2204 Walkley Road in Ottawa during the first quarter of 2007, 18 King Street in Toronto during the second quarter of 2007, 2 and 40 St. Clair West in Toronto during the third quarter of 2007, and Gulf Canada Square in Calgary during the fourth quarter of 2007. The consolidated carrying value of our properties is approximately $155 per square foot, significantly less than the estimated replacement cost of these assets. A breakdown of our commercial properties by region is as follows:

Region	Leasable Area (000's Sq. Ft.)	BPO Properties' Owned Interest (000's Sq. Ft.)	**December 31, 2007 (Millions)**	December 31, 2006 (Millions)
Toronto, Ontario	7,054	3,701	**$ 603.9**	$ 611.1
Ottawa, Ontario	2,780	695	**101.7**	103.3
Calgary, Alberta	6,704	3,259	**519.6**	530.7
Edmonton, Alberta	710	177	**17.6**	17.8
Vancouver, B.C.	853	853	**106.9**	106.8
Other	3	3	**1.9**	0.8
Continuing operations	18,104	8,688	**1,351.6**	1,370.5
Discontinued operations[1]	209	52	**3.2**	162.8
Total	18,313	8,740	**$ 1,354.8**	$ 1,533.3

[1] 4342 Queen Street was classified as discontinued operations at December 31, 2007, and December 31, 2006. Atrium on Bay, 18 King Street, 2 and 40 St. Clair West in Toronto, 2200 and 2204 Walkley Road in Ottawa and Gulf Canada Square in Calgary were classified as discontinued operations at December 31, 2006.

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 these capital expenditures, 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 installation costs for the year ended December 31, 2007, totaled $10.8 million, compared with $9.6 million during the same period in 2006. The increase was a result of tenant installation costs incurred on the lease-up of space throughout our portfolio.

Tenant installation costs are summarized as follows:

(Millions)	**2007**	2006
Leasing commissions	**$ 3.7**	$ 2.6
Tenant improvements	**7.1**	7.0
Total	**$ 10.8**	$ 9.6

We also invest in ongoing maintenance and capital-improvement projects to sustain the high quality of the infrastructure and tenant service amenities in our properties. Capital expenditures for the year ended December 31, 2007, totaled $15.6 million, compared with $11.3 million during the same period in 2006. 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 increase in revenue-enhancing capital expenditures is attributable to improvements and reconfiguration of space throughout our portfolio.

The details of our capital expenditures are summarized as follows:

(Millions)	**2007**	2006
Revenue enhancing	**$ 13.1**	$ 8.8
Non-revenue-enhancing	**2.5**	2.5
Total	**$ 15.6**	$ 11.3

COMMERCIAL DEVELOPMENTS

The details of the commercial properties development portfolio and related book values are as follows:

(Millions, except square feet)	Buildable Sq. Ft.	Sq. Ft. Currently Under Construction	**Dec. 31, 2007**	Dec. 31, 2006
Current developments				
Bay Adelaide Centre, Toronto	2,600,000	1,160,000	**$ 374.2**	$ 254.0
Bankers Court, Calgary	500,000	265,000	**21.7**	8.7
Planning				
Herald Block, Calgary	1,200,000	—	**52.5**	45.2
Others:				
Brookfield Place III, Toronto	800,000	—		
Place de Ville III, Ottawa	577,000	—		
	1,377,000		**4.1**	4.9
Total	5,677,000	1,425,000	**$ 452.5**	$ 312.8

Commercial developments consist of commercial property development sites, density rights, and related infrastructure. The total book value of this development land and infrastructure was $452.5 million at December 31, 2007, an increase of $139.7 million from $312.8 million at December 31, 2006. The increase is a result of the ongoing active construction at two of our development sites during the year ended December 31, 2007. The following is a brief description of our construction in progress:

- Bay Adelaide Centre in Toronto represents one of our largest development projects. Ground-breaking on Phase I of this project took place in July of 2006 and construction is actively underway. Phase I represents 1.2 million square feet of a three-phase project which is expected to total 2.6 million square feet and be completed in 2009. Due to the continuous construction on Phase I the book value of this site has increased by $120.2 million since December 31, 2006.

- Construction on Bankers Court in Calgary, a 500,000-square-foot, two-building project, commenced in the third quarter of 2006. Active development of the first building, totaling 265,000 square feet, is taking place and is expected to be complete in 2008. The building is 100% leased. As a result of the continuous development, the book value of this site has increased by $13.0 million since December 31, 2006.

During the second quarter of 2007, we expanded the Herald Block development site in Calgary with the acquisition of the Heagle building for $5.0 million, adding 100,000 square feet of additional density to the site, which now has a capacity of 1.2 million rentable square feet. The acquisition of the building also links the site to existing skybridge connections.

Although we are not generally a speculative developer, we are a full-service real estate Company with in-house development expertise. With over five million square feet of high-quality, centrally located development properties in Toronto, Ottawa, and Calgary, we will undertake developments when our risk-adjusted returns and preleasing targets have been achieved.

Expenditures for development on commercial properties totaled $135.6 million during the year ended December 31, 2007, compared with $49.8 million during the same period in 2006. The increase is due to construction costs incurred on the Bay Adelaide and Bankers Court projects mentioned above, which are currently under active development.

The details of development expenditures are as follows:

(Millions)		2007		2006
Construction costs	$	**97.0**	$	17.1
Interest capitalized		**23.3**		14.3
Property taxes and other		**15.3**		18.4
Total	$	**135.6**	$	49.8

LOANS RECEIVABLE

Loans receivable increased to $283.5 million at December 31, 2007, compared with $100.2 million at December 31, 2006. The increase primarily relates to a demand loan receivable of $220.3 million from our parent Company, Brookfield Properties Corporation ("BPC"). The loan receivable bears interest at 5%, or higher than what the Company would earn on short-term deposits. In addition, there was a repayment of $76.0 million from the Company's joint venture partners in the O&Y Debt, as noted in the "Commercial and development property debt" on page 16 of this MD&A. This is offset by the collection of the Atrium on Bay loan receivable upon disposition of the property during the first quarter of 2007 and the collection of the Exchange Tower loan receivable during the fourth quarter of 2007.

INTANGIBLE ASSETS

Pursuant to Emerging Issues Committee Abstract 140, "Accounting for Operating Leases Acquired in Either an Asset Acquisition or a Business Combination," 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. We assess the fair value of acquired intangible assets and liabilities, including tenant improvements, above- and below-market leases, origination costs, and other identified intangible assets and assumed liabilities. Intangible assets decreased to $40.2 million at December 31, 2007, from $51.7 million at December 31, 2006, primarily due to amortization during the year ended December 31, 2007. The components of intangible assets are as follows:

(Millions)		2007		2006
Intangible assets				
Lease-origination costs	$	**57.1**	$	57.1
Tenant relationships		**7.6**		7.6
Above-market in-place operating leases		**2.3**		2.3
		67.0		67.0
Less accumulation amortization				
Lease-originations costs		**(24.6)**		(14.2)
Tenant relationships		**(1.4)**		(0.6)
Above-market in-place operating leases		**(0.8)**		(0.5)
Total	$	**40.2**	$	51.7

TENANT RECEIVABLES AND OTHER ASSETS

Tenant receivables and other assets increased to $66.0 million at December 31, 2007, from $57.5 million at December 31, 2006, primarily due to the increase in tenant and other receivables and straight-line rent receivable. The components of tenant receivables and other assets are as follows:

(Millions)		2007		2006
Tenant and other receivables	$	**32.0**	$	21.6
Prepaid expenses and other assets		**16.4**		20.7
Straight-line rent receivable		**16.5**		13.8
Restricted cash		**1.1**		1.4
Total	$	**66.0**	$	57.5

During the third quarter of 2007, the Company decided not to proceed with a debt financing structure to issue long-term, fixed-rate notes backed by a pool of commercial properties. The costs incurred to date were approximately $4.0 million, and $0.8 million of this balance was included in Other Assets as of December 31, 2006. In accordance to Emerging Issues Committee Abstract 94, "Accounting for Corporate Transaction Costs," all costs related to structuring, broker, legal, accounting, appraisal, and due diligence on the properties were written off to transaction costs in the consolidated statement of income and comprehensive income.

CASH

We endeavor to maintain high levels of liquidity to ensure that we can react quickly to potential investment opportunities. To ensure we maximize our returns, cash balances are generally carried at a modest level.

As of December 31, 2007, cash balances increased to $37.7 million from $27.7 million at December 31, 2006. The increase is primarily due to cash flow provided by dispositions of properties (Atrium on Bay, 18 King Street, 2 and 40 St. Clair West in Toronto, 2200 and 2204 Walkley Road in Ottawa, and Gulf Canada Square in Calgary) and debt financing arrangements with the bank and related parties, offset by the repayment of debts related to the Royal Centre in Vancouver and the O&Y Debt, development activity expenditures, and the demand loan provided to BPC.

DISCONTINUED OPERATIONS

Properties that meet the criteria of CICA Handbook Section 3475, "Disposal of Long-Lived Assets and Discontinued Operations," are classified as discontinued operations. Any long-lived assets related to the property are recorded at the lower of carrying amount or fair value less estimated cost to sell and are not depreciated while classified as held for sale. The results of operations and balance sheet items of any property that has been identified as discontinued operations are reported separately if the operations of the property will be eliminated as a result of the disposal, and the Company will not have any significant continuing involvement in the operations of the property after the disposal transaction. Comparative amounts are also reclassified.

During the fourth quarter of 2007, the Company sold its 25% interest in Gulf Canada Square in Calgary, resulting in a gain of $25.6 million prior to income tax. In addition, a gain of $0.5 million was recorded resulting from the sale of non-core properties. Furthermore, the Company made a decision to sell its 25% interest in 4342 Queen Street in Niagara Falls. The Company has reclassified $4.2 million of assets and $3.0 million of liabilities to discontinued operations as of December 31, 2007, in connection with this property.

During the third quarter of 2007, the Company sold its 25% interest in 2 and 40 St. Clair West in Toronto, resulting in a gain of $5.6 million prior to income tax.

During the second quarter of 2007, the Company sold its 25% interest in 18 King Street in Toronto, resulting in a gain of $4.9 million prior to income tax.

During the first quarter of 2007, the Company sold its 50% interest in Atrium on Bay in Toronto and its 25% interest in 2200 and 2204 Walkley Road in Ottawa, resulting in a gain of $54.6 million prior to income tax.

Included in the assets and liabilities related to discontinued operations at December 31, 2006, were Atrium on Bay, 18 King Street, 2 and 40 St. Clair West in Toronto; 4342 Queen Street in Niagara Falls; 2202 and 2204 Walkley Road in Ottawa; and Gulf Canada Square in Calgary. Income attributable to discontinued operations was $80.0 million for 2007, compared with $19.4 million in 2006. The 2007 results included the gains on disposition of Atrium on Bay, 18 King Street, 2 and 40 St. Clair West in Toronto; 2200 and 2204 Walkley Road in Ottawa; and Gulf Canada Square in Calgary, while the 2006 results included the gains on the disposition of eight non-core assets in Calgary and Winnipeg.

The components of assets and liabilities related to discontinued operations are as follows:

(Millions)		**2007**		2006
Assets related to discontinued operations				
Commercial properties	**$**	**3.2**	$	162.8
Intangible assets		**0.1**		11.2
Tenant receivables and other assets		**0.9**		4.2
Total assets related to discontinued operations	**$**	**4.2**	$	178.2
Liabilities related to discontinued operations				
Commercial and development property debt		—		86.6
Intangible liabilities		—		5.6
Accounts payable and other liabilities		**3.0**		3.6
Total liabilities related to discontinued operations	**$**	**3.0**	$	95.8

The following table summarizes the income and gains from discontinued operations:

(Millions, except per-share amounts)	**2007**	2006
Revenue	**$ 18.2**	$ 42.4
Operating expenses	**(6.2)**	(18.3)
	12.0	24.1
Interest expense	**(2.2)**	(6.2)
	9.8	17.9
Depreciation and amortization	**(3.2)**	(8.5)
Income from discontinued operations prior to gains and taxes	**6.6**	9.4
Gains on sale of discontinued operations	**91.2**	15.9
Income taxes related to discontinued operations	**(17.8)**	(5.9)
Net income from discontinued operations	**$ 80.0**	$ 19.4
Net income from discontinued operations – per share	**$ 2.81**	$ 0.68

LIABILITIES AND SHAREHOLDERS' EQUITY

Our asset base of $2,235.7 million is financed with a combination of debt, preferred, and common equity. The components of our liabilities and shareholders' equity are as follows:

(Millions)	**2007**	2006
Liabilities		
Commercial and development property debt	**$ 965.5**	$ 887.2
Intangible liabilities	**85.0**	98.8
Accounts payable and other liabilities	**100.4**	67.6
Future income tax liabilities	**41.3**	10.2
Liabilities related to discontinued operations	**3.0**	95.8
Shareholders' equity		
Preferred shares	**381.7**	381.7
Common shares	**78.8**	78.9
Retained earnings	**580.0**	478.4
Total	**$ 2,235.7**	$ 2,098.6

COMMERCIAL AND DEVELOPMENT PROPERTY DEBT

Commercial and development property debt totaled $965.5 million at December 31, 2007, compared with $887.2 million at December 31, 2006. The increase is primarily attributed to the new financings obtained for the developments of Bay Adelaide Centre and Bankers Court, as well as a new credit facility arranged for the Royal Centre. The increase is offset by the repayment of debts related to Royal Centre in Vancouver upon their maturity in the first quarter of 2007 and the O&Y Acquisition Facility ("O&Y Debt") in the third quarter of 2007, and principal amortization during year.

In August 2007, the Company acquired 100% of the O&Y Debt through payment of $160.3 million to a subsidiary of Brookfield Asset Management Inc. ("BAM"), the ultimate parent of the Company. The O&Y Debt was associated with certain properties the Company acquired through its acquisition of a 25% joint venture interest in O&Y Properties Corporation and O&Y Real Estate Investment Trust in 2005. The Company was liable for $84.3 million or 52.6% of the O&Y Debt. As a result of this transaction, the Company had a loan receivable of $76.0 million (47.4% of the O&Y Debt) from one of the Company's joint venture partners, which represented the partner's initial share of the O&Y Debt owed to the subsidiary of BAM. During the fourth quarter of 2007, the Company collected $34.2 million of the balance owed, resulting in a $41.8 million outstanding balance at December 31, 2007 (compared with nil in 2006). The loan receivable bears interest of CDOR plus 1.10% to 1.45%.

During the third quarter of 2007, the Company completed a new, secured, nonrevolving credit facility totaling $420.0 million for the construction financing of the development of Bay Adelaide West Tower in Toronto. The facility, maturing July 2010 with two optional one-year extensions, is secured by the Bay Adelaide Centre project. The facility bears an annual interest rate of Bankers Acceptance plus 135 basis points. The Company currently has guaranteed up to $90.0 million of the facility; this guarantee reduces to $60.0 million upon meeting certain leasing thresholds. As of December 31, 2007, $105.7 million was drawn down on this facility.

During the fourth quarter of 2007, the Company completed a new, secured, bridge facility totaling $132.0 million for the Company's interest in Royal Centre in Vancouver. The facility matures in November 2008 and is secured by the Royal Centre property. The facility bears an annual interest rate of CDOR plus 150 basis points. As of December 31, 2007, $132.0 million was drawn down on this facility.

Commercial and development property debt at December 31, 2007, had an average interest rate of 6.9% and an average term to maturity of four years. All of our commercial property debts, which make up majority of the total commercial debt balance, are recourse only to specific properties, thereby reducing the overall financial risk to the Company.

The Company will continue to make efforts to match the maturity of our commercial property debt portfolio with the average lease term of our properties. The Company has debt on five of its properties maturing in 2008 in the amount of $384.3 million; this debt is expected to be refinanced in the normal course.

The details of commercial and development property debt at December 31, 2007, are as follows:

Commercial Property	Location	Interest Rate %	Maturity Date	Brookfield Properties' Consolidated Share (Millions)	Mortgage Details
105 Adelaide	Toronto	5.8	2008	$ 23.2	Nonrecourse - fixed rate
Petro-Canada Centre	Calgary	6.4	2008	122.7	Nonrecourse - fixed rate
22 Front St	Toronto	11.9	2008	6.4	Nonrecourse - fixed rate
Hudson's Bay Centre	Toronto	6.2	2008	100.0	Nonrecourse - variable rate
Royal Centre	Vancouver	6.5	2008	132.0	Nonrecourse - variable rate
First Canadian Place	Toronto	8.1	2009	62.5	Nonrecourse - fixed rate
Bankers Court	Calgary	6.1	2009	8.7	Recourse - variable rate
Place de Ville I	Ottawa	7.8	2009	6.5	Nonrecourse - fixed rate
Enbridge Tower	Edmonton	6.7	2009	2.4	Nonrecourse - fixed rate
Fifth Avenue Place	Calgary	7.6	2011	73.4	Nonrecourse - fixed rate
Queen's Quay Terminal	Toronto	7.3	2011	35.0	Nonrecourse - fixed rate
Bay Adelaide Centre	Toronto	5.9	2012	105.7	Recourse - variable rate
Exchange Tower	Toronto	6.8	2012	62.8	Nonrecourse - fixed rate
HSBC Building	Toronto	8.2	2012	23.4	Nonrecourse - fixed rate
151 Yonge Street	Toronto	6.0	2012	11.4	Nonrecourse - fixed rate
Bankers Hall	Calgary	7.2	2013	163.1	Nonrecourse - fixed rate
Bankers Hall	Calgary	6.7	2013	11.7	Nonrecourse - fixed rate
Jean Edmonds Tower	Ottawa	5.6	2014	1.6	Nonrecourse - fixed rate
Jean Edmonds Tower	Ottawa	6.8	2024	15.6	Nonrecourse - fixed rate
Premium on assumed mortgages	Various	—	—	6.2	
Continuing operations		6.9		$ 974.3	
Deferred financing costs [1]				(8.8)	
Total				$ 965.5	

[1] *Reclassed from other assets as a result of changes in accounting policy. Refer to Part IV of this MD&A for further details.*

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

(Millions)	Scheduled Amortization	Maturities	Total[1]	Weighted-Average Interest Rate at Dec. 31, 2007
2008	$ 16.5	$ 381.7	$ 398.2	6.4%
2009	14.4	73.8	88.2	8.0%
2010	10.2	—	10.2	—
2011	9.2	97.3	106.5	7.5%
2012	7.4	188.9	196.3	6.5%
2013 and thereafter	5.6	169.3	174.9	7.1%
Total	$ 63.3	$ 911.0	$ 974.3	6.9%

[1] *Excludes $8.8 million of deferred financing costs that have been classified from other assets to commercial and development property debt.*

CONTRACTUAL OBLIGATIONS

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

	Payments Due By Period			
(Millions)	Total	1 - 3 Years	4 - 5 Years	After 5 Years
Commercial property and development debt [1]	$ 974.3	$ 496.6	$ 302.9	$ 174.8
Interest expense[2] - Commercial and development property debt	169.2	110.1	36.9	22.2
Ground leases[3]	2,217.4	14.7	9.8	2,192.9
	$ 3,360.9	$ 621.4	$ 349.6	$ 2,389.9

(1) *Excludes deferred financing costs of $8.8 million.*

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

(3) *Represents minimum rental payments on land leases or other agreements largely expiring on or before the year 2099.*

CORPORATE GUARANTEES AND CONTINGENT OBLIGATIONS

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 15 to the consolidated financial statements.

INTANGIBLE LIABILITIES

Intangible liabilities are below-market tenant leases and above-market ground leases assumed on acquisitions, net of related accumulated amortization. Intangible liabilities decreased to $85.0 million at December 31, 2007, from $98.8 million at December 31, 2006, primarily due to amortization during the year ended December 31, 2007.

The composition of intangible liabilities is as follows:

(Millions)	**2007**	2006
Intangible liabilities		
Below-market in-place operating leases	**$ 68.3**	$ 67.9
Above-market ground lease obligations	**45.8**	45.8
	114.1	113.7
Less accumulated depreciation		
Below-market in-place operating leases	**(23.6)**	(11.9)
Above-market ground lease obligations	**(5.5)**	(3.0)
Total net	**$ 85.0**	$ 98.8

ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities totaled $100.4 million at December 31, 2007, compared with $67.6 million at December 31, 2006. The increase is primarily related to timing of accrued liabilities and an increase of accrued development costs.

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

(Millions)	**2007**	2006
Accounts payable and accrued liabilities	**$ 95.3**	$ 62.7
Accrued interest	**5.1**	4.9
Total	**$ 100.4**	$ 67.6

FUTURE INCOME TAXES

At December 31, 2007, we had a net future income tax liability of $41.3 million compared with $10.2 million at December 31, 2006, an increase of $31.1 million. The increase is primarily due to loss utilization as a result of income earned and gains realized on the sale of Atrium on Bay, 18 King Street, 2 and 40 St. Clair West in Toronto; 2200 and 2204 Walkley Road in Ottawa; and Gulf Canada Square in Calgary, offset by tax assets previously not recognized. The components of future income tax liabilities are as follows:

(Millions)	**2007**	2006
Future income tax assets related to operating and capital losses	**$ (16.6)**	$ (32.4)
Future income tax liabilities related to differences between tax and book basis	**57.9**	42.6
Total future income tax liabilities	**$ 41.3**	$ 10.2

At December 31, 2007, the Company had net operating loss carryforwards of $54.7 million (compared with $132.7 million on December 31, 2006), which are available to reduce taxable income in future years. The net operating loss carryforwards are scheduled to expire in the following years:

(Millions)		
2010	$	**10.5**
2011 - 2015		**34.6**
2016 & beyond		**9.6**
	$	**54.7**

The benefit of the tax losses, net of a valuation allowance, has been reflected in the future income tax assets. The amount of noncapital losses and deductible temporary differences, for which no future income tax assets have been recognized, is $158.1 million (compared with $153.4 million on December 31, 2006).

The components of income tax expense are as follows:

Continuing operations

(Millions)		**2007**		2006
Income tax expense at the Canadian federal and provincial income tax rate of 34% (2006 – 34%)	**$**	**29.6**	$	27.5
Increase (decrease) in income tax expense due to the following:				
Tax assets previously not recognized (net of de-recognition of tax assets)		**(4.7)**		—
Change in statutory tax rates		**2.9**		—
Other		**0.4**		—
Total	**$**	**28.2**	$	27.5

Discontinued operations

(Millions)		**2007**		2006
Income tax expense at the Canadian federal and provincial income tax rate of 34% (2006 – 34%)	**$**	**33.3**	$	8.6
Decrease in income tax expense due to the following:				
Nontaxable portion of capital gain		**(15.5)**		(2.7)
Total		**17.8**		5.9
Total income tax expense	**$**	**46.0**	$	33.4

The major components of income tax expense include the following:

(Millions)		**2007**		2006
Current tax expense	**$**	**12.0**	$	—
Future tax expense		**34.0**		33.4
Total	**$**	**46.0**	$	33.4

PREFERRED SHARES

At December 31, 2007, we had $381.7 million of preferred equity outstanding consistent with the balance at December 31, 2006. 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.

We have the following preferred shares outstanding:

(Millions, except share information)	Shares Outstanding	Cumulative Dividend Rate		2007		2006
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

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

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

During the year ended December 31, 2007, we paid preferred dividends of $18.2 million, compared with $16.0 million during the same period in 2006, due to an increase in interest rates on which the dividend rate is based.

COMMON EQUITY

As of December 31, 2007, 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, 2006.

The book value per common share at December 31, 2007, was $23.12 compared with $19.55 at December 31, 2006.

At December 31, 2007, the book value of our common equity was $658.8 million (versus $557.3 million on December 31, 2006), compared with a market equity capitalization of approximately $1,718.2 million (versus $1,994.5 million on December 31, 2006), calculated as total common shares outstanding multiplied by $60.30 per share, the closing price per common share on the Toronto Stock Exchange on December 31, 2007 (versus $69.92 per share on December 31, 2006).

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. Our principal liquidity needs for the next twelve months are to:

- fund recurring expenses;
- meet debt service requirements;
- make dividend payments;
- fund capital expenditures, including tenant improvements;
- fund current development costs not covered under construction loans;
- invest in the establishment of new funds;
- repurchase our stock; and
- possibly fund new property acquisitions

We believe that our liquidity needs will be satisfied using cash on hand, cash flows generated from operating activities and provided by financing activities, as well as proceeds from assets sales. Rental revenue, recoveries from tenants, interest and other income, available cash balances, draws on our corporate credit facilities and refinancings, including upward refinancings, of maturing indebtedness are our principal sources of capital used to pay operating expenses, dividend payments, debt service and recurring capital and leasing costs in our commercial property portfolio. We seek to increase income from our existing properties by maintaining quality standards for our properties that promote high occupancy rates and support increases in rental rates while reducing tenant turnover and controlling operating expenses. Another source of cash flow includes third-party fees generated by our asset management and leasing and development businesses. In addition, our tax status as a corporation and tax loss pools allow us to reinvest and retain cash generated by our operations without incurring significant cash taxes. Consequently, we believe our revenue along with proceeds from financing activities will continue to provide the necessary funds for our short-term liquidity needs. However, material changes in these factors may adversely affect our net cash flows.

Our principal liquidity needs for periods beyond the next twelve months are for development costs, potential property acquisitions, scheduled debt maturities and non-recurring capital expenditures. We plan to meet these needs with one or more of the following:

- construction loans;
- investment in new funds;
- income from operations;
- proceeds from sales of assets; and
- financings, including upward refinancings.

Our commercial and development property debt is primarily fixed-rate and nonrecourse to the Company. These investment-grade financings are typically structured on a loan-to-appraised-value basis of up to 70%. In addition, in certain circumstances where 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.

OPERATING RESULTS

Net Income

Our net income for the year ended December 31, 2007, was $138.8 million ($4.23 per common share) compared with $72.7 million ($1.99 per common share) during the same period in 2006.

The net increase is largely a result of the following:

- $8.8 million growth in net operating income, net of tax ($0.31 per share), mainly related to same-store growth and lease-termination income earned;
- $7.5 million decrease in interest expense, net of tax ($0.26 per share), related to the repayment of the O&Y Debt during the third quarter of 2007 and the repayment of Royal Centre debt upon maturity in the first quarter of 2007;
- $60.7 million increase in net income from discontinued operations, net of tax ($2.12 per share), primarily a result of the sale of Atrium on Bay, 2 and 40 St. Clair West, and 18 King Street in Toronto; 2200 and 2204 Walkley Road in Ottawa; and Gulf Canada Square in Calgary; offset by,
  - a $2.6 million transaction-cost write-off, net of tax ($0.09 per share), during the third quarter of 2007; and
  - a $5.9 million decrease in loans and investment income, net of tax ($0.21 per share), due to the repayment of loan receivables during 2007.

Revenue from commercial properties includes rental revenues earned from tenant leases, straight-line rent, percentage rent, and additional rent from the recovery of operating costs and property taxes. Revenue from commercial properties totaled $328.2 million during the year ended December 31, 2007, compared with $310.6 million during the same period in 2006.

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)		**2007**		2006		2005
Commercial properties						
Revenue	**$**	**328.2**	$	310.6	$	213.3
Expenses		**140.8**		136.5		99.3
Net operating income		**187.4**		174.1		114.0
Loans and investment income		**12.3**		21.3		34.6
		199.7		195.4		148.6
Expenses						
Interest		**30.0**		41.4		39.8
Administrative and large-corporation tax		**20.2**		16.9		8.8
Funds from operations[1]		**149.5**		137.1		100.0
Transaction costs		**4.0**		—		—
Depreciation and amortization		**58.5**		56.3		31.7
Income taxes		**28.2**		27.5		1.0
Net income from continuing operations		**58.8**		53.3		67.3
Discontinued operations[2]		**80.0**		19.4		0.9
Net income	**$**	**138.8**	$	72.7	$	68.2
Net income per common share						
Continuing operations	**$**	**1.42**	$	1.31	$	1.95
Property-disposition gains		**2.66**		0.46		—
Discontinued operations		**0.15**		0.22		0.03
	$	**4.23**	$	1.99	$	1.98
Funds from operations and gains per common share						
Continuing operations	**$**	**4.61**	$	4.25	$	3.09
Property-disposition gains		**3.20**		0.55		—
Discontinued operations		**0.34**		0.63		0.16
	$	**8.15**	$	5.43	$	3.25

[1] *Represents funds from continuing operations.*
[2] *Refer to page 14 for further details on discontinued operations.*

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 the Company, are required to charge their earnings with tax expense despite the presence of tax losses, which reduce the Company's cash tax obligation. This differs from the approach often used by entities that 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 common share and weighted-average common shares outstanding are calculated as follows:

(Millions, except per-share amounts)		**2007**		2006		2005
Net income	**$**	**138.8**	$	72.7	$	68.2
Preferred share dividends		**(18.2)**		(16.0)		(11.8)
Net income available to common shareholders	**$**	**120.6**	$	56.7	$	56.4
Weighted-average shares outstanding		**28.5**		28.5		28.5

RECONCILIATION OF NET INCOME TO FUNDS FROM OPERATIONS

(Millions, except per-share amounts)	2007	2006	2005
Net income	**$ 138.8**	$ 72.7	$ 68.2
Depreciation and amortization[1]	**61.7**	64.8	34.7
Income taxes[2]	**46.0**	33.4	1.5
Transaction costs	**4.0**	—	—
Funds from operations and gains	**250.5**	170.9	104.4
Property disposition gains	**(91.2)**	(15.9)	—
Funds from operations	**$ 159.3**	$ 155.0	$ 104.4

[1] *Includes depreciation and amortization from discontinued operations of $3.2 million, $8.5 million, and $3.0 million for the years ended December 31, 2007, 2006, and 2005, respectively.*

[2] *Includes income taxes from discontinued operations of $17.8 million, $5.9 million, and $0.5 million for the years ended December 31, 2007, 2006, and 2005, respectively.*

After providing for preferred-share dividends, our funds from operations per share, excluding property disposition gains, is calculated as follows:

(Millions, except per-share amounts)	2007	2006	2005
Funds from operations	**$ 159.3**	$ 155.0	$ 104.4
Preferred share dividends	**(18.2)**	(16.0)	(11.8)
	141.1	139.0	92.6
Weighted-average shares outstanding	**28.5**	28.5	28.5
Funds from operations per share	**$ 4.95**	$ 4.88	$ 3.25

Funds from operations increased 1.4% to $4.95 per share during the year 2007 compared with $4.88 per share in 2006. The increase is primarily related to an increase in operating income from same-store growth and a decrease in interest expenses, offset by a decrease in loans and investment income.

REVENUE

The components of revenue are as follows:

(Millions)	2007	2006	2005
Revenue from continuing operations	**$ 315.6**	$ 298.6	$ 211.9
Fee income	**12.6**	12.0	1.4
Revenue from discontinued operations	**18.2**	42.4	18.7
Total commercial property revenue	**346.4**	353.0	232.0
Loans and investment income	**12.3**	21.3	34.6
Total	**$ 358.7**	$ 374.3	$ 266.6

COMMERCIAL PROPERTY OPERATIONS

Commercial property net operating income totaled $187.4 million in 2007 compared with $174.1 million in 2006. The components of commercial property net operating income from continuing operations are as follows:

(Millions)	2007	2006	2005
Revenue from continuing operations and fee income	**$ 328.2**	$ 310.6	$ 213.3
Operating expenses	**140.8**	136.5	99.3
Total	**$ 187.4**	$ 174.1	$ 114.0

(Millions)	2007	2006	2005
Net operating income – same property	**$ 169.8**	$ 117.9	$ 106.3
Net operating income – properties acquired	**12.0**	52.2	6.1
Nonrecurring fees and other income	**5.6**	4.0	1.6
Total	**$ 187.4**	$ 174.1	$ 114.0

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

(Millions)		**2007**		2006		2005
Revenue from discontinued operations	**$**	**18.2**	$	42.4	$	18.7
Property operating expenses		**(6.2)**		(18.3)		(10.9)
Net operating income from discontinued operations	**$**	**12.0**	$	24.1	$	7.8

Revenue from commercial properties includes rental revenues earned from tenant leases, straight-line rent, percentage rent, and additional rent from the recovery of operating costs and property taxes. Revenue from commercial properties totaled $328.2 million during 2007, compared with $310.6 million during 2006.

Our leases generally have clauses that 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 tenants in our portfolio lowers the risk of not realizing these increases. GAAP requires that these increases be recorded on a straight-line basis over the life of the lease. For the year ended December 31, 2007, we recognized $2.9 million straight-line rental revenue, compared with $3.6 million in 2006.

Commercial property operating costs, which include real estate taxes, utilities, insurance, repairs and maintenance, cleaning, and other property-related expenses, were $140.8 million in 2007, as compared with $136.5 million in 2006. The increase was the result of a 10% increase in utility costs generally due to increased gas and electricity costs.

Substantially all of our leases are net leases in which the lessee is required to pay its proportionate share of the property's operating expenses, such as utilities, repairs, insurance, and taxes. Consequently, leasing activity is the principal contributor to the change in same-property net operating income. At December 31, 2007, average in-place net rent throughout the portfolio was $21 per square foot, compared with $19 per square foot at December 30, 2006.

The following table shows the average in-place rents and estimated current market rents for similar space in each of our markets as of December 31, 2007:

	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	7,054	7	$	23	$	27
Ottawa, Ontario	2,780	6		17		19
Calgary, Alberta	6,704	6		23		35
Edmonton, Alberta	710	7		10		21
Vancouver, B.C.	853	11		15		27
Other	212	6		8		9
Total[1]	18,313	7	$	21	$	28

[1] *Excludes developments.*

Our total portfolio occupancy rate increased by 120 basis points to 98.4% at December 31, 2007, compared with 97.2% at December 31, 2006, primarily due to the continuing lease-ups in Toronto, Ottawa, Edmonton, Calgary, and Vancouver.

A summary of current and historical occupancy levels for the past two years is as follows:

	December 31, 2007		December 31, 2006	
	Total Sq. Ft.	**% Leased**	Total Sq. Ft.	% Leased
Toronto, Ontario	**7,054**	**97.5**	8,994	94.8
Ottawa, Ontario	**2,780**	**99.4**	2,939	99.2
Calgary, Alberta	**6,704**	**99.8**	7,845	99.8
Edmonton, Alberta	**710**	**99.1**	710	98.4
Vancouver, B.C.	**853**	**97.4**	853	95.4
Other	**212**	**68.6**	212	85.2
Total[1]	**18,313**	**98.4**	21,553	97.2

[1] *Excludes developments.*

During 2007, we leased 2.6 million square feet of space, approximately four times the amount of space contractually expiring in the year. This included 1.8 million square feet of new leases and 0.4 million square feet of renewals compared with expiries of 0.7 million square feet and accelerated expiries of 1.4 million square feet. The average leasing net rent is $28, an increase of 27% over the average expiring net rent of $22.

The details of our leasing activity for 2007 are as follows:

	Dec. 31, 2006		Activities During the Year Ended December 31, 2007						Dec. 31, 2007	
(Thousands of sq. ft.)	GLA[1]	Leased	Expiries	Average Expiring Net Rent	Leasing	Year One[2][4] Leasing Net Rent	Average[3][4] Leasing Net Rent	Acq. (Disp.)	GLA[1]	Leased
Toronto, Ontario	8,994	8,584	(698)	$ 20	781	$ 22	$ 22	(1,940)	7,054	6,901
Ottawa, Ontario	2,939	2,924	(139)	14	143	20	20	(159)	2,780	2,769
Calgary, Alberta	7,845	7,830	(1070)	25	1,071	34	34	(1,141)	6,704	6,690
Edmonton, Alberta	710	701	(69)	15	73	24	25	—	710	705
Vancouver, B.C.	853	826	(63)	20	75	27	27	—	853	838
Other	212	189	(71)	10	46	10	10	—	212	164
Total[1]	21,553	21,054	(2,110)	$ 22	2,189	$ 28	$ 28	(3,240)	18,313	18,067
Development Pre-Leasing					414					
Total Leasing					2,603					

(1) Excludes developments.

(2) Represents net rent in the first year.

(3) Represents average net rent over lease term.

(4) Excludes noncore properties sold.

INTEREST AND OTHER INCOME

Loans and investment income totaled $12.3 million in 2007, compared with $21.3 million 2006. The decrease primarily relates to the repayment of the Atrium on Bay loan receivable upon disposition in the first quarter of 2007, repayment of the Exchange Tower loan receivable in the fourth quarter of 2007, a gain on the sale of a small noncore investment in 2006, and the yield-maintenance payment received in 2006 from the borrower of a mezzanine debt that we own. This note was paid down by US$6.0 million in the first quarter of 2006.

INTEREST EXPENSE

Interest expense was $30.0 million in 2007, compared with $41.4 million in 2006. The decrease relates to the repayment of the Royal Centre debt in Vancouver during the first quarter of 2007, the repayment of the O&Y Debt during the third quarter of 2007, the repayment of the Queen's Quay Terminal debt in Toronto during the fourth quarter of 2007, and an increase in interest capitalized for our development sites.

ADMINISTRATIVE AND LARGE-CORPORATION TAX EXPENSES

Administrative and large corporation tax expenses totaled $20.2 million in 2007, compared with $16.9 million in 2006. The increase is primarily due to a nonrecurring litigation settlement and related legal fees in the first quarter of 2007. Administrative expenses include $11.4 million (compared with $11.1 million in 2006), net of recoveries, paid pursuant to management contracts with Brookfield Properties Ltd. under which services and facilities are provided to the Company (refer to page 35).

DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation and amortization expense includes amortization of the value of buildings over their useful lives and the accelerated amortization of lease-origination and tenant-relationship costs over the average life of the lease portfolio. Depreciation and amortization expense for 2007 was $58.5 million compared with $56.3 million 2006.

QUARTERLY RESULTS

The 2007 and 2006 results by quarter are as follows:

	2007				2006			
(Millions, except per-share amounts)	**Q4**	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total Revenue	**$ 90.6**	$ 86.9	$ 90.2	$ 91.0	$ 98.6	96.2	$ 88.8	$ 90.8
Net operating income								
Operating income from commercial properties	**47.6**	46.0	48.8	45.0	47.8	45.4	40.7	40.2
Interest and other	**5.1**	2.3	2.0	2.9	4.2	6.3	3.2	7.6
	52.7	48.3	50.8	47.9	52.0	51.7	43.9	47.8
Expenses								
Interest	**6.1**	8.2	7.4	8.3	10.0	10.5	10.4	10.5
Administrative and large corporation tax	**4.8**	4.5	5.1	5.8	4.0	4.1	5.1	3.7
Transaction costs	—	4.0	—	—	—	—	—	—
	41.8	31.6	38.3	33.8	38.0	37.1	28.4	33.6
Depreciation and amortization	**15.6**	13.6	14.4	14.9	14.8	14.9	13.7	12.9
Income taxes	**5.7**	7.9	8.1	6.5	7.9	7.5	5.0	7.1
Net income from continuing operations	**20.5**	10.1	15.8	12.4	15.3	14.7	9.7	13.6
Discontinued operations	**22.5**	5.3	5.3	46.9	2.0	1.6	14.9	0.9
Net income	**$ 43.0**	$ 15.4	21.1	$ 59.3	$ 17.3	$ 16.3	$ 24.6	$ 14.5
Net income per common share								
Continuing operations	**$ 0.55**	$ 0.19	$ 0.40	$ 0.27	$ 0.39	$ 0.36	$ 0.21	$ 0.35
Discontinued operations	**0.79**	0.19	0.19	1.65	0.07	0.06	0.52	0.03
	$ 1.34	$ 0.38	0.59	$ 1.92	$ 0.46	$ 0.42	**$** 0.73	**$** 0.38
Funds from operations per common share								
Continuing operations	**$ 1.30**	$ 1.09	$ 1.19	$ 1.03	$ 1.18	$ 1.15	$ 0.85	$ 1.06
Discontinued operations	**0.05**	0.06	0.11	0.12	0.16	0.15	0.18	0.15
Property disposition gains	**0.92**	0.20	0.17	1.91	—	—	0.55	—
	$ 2.27	$ 1.35	$ 1.47	$ 3.06	$ 1.34	$ 1.30	$ 1.58	$ 1.21

Operating income from current properties has increased since 2006 due to higher occupancy rates and the disposition of noncore properties in our portfolio. The second quarter of 2007 included $2.8 million of nonrecurring fees earned on the termination of a Toronto lease.

Interest expense decreased in fourth quarter of 2007 as a result of the repayment of the Royal Centre debt in Vancouver during first quarter of 2007, the O&Y Debt during the third quarter of 2007, and the Queen's Quay Terminal debt in Toronto during the fourth quarter of 2007. General and administrative expenses in the first quarter of 2007 included a nonrecurring litigation settlement.

Net income increased during the fourth quarter of 2007 primarily due to gain on sale of Gulf Canada Square in Calgary, a reduction of interest expenses, and an increase in investment income.

PART III – RISKS AND UNCERTAINTIES

BPO Properties' financial results are affected by the performance of our operations and various external factors influencing the specific sectors and geographic locations in which we operate, as well as macroeconomic factors such as economic growth, inflation, and interest rates; regulatory requirements and initiatives; and litigation and claims that arise in the normal course of business.

Our strategy is to invest in premier assets that generate sustainable streams of cash flow. Although high-quality assets may initially generate lower returns on capital, we believe that the sustainability and future growth of their cash flows is more assured over the long term, and as a result, warrant higher valuation levels. We also believe that the high quality of our asset base protects the Company against future uncertainty and enables us to invest with confidence when opportunities arise.

The following is a review of the material factors and the potential impact these factors may have on the Company's business operations. A more detailed description of the business environment and risks is contained in our Annual Information Form which is posted on our Web site.

PROPERTY-RELATED RISKS

Our strategy is to invest in high-quality core office properties as defined by the physical characteristic of the asset and, more importantly, the certainty of receiving rental payments from large corporate tenants (with investment-grade credit ratings – see "Credit Risk" below) that these properties attract. Nonetheless, we remain exposed to certain risks inherent in the core office-property business.

Commercial property 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 costs 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 other landlords with competitive space, and our ability 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 a property is producing sufficient income to service these expenses. Our core office properties are subject to mortgages that require substantial debt service payments. If we become 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 of sale. We believe the stability and long-term nature of our contractual revenues effectively mitigates these risks.

As owners and managers of premier office properties, lease rollovers also present a risk factor, as 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. Refer to "Lease Rollover Risk" on page 30 of this MD&A for further details.

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 20 of this MD&A, we have an ongoing obligation 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 is to stagger the maturities of our mortgage portfolio attempts to mitigate our exposure to excessive amounts of debt maturing in any one year.

Approximately 36% of the Company's outstanding commercial and development property debt at December 31, 2007 is floating rate debt (December 31, 2006 – 20%). The effect of a 25 basis point increase in interest rates on interest expense relating to our floating rate debt, all else being equal, is an increase in interest expense of $0.9 million or approximately $0.03 per share, consistent with the prior year. The analysis does not reflect the impact a changing interest rate environment could have on our overall performance, and as a result, it does not reflect the actions management may take in such an environment.

CREDIT RISK

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 any one business sector is lessened. Currently, no one tenant represents more than 13% of total leasable area.

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

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)
Government of Canada	Toronto, Ottawa, Edmonton	2013	1,875	12.5	AAA
Bank of Montreal/Nesbitt Burns	Toronto, Ottawa, Calgary	2018	1,137	7.6	A+
Petro-Canada	Calgary	2013	897	6.0	BBB
Imperial Oil	Calgary	2011	633	4.2	AAA
Talisman Energy	Calgary	2015	527	3.5	BBB+
RBC Financial Group	Toronto, Calgary, Edmonton, Vancouver	2023	443	3.0	AA-
Enbridge Inc.	Calgary, Edmonton	2015	396	2.6	A-
Canadian Natural Resources	Calgary	2011	325	2.2	BBB
CIBC	Toronto, Calgary	2034	281	1.9	A+
EnCana Corporation	Calgary	2014	241	1.6	A-
Manufacturers Life Insurance	Toronto	2013	169	1.1	AAA
Amdocs Canada Inc	Toronto	2012	149	1.0	BBB-
Lombard Insurance	Toronto	2012	134	0.9	BBB+
Westcoast Energy	Calgary, Vancouver	2012	132	0.9	BBB+
HSBC Of Canada	Toronto	2011	103	0.7	AA
National Bank of Canada	Toronto	2013	96	0.6	A
State Street Trust Company	Toronto	2008	92	0.6	AA-
Xstrata (Falconbrigde)	Toronto	2017	81	0.5	BBB+
Other investment-grade	Various	Various	425	2.8	BBB- or higher
			8,136	54.2	
Government Agencies and Other					
Osler, Hoskin & Harcourt	Toronto	2015	270	1.8	
Bennett Jones	Toronto, Calgary	2010	257	1.7	
Fraser Milner	Calgary	2010	222	1.5	
Bell Canada	Calary, Toronto	2011	216	1.4	
The Hudson's Bay Company	Toronto	2009	209	1.4	
CI Investments Inc.	Toronto	2012	195	1.3	
Toronto Stock Exchange	Toronto	2018	179	1.2	
Gowlings Canada Inc.	Toronto	2020	170	1.1	
Davies Ward Philips Vineberg	Toronto	2013	119	0.8	
Precision Drilling Corp.	Calgary	2011	93	0.6	
Other government agencies	Various	Various	189	1.3	
Total			10,255	68.4	

(1) *Weighted average based on square feet.*
(2) *Prior to considering partnership interests in partially owned properties.*
(3) *From Standard & Poor's, Moody's, or Dominion Bond Rating Service.*

Because 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.

LEASE ROLLOVER RISK

Lease rollover risk arises from the possibility that we may experience difficulty renewing leases as they expire or in re-leasing 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; approximately 7.8% of our leases mature annually over the next five years. Our portfolio has a weighted-average lease life of seven years. 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.

The following table sets out lease expiries, by square footage, for our portfolio at December 31, 2007:

(000's Sq. Ft.)	Currently Available	2008	2009	2010	2011	2012	2013	2014	2015 & Beyond	Parking	Total
Toronto	153	334	502	489	286	802	1,205	110	2,344	829	7,054
Ottawa	11	91	36	2	—	6	1,055	9	540	1,030	2,780
Calgary	14	127	304	421	1,383	497	1,337	98	1,500	1,023	6,704
Edmonton	5	9	38	125	71	30	7	17	287	121	710
Vancouver	15	11	23	43	73	61	80	5	278	264	853
Other	48	1	4	34	6	11	1	—	47	60	212
Total	246	573	907	1,114	1,819	1,407	3,685	239	4,996	3,327	18,313
% of total	1.6%	3.8%	6.1%	7.4%	12.1%	9.4%	24.6%	1.6%	33.4%	—	100.0%

ENVIRONMENTAL RISKS

As an owner of real property, we are subject to various federal, provincial, state, 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 noncompliance 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 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.

Although the outlook for commercial office rents is positive in the long term, 2008 may not provide the same level of increases in rental rates on renewal as compared with 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.

The Company has insurance covering certain acts of terrorism for up to US$700 million of damage and resulting 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 the Company's properties.

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 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 nonhedging derivative contracts is governed by documented risk-management policies and approved limits.

At December 31, 2007, our use of derivative financial instruments was limited to foreign-exchange contracts and forward gas 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 and are reflected in receivables and other assets or accounts payable and other liabilities, as appropriate, on the balance sheet.

At December 31, 2007, we had foreign-exchange contracts to sell a notional amount of US$21.0 million (compared with US$21 million on December 31, 2006) at an exchange rate of US$1.00 = C$1.01, maturing in March 2008, which have not been designated as hedges for financial reporting purposes. The aggregate fair value of these contracts at December 31, 2007, was nil.

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 cash flows attributable to, the hedged item and the hedging item.

PART IV – CRITICAL ACCOUNTING POLICIES AND ESTIMATES

CHANGES IN ACCOUNTING POLICIES

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”), or Emerging Issues Committee Abstracts (“EIC”).

Variability in Variable Interest Entities (“VIE”)

On September 15, 2006, the Emerging Issues Committee of the CICA, issued Abstract No. 163, "Determining the Variability to be Considered in Applying Acg-15" (EIC 163). EIC 163 provides additional clarification on how to analyze and consolidate VIEs. EIC 163 became effective for the Company on April 1, 2007; however, the impact was not material to our consolidated financial position or results of operations.

Accounting Changes

Effective January 1, 2007, the Company adopted CICA Handbook Section 1506, “Accounting Changes”. The new standard sets out the conditions that must be met for a change in accounting policy to be applied in accordance with GAAP, specifies how such changes should be applied and requires disclosure of the impact of changes in accounting policies. The standard also specifies that changes in accounting estimate be recognized prospectively in net income and requires disclosure of the impact of a change in estimate on the current and future periods. The adoption of this standard did not impact the Company’s consolidated financial statements.

Financial Instruments

On January 1, 2007, the Company adopted five new accounting standards that were issued by the CICA, as described below, together with consequential amendments to related standards. The Company adopted these standards retrospectively without restatement; accordingly, comparative amounts for prior periods have not been restated.

(i) Comprehensive Income, CICA Handbook Section 1530

CICA Handbook Section 1530 requires presentation of comprehensive income, which consists of net income and other comprehensive income (“OCI”). Major components of other comprehensive income could include unrealized gains and losses on financial assets classified as available-for-sale and changes in fair value of the effective portion of cash flow hedging instruments. As a result of adopting this standard, a Consolidated Statement of Comprehensive Income has been included in the Company’s consolidated financial statements and a continuity of Accumulated Other Comprehensive Income (“AOCI”) has been included in the consolidated statement of changes in shareholders’ equity.

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

CICA Handbook Section 3855 establishes standards for recognizing and measuring financial assets and financial liabilities including financial and nonfinancial derivatives. This standard requires all financial assets and financial liabilities to be measured at fair value on initial recognition in the consolidated balance sheet. Measurement in subsequent periods depends on whether the financial instrument has been classified as trading, available-for-sale, held-to-maturity, loans and receivables, or other financial liabilities.

Financial assets and financial liabilities classified as trading are measured at fair value with changes in those fair values recognized in interest and other income. Financial assets held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost, net of associated transaction costs, using the effective-interest method. Available-for-sale financial assets are presented as receivables and other on the Company’s consolidated balance sheet and measured at fair value with changes there in, together with foreign-currency translation gains and losses, recognized in OCI.

Derivative instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial or nonfinancial contracts that are not closely related to the host contract. Changes in the fair value of derivative instruments are recognized in net income with the exception of derivatives designated in effective cash flow hedge relationships. The Company performed a search for embedded derivatives within its contracts going back to January 1, 2001.

(iii) Hedges, CICA Handbook Section 3865

CICA Handbook Section 3865 specifies the criteria that must be satisfied in order to apply hedge accounting and the accounting for each of the permitted hedging strategies. For the Company’s accounting policy on hedge accounting, refer to note 1(k) of these consolidated financial statements.

(iv) Financial Instruments – Presentation and Disclosure, CICA Handbook Section 3861

CICA Handbook Section 3861 sets out presentation and disclosure requirements for financial instruments. The standard replaces CICA Handbook Section 3860, "Financial Instruments – Disclosure and Presentation." Section 3861 carries forward the presentation and disclosure requirements of Section 3860 and includes some incremental disclosure requirements relating to the new financial instruments standards.

(v) Equity, CICA Handbook Section 3251

CICA Handbook Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements of this section are in addition to those noted in Section 1530. This standard requires the disclosure of both the changes in equity during the periods presented and the components of equity as the end of the periods presented. As a result of adopting this standard, AOCI has been presented as a separate component of shareholders' equity.

Impact of adopting sections 1530, 3855, and 3865

The Company has recorded the following transition adjustments in the consolidated financial statements: (i) an increase of $0.2 million, net of taxes, to our opening retained earnings, representing changes made to the carrying value of certain financial instruments in compliance with the measurement basis under the new standards; and (ii) reclassification of deferred financing costs of $3.6 million from other assets to commercial and development property debt.

Accounting Policy Choice for Transaction Costs

On June 1, 2007, the Emerging Issues Committee of the CICA issued Abstract No. 166, "Accounting Policy Choice for Transaction Costs" "EIC-166". This EIC addresses the accounting policy choice of expensing or adding transaction costs related to the acquisition of financial assets and financial liabilities that are classified as other than held-for-trading. Specifically, it requires that the same accounting policy choice be applied to all similar financial instruments classified as other than held-for-trading, but permits a different policy choice for financial instruments that are not similar. EIC-166 was effective on September 30, 2007, and requires retroactive application to all transaction costs accounted for in accordance with CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement." The impact of adopting this guidance was not material to the Company's consolidated financial position and results of operations. The Company includes transaction costs associated with the origination of interest bearing financial assets and liabilities as a component of the initial carrying amount of the instrument.

FUTURE ACCOUNTING POLICY CHANGES

Capital Disclosures

On December 1, 2006, the CICA issued Handbook Section 1535, "Capital Disclosures." Section 1535 requires the disclosure of (i) an entity's objectives, policies, and process for managing capital; (ii) quantitative data about an entity's managed capital; (iii) whether an entity has complied with capital requirements; and (iv) if an entity has not complied with such capital requirements, the consequences of such noncompliance. Section 1535 will be effective for the Company's first quarter of 2008.

Financial Instruments – Disclosures and Presentation

On December 1, 2006, the CICA issued two new accounting standards: Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation. These standards replace Section 3861, Financial Instruments – Disclosure and Presentation and require additional disclosure of the nature and extent of risks arising from financial instruments and how the entity manages those risks. Sections 3862 and 3863 will be effective for the Company's first quarter of 2008.

Goodwill and Intangible Assets

In February 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal years beginning January 1, 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

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 cash flows and probabilities in assessing net recoverable amounts and net realizable values, the allocation of the purchase prices to components of commercial properties and businesses acquired, the useful lives for depreciation and amortization, the Company's ability to utilize tax losses and the rates at which those losses will be realized, the effectiveness of hedges, and fair value of financial instruments for disclosure purposes.

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, 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 cash flow projections that utilize appropriate discount rates, as well as available market information. Estimates of future cash flows 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 intangible value with regard to the customer relationship, 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 values, using a discount rate that 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 affect 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 cash flows 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 cash flows 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, 2007, or December 31, 2006.

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 geography-specific credit considerations.

Recoveries from tenants, consisting of amounts due from tenants 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 commercial and development property debt 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 similar 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 $1.0 million (compared with nil in 2006) of tax-valuation allowances following the completion of certain reviews by taxation authorities, and de-recognized $8.2 million (compared with nil in 2006) in previously recognized tax assets in connection with a strategic tax review undertaken by the Company and determination of the necessary plans to realize such assets. Both these changes are reflected in our income tax provision.

RELATED-PARTY TRANSACTIONS

In the normal course of operations, the Company enters into various transactions on market terms with related parties. These transactions have been measured at exchange value and are recognized in the consolidated financial statements.

The Company has entered into two service-support agreements with Brookfield Properties Ltd. (“BPL”), a subsidiary of BPC (one agreement dated October 21, 2005, relating to the former O&Y properties and the other dated January 1, 2006, in relation to the other properties owned by the Company as of such date). The purpose of the agreements is to provide the services of certain personnel and consultants as well as such facilities of BPL as are necessary to help the Company provide the services and facilities required of it pursuant to property-management services to which it is a party. The fees paid to BPL are on a cost-recovery basis and totaled $11.4 million during 2007 (compared with $11.1 million in 2006). The service-support agreements also permit the Company to charge costs and expenses payable by the Company, which are attributable to BPL on a cost-recovery basis. Total costs charged to BPL during the year totaled $0.6 million (compared with $0.4 million in 2006).

Prior to the repayment of the O&Y Debt, the Company had commercial and development property debt of $84.3 million outstanding to a subsidiary of BAM (compared with $84.3 million on December 31, 2006). The balance has been repaid by the end of the current year. Interest expense related to this commercial and development property debt totaled $2.8 million for the current year (compared with $4.3 million in 2006).

During the year, the Company had a loan payable outstanding to BPC, which has been repaid as of December 31, 2007. Interest expense related to this loan of $0.4 million (compared with nil in 2006) was recorded during the year.

Included in loans receivable is $220.3 million (compared with nil in 2006) demand loan receivable issued to BPC on December 24, 2007. Interest income related to this loan of $0.2 million (compared with nil in 2006) was recorded during 2007.

Included in rental revenues during the year are amounts received from BAM and its affiliates of $0.4 million (compared with $2.1 million in 2006). In addition, we have certain arrangements with BAM and its affiliates to acquire insurance in the normal course and at market rates or at cost. The expense for the year ended December 31, 2007 was $0.1 million.

All related party transactions have been recorded at exchange amounts.

PART V – BUSINESS ENVIRONMENT AND OUTLOOK

COMMERCIAL OPERATIONS

The office property markets where we are invested have stabilized and are exhibiting strong fundamentals. Absorption rates have become positive in most markets, with the most significant improvements having taken place in Calgary.

The lack of development, especially in central business districts, has created some stability. Office vacancy rates are generally expected to continue to decline gradually over the near term, with the pace of absorption accelerating during 2008. As a result, rental rates are expected to continue to move upward in 2008, with leasing costs and landlord incentives expected to decline. However, any significant slowdown in the economy could have a dampening effect on office market conditions.

The investment market continues to remain highly 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, 2007, 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.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The design of internal controls over financial reporting was evaluated in accordance with the COSO control framework and Multilateral Instrument 52-109. Based on the results of this evaluation, Management concluded that the internal controls over financial reporting are designed to provide reasonable assurance that its financial reporting is reliable and that the consolidated financial statements were prepared in accordance with GAAP.

Management took appropriate steps that enabled it to conclude that during the fiscal year ended December 31, 2007, no changes were made to internal controls over financial reporting that would have materially affected or would be reasonably considered to materially affect these controls.

OUTLOOK

We are optimistic as we look to 2008. The leasing markets in which we operate are continuing to improve and the general economic environment has strengthened, although there are some conditions that warrant continued caution. Further, markets continue to remain very sound in Alberta, giving us expectations of another successful year from these operations. With a solid growth platform consisting of a strong balance sheet, over five million square feet of development opportunities, and significant financial flexibility, BPO Properties is well-positioned to continue to deliver on its commitments to shareholders.

Bryan Davis

Senior Vice President and Chief Financial Officer
March 7, 2008

DISTRIBUTIONS

Distributions paid by the Company during the year ended December 31, 2007, and the past three fiscal years are as follows:

	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004
Common shares[1]	**$ 0.60**	$ 0.60	$ 0.60	$ 0.60
Preferred shares				
Series G	**1.05**	0.92	0.73	0.73
Series J	**1.06**	0.95	0.74	0.71
Series K	**24,662.88**	22,194.65	15,646.94	13,490.21
Series M	**1.06**	0.95	0.74	0.71
Series N	**1.23**	1.11	0.78	0.67

(1) Excludes the special common share dividend of $15.00 per share in 2004.