**BPO PROPERTIES LTD.**
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www.**bpoproperties**.com

# BPO PROPERTIES

2009 Annual Report

## BPO Properties Corporate Information

### HEAD OFFICE

181 Bay Street, Suite 330
Toronto, Ontario M5J 2T3
Tel: 416.359.8555
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### TRANSFER AGENT

CIBC Mellon Trust Company
P.O. Box 7010
Adelaide Street Postal Station
Toronto, Ontario M5C 2W9
Tel: 416.643.5500 / 800.387.0825
Fax: 416.643.5501
Web site: www.cibcmellon.com
E-mail: inquiries@cibcmellon.com

### STOCK EXCHANGE LISTING

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

### SHAREHOLDER INFORMATION

BPO Properties welcomes inquiries from shareholders, analysts, media representatives and other interested parties. Questions relating to investor relations or media inquiries can be directed to Melissa Coley, Vice President, Investor Relations at 416.359.8593 or via e-mail at melissa.coley@brookfield.com. Inquiries regarding financial results should be directed to Bryan Davis, Senior Vice President and Chief Financial Officer at 416.359.8612 or via e-mail at bryan.davis@brookfield.com.

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

## DEAR SHAREHOLDERS:

It is my pleasure to report that 2009 was another strong year for BPO Properties. Although we — along with our industry peers, tenants and business partners — were challenged by a difficult economy in 2009, our performance did not suffer, and we made significant accomplishments in line with our objectives. We generated net operating income from commercial properties of $202.6 million, a 4% increase over 2008. Our office portfolio finished the year at 98.6% leased, well above the Canadian national average of 91.5%.

As we move into 2010, we are hopeful that the economy is back on the upswing. The fourth quarter of 2009 brought signs of optimism for our industry. Many of our largest tenants — especially our financial services tenants in Toronto — have begun hiring again, which is an encouraging sign for our business.

In last year's letter to shareholders we outlined our primary objectives for the year. I am proud to announce that we have made meaningful strides and reached several notable milestones during 2009:

Our major priorities for the year included:

- Generating capital through refinancings;
- Leasing up and completing our two active development projects and positioning our pipeline sites for future development;
- Aggressively pursuing new leases and renewals in advance of maturities in order to limit our vacancy exposure in a lethargic tenant market; and
- Proactively managing our assets to make them more valuable and sustainable over the long term.

The following are some of our accomplishments.

## FINANCIAL HIGHLIGHTS

All amounts expressed in Canadian dollars unless otherwise noted

| (Millions, except per share information) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Results of Operations** | | | |
| Net income | $ 61.5 | $ 65.3 | $ 138.8 |
| Commercial property net operating income[1] | 202.6 | 195.2 | 187.4 |
| Funds from operations[2] | 117.7 | 153.7 | 159.3 |
| **Per Common Share[3]** | | | |
| Net income | $ 0.66 | $ 0.60 | $ 1.41 |
| Funds from operations[2] | 1.32 | 1.64 | 1.65 |
| Dividends paid | 0.30 | 0.20 | 0.20 |
| Book value | 4.33 | 5.63 | 7.71 |
| Closing market price — TSX | 19.55 | 8.00 | 20.10 |
| **Financial Position** | | | |
| Total assets | $ 2,406.2 | $ 2,351.8 | $ 2,235.7 |
| Shareholders' equity | 749.9 | 860.4 | 1,040.5 |

[1] Excludes net operating income from discontinued operations
[2] Excludes gains
[3] Reflects a three-for-one common stock split

## CAPITAL GENERATION

Among our most significant achievements of the year were the refinancings of Suncor Energy Centre (formerly Petro-Canada Centre) in Calgary for $370 million and First Canadian Place in Toronto for $310 million (both on a 100% basis), which generated net proceeds of $90 million to BPO Properties based on our ownership interest. The ability to execute these large-scale refinancing deals in the challenging credit environment we experienced in 2009 underscores the market's high regard for premier assets like Suncor Energy Centre and First Canadian Place.

We also completed the refinancing of Enbridge Tower in Edmonton for $25 million on a 100% basis.

## LEASING

We leased 1.3 million square feet of office space during the year, maintaining an occupancy rate of 98.6% in our portfolio, virtually unchanged from last year. More importantly, we have just 5% of our leases expiring in 2010, and our three-year expiry profile stands at a manageable 19%.

Our leasing teams secured many new large leases and renewals during the year, including a 10-year renewal with The Bay for 209,000 square feet at Hudson's Bay Centre in Toronto; a new five-year lease with Bennett Jones for 161,000 square feet at Bankers Hall in Calgary; a seven-year lease renewal and expansion with CI Investments for 74,000 square feet at 2 Queen St. East in Toronto; and a five-year lease renewal with CGI Information Systems for 57,000 square feet at Canadian Western Bank Place in Edmonton.

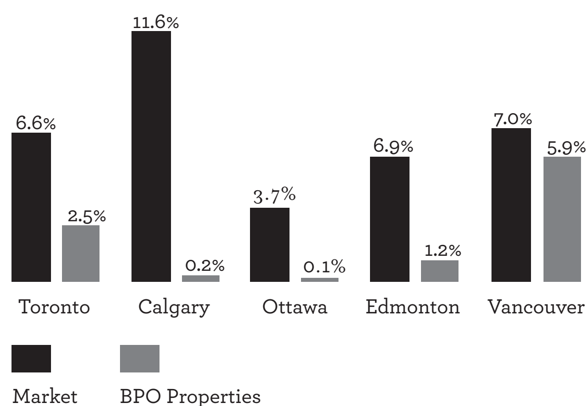
## DEVELOPMENT & SUSTAINABILITY

By September, we had completed and opened for business our final two active development projects, Bay Adelaide Centre in Toronto and Bankers Court in Calgary, both of which were completed on schedule and on budget, and at high pre-leasing levels. Consistent with the company's commitment to sustainability and environmental friendliness, both buildings were built to a LEED Gold standard.

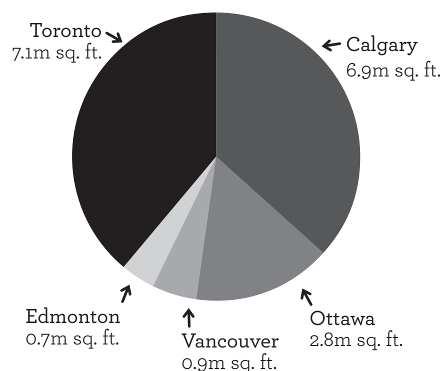
In September, we announced along with our ownership partners a project to renovate and reclad First Canadian Place — Canada's tallest office tower — to make the building more sustainable. Each of the building's original 45,000 pieces of white marble will be removed, recycled and replaced by more efficient and durable glass spandrel panels. The lobby, ground-level retail and public areas are also being upgraded and modernized. First Canadian Place is being redeveloped to achieve LEED certification upon its completion in 2011.

In addition to these LEED certification efforts, BOMA's BESt (Building Environmental Standards) certification was achieved at all of our existing office assets.

## BPO PROPERTIES VS. MARKET VACANCY




## MARKETS BY SQUARE FEET




### STOCK SPLIT & DIVIDEND INCREASE

In November, the Board of Directors approved a three-for-one stock split in the form of a stock dividend. As a result of the split, our shareholders received two additional BPP common shares for each common share held.

We executed the stock split to ensure our shares remain accessible to individual shareholders, and to further enhance the liquidity of the company's shares.

Taking advantage of our strong liquidity position, we were pleased to announce a 100% increase to the quarterly dividend on our common shares commencing in the third quarter of 2009, from $0.05 to $0.10 per share (on a post-split basis).

### OUTLOOK

Moving through 2010 as the economy continues to stabilize, our core strategies remain unchanged: the generation of capital, being proactive in our leasing efforts to limit vacancy and rollover exposure, the reinvestment of capital into our owned assets, and the continued preparation of our development sites for future construction when office markets call for new inventory.

### IN CLOSING

With steady operating income, well-occupied buildings, and a focus on investing capital into our existing assets, we are confident about our future performance and the sustainability of our operating platform.

On behalf of all BPO Properties employees and our Board of Directors, I thank you for your continued support.

Sincerely,

Thomas F. Farley
President & Chief Executive Officer

February 26, 2010

## PORTFOLIO BY CITY

BPO Properties Ltd., one of Canada's largest commercial real estate companies, owns, develops and manages premier office properties. BPO Properties' portfolio comprises 28 commercial properties totalling 18.3 million square feet and includes 3.2 million square feet of parking. The development portfolio consists of seven properties totalling over five million square feet in the downtown cores of Toronto, Calgary and Ottawa. Landmark properties include First Canadian Place in Toronto and Bankers Hall in Calgary.

| December 31, 2009 | Number of Properties | Leased % | Office 000's Sq. Ft. | Retail 000's Sq. Ft. | Leasable Area 000's Sq. Ft. | Parking 000's Sq. Ft. | Total 000's Sq. Ft. | Effective Ownership Interest % | BPO's Effective Interest 000's Sq. Ft. |
|---|---|---|---|---|---|---|---|---|---|
| **DIRECT** | | | | | | | | | |
| **Toronto, Ontario** | | | | | | | | | |
| Exchange Tower | 1 | 98.6% | 963 | 66 | 1,029 | 131 | 1,160 | 50% | 580 |
| Hudson's Bay Centre | 1 | 97.4% | 536 | 261 | 797 | 295 | 1,092 | 100% | 1,092 |
| Queens Quay Terminal | 1 | 98.5% | 428 | 76 | 504 | — | 504 | 100% | 504 |
| 105 Adelaide St. W. | 1 | 99.5% | 177 | 7 | 184 | 48 | 232 | 100% | 232 |
| HSBC Building | 1 | 100.0% | 188 | 6 | 194 | 31 | 225 | 100% | 225 |
| 20-22 Front St. | 1 | 100.0% | 135 | 8 | 143 | — | 143 | 100% | 143 |
| | 6 | 98.5% | 2,427 | 424 | 2,851 | 505 | 3,356 | | 2,776 |
| **Calgary, Alberta** | | | | | | | | | |
| Bankers Hall | 3 | 99.9% | 1,944 | 224 | 2,168 | 409 | 2,577 | 50% | 1,289 |
| Bankers Court | 1 | 100.0% | 255 | 6 | 261 | 62 | 323 | 50% | 162 |
| Suncor Energy Centre | 2 | 100.0% | 1,710 | 22 | 1,732 | 220 | 1,952 | 50% | 976 |
| Fifth Avenue Place | 2 | 99.5% | 1,430 | 46 | 1,476 | 206 | 1,682 | 50% | 841 |
| | 8 | 99.8% | 5,339 | 298 | 5,637 | 897 | 6,534 | | 3,268 |
| **Vancouver, B.C.** | | | | | | | | | |
| Royal Centre | 1 | 94.1% | 493 | 96 | 589 | 264 | 853 | 100% | 853 |
| **Other** | | | | | | | | | |
| Merivale Place, Nepean | 1 | 100.0% | — | 3 | 3 | — | 3 | 100% | 3 |
| **Total Direct** | **16** | **99.0%** | **8,259** | **821** | **9,080** | **1,666** | **10,746** | | **6,900** |
| **CANADIAN FUND** | | | | | | | | | |
| **Toronto, Ontario** | | | | | | | | | |
| First Canadian Place | 1 | 96.1% | 2,379 | 232 | 2,611 | 170 | 2,781 | 25% | 695 |
| 2 Queen St. E. | 1 | 98.6% | 448 | 16 | 464 | 81 | 545 | 25% | 136 |
| 151 Yonge St | 1 | 97.8% | 289 | 10 | 299 | 72 | 371 | 25% | 93 |
| | 3 | 96.6% | 3,116 | 258 | 3,374 | 323 | 3,697 | | 924 |
| **Ottawa, Ontario** | | | | | | | | | |
| Place de Ville I | 2 | 99.8% | 569 | 13 | 582 | 502 | 1,084 | 25% | 271 |
| Place de Ville II | 2 | 100.0% | 597 | 12 | 609 | 433 | 1,042 | 25% | 261 |
| Jean Edmonds Towers | 2 | 100.0% | 541 | 13 | 554 | 95 | 649 | 25% | 162 |
| | 6 | 99.9% | 1,707 | 38 | 1,745 | 1,030 | 2,775 | | 694 |
| **Calgary, Alberta** | | | | | | | | | |
| Altius Centre | 1 | 99.4% | 304 | 3 | 307 | 71 | 378 | 25% | 95 |
| **Edmonton, Alberta** | | | | | | | | | |
| Canadian Western Bank Place | 1 | 98.2% | 371 | 36 | 407 | 91 | 498 | 25% | 125 |
| Enbridge Tower | 1 | 100.0% | 184 | — | 184 | 30 | 214 | 25% | 54 |
| | 2 | 98.8% | 555 | 36 | 591 | 121 | 712 | | 179 |
| **Total Canadian Fund** | **12** | **97.9%** | **5,682** | **335** | **6,017** | **1,545** | **7,562** | | **1,892** |
| **Total Commerical Properties** | **28** | **98.6%** | **13,941** | **1,156** | **15,097** | **3,211** | **18,308** | | **8,792** |
| **DEVELOPMENT** | | | | | | | | | |
| **Toronto, Ontario** | | | | | | | | | |
| Bay Adelaide Centre | 3 | — | 2,600 | — | 2,600 | — | 2,600 | 100% | 2,600 |
| Brookfield Place III | 1 | — | 800 | — | 800 | — | 800 | 54% | 432 |
| | 4 | — | 3,400 | — | 3,400 | — | 3,400 | | 3,032 |
| **Ottawa, Ontario** | | | | | | | | | |
| 300 Queen Street | 1 | — | 577 | — | 577 | — | 577 | 25% | 144 |
| | 1 | — | 577 | — | 577 | — | 577 | | 144 |
| **Calgary, Alberta** | | | | | | | | | |
| Herald Block | 1 | — | 1,200 | — | 1,200 | — | 1,200 | 100% | 1,200 |
| Bankers West Parkade | 1 | — | 250 | — | 250 | — | 250 | 50% | 125 |
| | 2 | | 1,450 | | 1,450 | | 1,450 | | 1,325 |
| **Total Development** | **7** | **—** | **5,427** | **—** | **5,427** | **—** | **5,427** | | **4,501** |
| **Total Portfolio** | **35** | **98.6%** | **19,368** | **1,156** | **20,524** | **3,211** | **23,735** | | **13,293** |

# Management's Discussion and Analysis of Financial Results

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**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, including changes in accounting policies to be adopted under International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards; 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, except as required by securities laws.

# Management's Discussion and Analysis of Financial Results

February 26, 2010

## 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, 2009, includes material information up to February 26, 2010. 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 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 39 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, one-time transaction costs, depreciation and amortization, future income taxes, and certain other non-cash items. 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 do not depreciate in value systematically but fluctuate in value according to market conditions. We provide the components of net operating income and a full reconciliation from net income to funds from operations on page 20. 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, 2009, the book value of BPO Properties' total assets was $2,406.2 million. During 2009, we generated $61.5 million of net income ($0.66 per common share) and $117.7 million of funds from operations ($1.32 per common share).

### FINANCIAL HIGHLIGHTS

BPO Properties' financial results are as follows:

| (Millions, except per-share amounts) | 2009 | 2008[1] | 2007 |
|---|---|---|---|
| **Results of operations** | | | |
| Net income | **$ 61.5** | $ 65.3 | $ 138.8 |
| Net income per share[3] | **0.66** | 0.60 | 1.41 |
| Common share dividends paid per share [2][3] | **0.30** | 0.20 | 0.20 |
| Funds from operations[4] | **117.7** | 153.7 | 159.3 |
| Funds from operations per share[3][4] | **1.32** | 1.64 | 1.65 |

| (Millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Balance sheet data** | | | |
| Total assets | **$ 2,406.2** | $ 2,351.8 | $ 2,235.7 |
| Commercial properties | **1,384.4** | 1,338.0 | 1,351.6 |
| Commercial and development property debt | **1,447.7** | 1,255.3 | 965.5 |
| Shareholders' equity | **749.9** | 860.4 | 1,040.5 |
| Book value per common share [3] | **4.33** | 5.63 | 7.71 |

[1] *Restated for the adoption of a new accounting policy, refer to Part V ("Critical Accounting Policies and Estimates") on page 32.*

[2] *Excludes the special common share dividend of $1.65 and $2.42 per share in 2009 and 2008, respectively.*

[3] *The Company issued a common stock dividend that effectively split the shares on a three-for-one basis. Prior year comparatives have been restated.*

[4] *Excludes gains.*

**COMMERCIAL PROPERTY OPERATIONS**

Our strategy of owning, pro-actively 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 3.2 million square feet of parking. Our development portfolio comprises five development sites totaling 5.4 million square feet. Our primary markets are the financial, energy, and government sectors in the cities of Toronto, Ottawa, Calgary, Edmonton, and Vancouver. We intend to continue our strategy of concentrating operations within a select number of gateway cities 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:

- Realizing 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 supply constraints create opportunities; and
- Expanding our asset management platform through the establishment of new joint-venture opportunities or funds.

The following table summarizes our investment by market:

| Region | Number of Properties | Total Area (000's Sq. Ft.) | BPO Properties' Owned Interest (000's Sq. Ft.) | Book Value (Millions) | Book Value Per Sq. Ft. | Debt[1] (Millions) | Net Book Equity (Millions) |
|---|---|---|---|---|---|---|---|
| Toronto, Ontario | 9 | 7,053 | 3,700 | $ 593.0 | $ 160 | $ 381.5 | $ 211.5 |
| Ottawa, Ontario | 6 | 2,775 | 694 | 97.9 | 141 | 23.6 | 74.3 |
| Calgary, Alberta | 9 | 6,912 | 3,363 | 566.9 | 169 | 518.6 | 48.3 |
| Edmonton, Alberta | 2 | 712 | 179 | 18.0 | 101 | 20.4 | (2.4) |
| Vancouver, B.C. | 1 | 853 | 853 | 105.7 | 124 | 117.6 | (11.9) |
| Other | 1 | 3 | 3 | 2.9 | — | — | 2.9 |
| Commercial properties | 28 | 18,308 | 8,792 | 1,384.4 | 157 | 1,061.7 | 322.7 |
| Commercial developments | 7 | 5,427 | 4,501 | 744.0 | 165 | 386.0 | 358.0 |
| Total | 35 | 23,735 | 13,293 | $ 2,128.4 | $ 160 | $ 1,447.7 | $ 680.7 |

[1] *Includes $6.3 million of deferred financing costs*

We have historically explored property-level joint-venture opportunities with strategic institutional partners. Although we plan to continue with this endeavor, we also pursue acquisitions of individual assets and portfolios through joint-venture fund vehicles. In 2005, we formed our Canadian Office Fund (the "Fund") to acquire the Olympia & York ("O&Y") portfolio. Of our 28 properties, seven are wholly owned, nine are held in property-level joint-ventures or co-tenancies, and 12 were acquired through the O&Y portfolio acquisition. The Fund consists of a consortium of institutional investors that 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 the Fund.

We believe that investing our liquidity with these partners in fund formats enables us to enhance returns. The Fund 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 particularly in these markets 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 Public Works and Government Services Canada, Bank of Montreal/Nesbitt Burns, Suncor Energy Inc., 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 25.

Our strategy is to sign long-term leases in order to mitigate risk and reduce our overall re-tenanting 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 8.7% of our leases mature annually over the next five years.

The following is a breakdown of lease maturities by region with associated expiring 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 | 212 | 1.4 | | 157 | 2.5 | | 1 | 0.1 | | 12 | 0.2 | |
| 2010 | 750 | 5.0 | $ 27 | 518 | 8.3 | $ 28 | 9 | 0.5 | $ 31 | 170 | 2.9 | $ 26 |
| 2011 | 1,109 | 7.3 | 27 | 313 | 5.0 | 27 | 14 | 0.8 | 17 | 656 | 11.0 | 29 |
| 2012 | 1,094 | 7.2 | 27 | 553 | 8.9 | 25 | 13 | 0.7 | 22 | 459 | 7.7 | 30 |
| 2013 | 3,163 | 21.0 | 25 | 1,416 | 22.7 | 28 | 1,151 | 66.0 | 20 | 501 | 8.4 | 33 |
| 2014 | 439 | 2.9 | 31 | 235 | 3.8 | 29 | 9 | 0.5 | 26 | 161 | 2.7 | 37 |
| 2015 | 2,404 | 15.9 | 25 | 455 | 7.3 | 28 | 543 | 31.1 | 14 | 1,197 | 20.1 | 31 |
| 2016 | 1,275 | 8.4 | 27 | 473 | 7.6 | 28 | 4 | 0.2 | 20 | 753 | 12.7 | 28 |
| 2017 & beyond | 4,651 | 30.9 | 26 | 2,105 | 33.9 | 20 | 1 | 0.1 | 30 | 2,035 | 34.3 | 35 |
| Parking | 3,211 | — | — | 828 | — | — | 1,030 | — | — | 968 | — | — |
| Total | 18,308 | 100.0 | | 7,053 | 100.0 | | 2,775 | 100.0 | | 6,912 | 100.0 | |
| Average market net rent | | | $ 25 | | | $ 24 | | | $ 22 | | | $ 30 |

| | Edmonton, Alberta | | | Vancouver, B.C. | | | Other | | |
|---|---|---|---|---|---|---|---|---|---|
| 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] |
| Currently available | 7 | 1.2 | | 35 | 5.9 | | — | — | |
| 2010 | 33 | 5.6 | $ 21 | 20 | 3.4 | $ 22 | — | — | $ — |
| 2011 | 55 | 9.3 | 13 | 71 | 12.1 | 24 | — | — | — |
| 2012 | 7 | 1.2 | 21 | 62 | 10.5 | 22 | — | — | — |
| 2013 | 9 | 1.5 | 21 | 84 | 14.3 | 22 | 2 | 66.7 | 32 |
| 2014 | 27 | 4.6 | 13 | 7 | 1.2 | 29 | — | — | — |
| 2015 | 148 | 25.0 | 19 | 61 | 10.4 | 24 | — | — | — |
| 2016 | 20 | 3.4 | 23 | 25 | 4.2 | 22 | — | — | — |
| 2017 & beyond | 285 | 48.2 | 17 | 224 | 38.0 | 11 | 1 | 33.3 | 28 |
| Parking | 121 | — | — | 264 | — | — | — | — | — |
| | 712 | 100.0 | | 853 | 100.0 | | 3 | 100.0 | |
| Average market net rent | | | $ 21 | | | $ 26 | | | $ 27 |

*[1] Net rent at expiration of lease*

**COMMERCIAL DEVELOPMENT**

We hold interests in 5.4 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 pre-leasing targets with one or more lead tenants have been achieved. We currently have one project under development that is outlined on page 11 of this MD&A.

The following table summarizes our commercial development projects at December 31, 2009:

| | 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 | 54% | 800,000 |
| **Ottawa, Ontario** | | | | | |
| 300 Queen Street | Third phase of Place de Ville project | 1 | 1 | 25% | 577,000 |
| **Calgary, Alberta** | | | | | |
| Herald Block | 1st Street and 7th Avenue, within one block of our existing Calgary assets | 1 | 1 | 100% | 1,200,000 |
| Bankers West Parkade | West Parkade adjacent to Bankers Hall | 1 | 1 | 50% | 250,000 |
| | | 7 | 5 | | 5,427,000 |

## 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. Although net income is calculated in accordance with 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 and a full reconciliation from net income to funds from operations on page 20 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 dispositions and acquisitions.

### Funds From Operations

Funds from operations was redefined in the first quarter of 2009 as net income prior to extraordinary items, one-time transaction costs, depreciation and amortization, future income taxes, and certain other non-cash items. Comparatives have not been restated. We believe that funds from operations is the most relevant measure to analyze real estate as commercial properties generally do not depreciate in value systematically, but fluctuate in value according to market conditions. 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 as 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 operating costs through achieving economies of scale and diligently managing contracts.

We also believe that the key external performance drivers are:

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

## PART II – FINANCIAL STATEMENT ANALYSIS

### ASSET PROFILE

Our total asset book value was $2,406.2 million at December 31, 2009 (compared to $2,351.8 million on December 31, 2008). The following is a summary of our assets:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Commercial properties | **$ 1,384.4** | $ 1,338.0 |
| Commercial developments | **744.0** | 689.1 |
| Loans receivable | **85.0** | 150.6 |
| Intangible assets | **23.9** | 30.3 |
| Tenant receivables and other assets | **113.2** | 82.3 |
| Cash and cash equivalents | **55.7** | 61.5 |
| Total | **$ 2,406.2** | $ 2,351.8 |

### COMMERCIAL PROPERTIES

The book value of our commercial properties was $1,384.4 million at December 31, 2009 (compared to $1,338.0 million on December 31, 2008). The increase in commercial properties is primarily attributable to the transition of Bankers Court from a commercial development to a commercial property, offset by depreciation and amortization during the year ended December 31, 2009. There were no commercial properties held for sale at December 31, 2009. The consolidated carrying value of our properties is approximately $157 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 | Total Area (000's Sq. Ft.) | BPO Properties' Owned Interest (000's Sq. Ft.) | **Book Value 2009 (Millions)** | Book Value 2008 (Millions) |
|---|---|---|---|---|
| Toronto, Ontario | 7,053 | 3,700 | **$ 593.0** | $ 597.4 |
| Ottawa, Ontario | 2,775 | 694 | **97.9** | 99.4 |
| Calgary, Alberta | 6,912 | 3,363 | **566.9** | 511.3 |
| Edmonton, Alberta | 712 | 179 | **18.0** | 17.4 |
| Vancouver, B.C. | 853 | 853 | **105.7** | 109.7 |
| Other | 3 | 3 | **2.9** | 2.8 |
| Total | 18,308 | 8,792 | **$ 1,384.4** | $ 1,338.0 |

### 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 and recovered through rental payments. Expenditures for tenant installation costs for the year ended December 31, 2009, totaled $14.0 million (compared to $11.0 million in 2008). The increase was a result of tenant installation costs incurred on the lease-up of space, primarily at Hudson’s Bay Centre, Queen’s Quay Terminal and Suncor Energy Centre.

Tenant installation costs are summarized as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Leasing commissions | **$ 3.3** | $ 3.7 |
| Tenant improvements | **10.7** | 7.3 |
| Total | **$ 14.0** | $ 11.0 |

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, 2009, totaled $17.5 million (compared to $20.2 million in 2008). 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 maintain or extend the service life of an asset.

The details of our capital expenditures are summarized as follows:

| (Millions) | | 2009 | | 2008 |
|---|---|---|---|---|
| Revenue-enhancing | $ | **15.9** | $ | 17.5 |
| Non-revenue-enhancing | | **1.6** | | 2.7 |
| Total | $ | **17.5** | $ | 20.2 |

**COMMERCIAL DEVELOPMENTS**

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

| (Millions, except square feet) | Buildable Sq. Ft. | Sq. Ft. Currently In active development | | 2009 | | 2008 |
|---|---|---|---|---|---|---|
| **Active developments** | | | | | | |
| Bay Adelaide Centre, Toronto | 2,600,000 | 1,160,000 | $ | **681.2** | $ | 578.9 |
| Bankers Court, Calgary[1] | — | — | | — | | 49.1 |
| | | | | | | |
| **Planning** | | | | | | |
| Herald Block, Calgary | 1,200,000 | — | | **59.3** | | 57.5 |
| ***Others:*** | | | | | | |
| Bankers West Parkade, Calgary | 250,000 | | | | | |
| Brookfield Place III, Toronto | 800,000 | — | | | | |
| 300 Queen Street, Ottawa[2] | 577,000 | — | | | | |
| | 1,627,000 | | | **3.5** | | 3.6 |
| Total | 5,427,000 | 1,160,000 | $ | **744.0** | $ | 689.1 |

[1] *Bankers Court was transferred from commercial developments to commercial properties on August 1, 2009*

[2] *Previously referred to as Place de Ville III*

Commercial developments consist of commercial property development sites, density rights, and related infrastructure. The total book value of this development land and infrastructure was $744.0 million at December 31, 2009, an increase of $54.9 million from $689.1 million at December 31, 2008. The increase is a result of the ongoing active construction at Bay Adelaide Centre in Toronto, offset by the transition of Bankers Court to commercial properties during the third quarter of 2009. The following is a brief description of our construction activities during the year:

- Bay Adelaide Centre in Toronto represents our largest development project. Ground-breaking on Phase I of this project took place in July of 2006 and the opening took place in September of 2009. The new 51-storey office tower, represents approximately 1.2 million square feet of a three-phase project expected to total 2.6 million square feet and is 74% leased. Construction activities on Phase I have increased the book value of this site by $102.3 million since December 31, 2008.
- Bankers Court was transitioned into commercial properties on August 1, 2009 with a book value of $59.6 million. The building which is 100% occupied had all of its tenants move in during the third quarter.

BPO Properties' development permit application for the construction of a 1.2 million square foot office tower on the Herald site continues to progress through the City of Calgary's approval process.

Although we are not 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 pre-leasing targets have been achieved.

The details of development expenditures are as follows:

| (Millions) | | 2009 | | 2008 |
|---|---|---|---|---|
| Construction costs | $ | **54.8** | $ | 195.0 |
| Interest capitalized | | **30.4** | | 27.3 |
| Net operating income capitalized | | **(5.2)** | | (4.2) |
| Property taxes and other | | **21.4** | | 20.3 |
| Tenant improvements | | **13.1** | | — |
| Total | $ | **114.5** | $ | 238.4 |

**LOANS RECEIVABLE**

Loans receivable decreased to $85.0 million at December 31, 2009, compared to $150.6 million at December 31, 2008. The decrease is primarily a result of the following transactions during the year:

(i) the repayment in the first quarter from our parent company, Brookfield Properties Corporation ("BPC"), of the $125.0 million on-demand deposit that was issued in the second quarter of 2008;

(ii) the full loan receivable repayment in the second quarter (at par value plus accrued interest) of $23.2 million (repaid in U.S. dollars of US$20.9 million); and

(iii) the issuance of a new $85.0 million on-demand deposit during the fourth quarter.

The on-demand deposit of $85.0 million outstanding from BPC as at December 31, 2009, earns interest at the bank overnight lending rate plus 100 basis points.

**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 in-place operating leases, origination costs, and other identified intangible assets and assumed liabilities. Net intangible assets decreased to $23.9 million at December 31, 2009, from $30.3 million at December 31, 2008, primarily due to amortization during the year ended December 31, 2009. Approximately $3.2 million of fully amortized intangible assets and their corresponding accumulated amortization were written off during the year ended December 31, 2009.

The components of intangible assets are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Intangible assets | | |
| Lease-origination costs | **$ 37.4** | $ 40.4 |
| Tenant relationships | **6.3** | 6.5 |
| Above-market in-place operating leases | **2.0** | 2.0 |
| | **45.7** | 48.9 |
| Less accumulated amortization | | |
| Lease-originations costs | **(18.5)** | (16.2) |
| Tenant relationships | **(2.2)** | (1.6) |
| Above-market in-place operating leases | **(1.1)** | (0.8) |
| Total | **$ 23.9** | $ 30.3 |

**TENANT RECEIVABLES AND OTHER ASSETS**

Tenant receivables and other assets increased to $113.2 million at December 31, 2009, from $82.3 million at December 31, 2008, primarily due to the increase in restricted cash as well as tenant and other receivables as a result of the timing of accrued receivables. Restricted cash includes cash as collateral against letters of credit issued for performance under certain contracts and cash reserved for certain revenue-enhancing capital projects.

The components of tenant receivables and other assets are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Tenant and other receivables | **$ 49.3** | $ 44.4 |
| Straight-line rent receivable | **19.3** | 18.3 |
| Prepaid expenses and other assets | **28.7** | 18.5 |
| Restricted cash | **15.9** | 1.1 |
| Total | **$ 113.2** | $ 82.3 |

**CASH AND CASH EQUIVALENTS**

We endeavor to maintain high levels of liquidity to ensure that we can react quickly to changes in market conditions and to potential investment opportunities.

At December 31, 2009, cash balances were $55.7 million (compared to $61.5 million at December 31, 2008). The change in cash balances is primarily due to funds generated from our operating and financing activities as well as changes in our on-demand deposit with BPC; offset by development expenditures and dividend payments, including the special dividend payment of $140.2 million, during the year. At December 31, 2009, the Company had $2.7 million of cash placed in term deposits.

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Our asset base of $2,406.2 million is financed with a combination of debt, preferred, and common equity. The components of our liabilities and shareholders' equity are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| **Liabilities** | | |
| Commercial and development property debt | **$ 1,447.7** | $ 1,255.3 |
| Intangible liabilities | **62.8** | 71.9 |
| Accounts payable and other liabilities | **115.1** | 135.6 |
| Future income tax liabilities | **30.7** | 28.6 |
| | | |
| **Shareholders' equity** | | |
| Preferred shares | **381.7** | 381.7 |
| Common shares | **78.3** | 78.4 |
| Retained earnings and AOCI | **289.9** | 400.3 |
| Total | **$ 2,406.2** | $ 2,351.8 |

**COMMERCIAL AND DEVELOPMENT PROPERTY DEBT**

Commercial and development property debt totaled $1,447.7 million at December 31, 2009 (compared to $1,255.3 million at December 31, 2008). The increase is primarily attributed to the up-financing of Suncor Energy Centre and First Canadian Place of $70.0 million and $19.8 million respectively and additional advances on the development loans of Bay Adelaide Centre in Toronto and Bankers Court in Calgary. The details of the financing transactions completed in 2009 are as follows:

| (Millions) | | | New Proceeds | Repayments | Net Proceeds Generated For BPO[2] | Interest Rate (%) | Mortgage Details | Maturity |
|---|---|---|---|---|---|---|---|---|
| Enbridge Tower | Q2 | Refinancing | $ 6.3 | $ (2.2) | $ 4.1 | 6.50% | Non-recourse | July 2019 |
| Suncor Energy Centre[1] | Q2 | New financing | 220.0 | (150.0) | 70.0 | 6.38% | Limited recourse | June 2014 |
| First Canadian Place | Q4 | Refinancing | 77.5 | (57.7) | 19.8 | 5.37% | Non-recourse | December 2014 |

*(1) This loan includes a $35.0 million unsecured loan from an affiliate of the property's joint-venture partner*

*(2) Excludes financing costs*

Commercial and development property debt at December 31, 2009, had a weighted-average interest rate of 4.9%. The majority of our debt on our commercial properties are recourse only to specific properties, thereby reducing overall financial risk to the Company. Excluding the floating rate debt on Bay Adelaide Centre and Bankers Court, at December 31, 2009, our average term to maturity of our commercial property debt was four years, compared to our average lease term of seven years. We will continue to make efforts to match the maturity of our commercial and development property debt portfolio with the average lease term of our properties.

The tight credit supplies currently available in the credit markets continue to pose a significant challenge to property owners and managers. However, in spite of these conditions, we have had success in refinancing over $300 million of commercial property debt throughout 2009, at our ownership ($705 million on a 100% basis). We believe completing these financings in this tough credit environment is a validation of our strategy of owning high-quality assets in Canada's top markets. With respect to the 2010 year, the Company has debt totaling $49.8 million maturing, representing 3.4% of the Company's total debt outstanding at December 31, 2009. Management expects these debts to be refinanced in the normal course of business. The Company also has development debt at Bay Adelaide Centre of $386.7 million, which has two one-year extension options at maturity, and the criteria to exercise the first option to 2011 has been met at December 31, 2009.

The details of commercial and development property debt at December 31, 2009, are as follows:

| Commercial Property | Location | Interest Rate % | Maturity Date | | BPO Properties' Consolidated Share (Millions) | Mortgage Details |
|---|---|---|---|---|---|---|
| **Direct** | | | | | | |
| Bay Adelaide Centre[(1)(4)] | Toronto | 1.8 | July 2010 | $ | 386.7 | Limited recourse- variable rate |
| Bankers Court | Calgary | 1.9 | October 2010 | | 44.4 | Non-recourse - variable rate |
| Queen's Quay Terminal | Toronto | 7.3 | March 2011 | | 33.0 | Non-recourse - fixed rate |
| Fifth Avenue Place | Calgary | 7.6 | August 2011 | | 69.4 | Non-recourse - fixed rate |
| Exchange Tower | Toronto | 6.8 | April 2012 | | 59.4 | Non-recourse - fixed rate |
| Royal Centre | Vancouver | 5.0 | May 2012 | | 118.1 | Non-recourse - fixed rate |
| HSBC Building | Toronto | 8.2 | October 2012 | | 22.1 | Non-recourse - fixed rate |
| 105 Adelaide | Toronto | 5.3 | February 2013 | | 22.3 | Non-recourse - fixed rate |
| Hudson's Bay Centre[(3)(5)] | Toronto | 5.2 | May 2013 | | 110.0 | Limited recourse - fixed rate |
| Bankers Hall | Calgary | 6.7 | November 2013 | | 11.0 | Non-recourse - fixed rate |
| Bankers Hall | Calgary | 7.2 | November 2013 | | 157.5 | Non-recourse - fixed rate |
| Suncor Energy Centre[(2)] | Calgary | 6.4 | June 2014 | | 218.2 | Limited recourse - fixed rate |
| 20-22 Front St. | Toronto | 6.2 | October 2020 | | 19.6 | Non-recourse - fixed rate |
| **Total Direct** | | | | | 1,271.7 | |
| **Canadian Fund** | | | | | | |
| Place de Ville I | Ottawa | 7.8 | February 2010 | $ | 5.4 | Non-recourse - fixed rate |
| 151 Yonge Street | Toronto | 6.0 | June 2012 | | 10.8 | Non-recourse - fixed rate |
| Jean Edmonds Tower | Ottawa | 5.6 | January 2014 | | 1.1 | Non-recourse - fixed rate |
| First Canadian Place | Toronto | 5.4 | December 2014 | | 77.8 | Non-recourse - fixed rate |
| Canadian Western Bank Place | Edmonton | 5.6 | December 2017 | | 14.5 | Non-recourse - fixed rate |
| Altius Centre | Calgary | 5.6 | December 2017 | | 20.5 | Non-recourse - fixed rate |
| 2 Queen Street | Toronto | 5.6 | December 2017 | | 28.6 | Non-recourse - fixed rate |
| Enbridge Tower | Edmonton | 6.5 | July 2019 | | 6.2 | Non-recourse - fixed rate |
| Jean Edmonds Tower | Ottawa | 6.8 | January 2024 | | 15.6 | Non-recourse - fixed rate |
| **Total Canadian Fund** | | | | | 180.5 | |
| **Debt before premiums and deferred financing costs** | | 4.9 | | | 1,452.2 | |
| Premium on assumed mortgages | | | | | 1.8 | |
| Deferred financing costs | | | | | (6.3) | |
| **Total** | | | | $ | 1,447.7 | |

*(1) This loan has limited recourse to the Company for up to $60.0 million*

*(2) This loan includes a $35.0 million unsecured loan from an affiliate of the property's joint-venture partner*

*(3) This loan has limited recourse to the Company for up to $15.0 million*

*(4) Two one-year extension options available at maturity. The criteria to extend the first option to 2011 has been met as at December 31, 2009*

*(5) Two-year extension option that extends the maturity to May 2015 is available to the Company provided that certain debt service and loan-to-value thresholds are met*

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

| (Millions, except interest data) | Scheduled Amortization | Maturities | Total | Weighted-Average Interest Rate (%) at Dec. 31, 2009 |
|---|---|---|---|---|
| 2010 | $ 18.3 | $ 436.5 | $ 454.8 | 1.8% |
| 2011 | 19.7 | 97.3 | 117.0 | 7.5% |
| 2012 | 16.0 | 195.6 | 211.6 | 5.9% |
| 2013 | 11.8 | 276.8 | 288.6 | 6.3% |
| 2014 | 4.6 | 267.7 | 272.3 | 6.1% |
| 2015 and thereafter | 5.4 | 98.0 | 103.4 | 6.0% |
| Total | $ 75.8 | $ 1,371.9 | $ 1,447.7 | 4.9% |

## CONTRACTUAL OBLIGATIONS

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

| | Payments Due By Period | | | |
|---|---|---|---|---|
| (Millions) | Total | 1 - 3 Years | 4 - 5 Years | After 5 Years |
| Commercial and development property debt | $ 1,447.7 | $ 783.4 | $ 560.9 | $ 103.4 |
| Interest expense - commercial and development property debt[1] | 243.4 | 163.6 | 51.4 | 28.4 |
| Minimum rental payments - ground leases[2] | 382.5 | 13.6 | 9.1 | 359.8 |
| | $ 2,073.6 | $ 960.6 | $ 621.4 | $ 491.6 |

*[1] Represents aggregate interest expense expected to be paid over the term of the debt, on an undiscounted basis, based on current interest rates*

*[2] Represents payments, on an undiscounted basis, on land leases or other agreements*

## 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 in-place operating leases and above-market ground leases assumed on acquisitions, net of related accumulated amortization. Net intangible liabilities decreased to $62.8 million at December 31, 2009, from $71.9 million at December 31, 2008, primarily due to amortization during the year ended December 31, 2009. Approximately $12.4 million of fully amortized intangible liabilities and their corresponding accumulated amortization were written off during the year ended December 31, 2009.

The composition of intangible liabilities is as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Intangible liabilities | | |
| Below-market in-place operating leases | **$ 44.4** | $ 56.8 |
| Above-market ground lease obligations | **45.8** | 45.8 |
| | **90.2** | 102.6 |
| Less accumulated amortization | | |
| Below-market in-place operating leases | **(16.8)** | (22.6) |
| Above-market ground lease obligations | **(10.6)** | (8.1) |
| Total | **$ 62.8** | $ 71.9 |

## ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities totaled $115.1 million at December 31, 2009 (compared to $135.6 million on December 31, 2008). The decrease is primarily related to the release of construction holdbacks following the completion of our two development projects, Bay Adelaide Centre in Toronto and Bankers Court in Calgary.

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

| (Millions) | **2009** | 2008 |
|---|---|---|
| Accounts payable and accrued liabilities | **$ 110.0** | $ 131.3 |
| Accrued interest | **5.1** | 4.3 |
| Total | **$ 115.1** | $ 135.6 |

## INCOME TAXES

At December 31, 2009, we had net future income tax liabilities of $30.7 million (compared to $28.6 million on December 31, 2008). The increase of $2.0 million is due to a decrease of future income tax assets related to operating and capital losses.

The components of future income tax liabilities are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Future income tax assets related to operating and capital losses | **$ (11.3)** | $ (13.7) |
| Future income tax liabilities related to differences between tax and book basis | **42.0** | 42.3 |
| Total | **$ 30.7** | $ 28.6 |

At December 31, 2009, we had net operating loss carryforwards of approximately $33.4 million (compared to $34.7 million on December 31, 2008), which are available to reduce taxable income over the next 20 years.

Income tax expense is calculated as follows:

| (Millions) | | 2009 | | 2008 |
|---|---|---|---|---|
| Income tax expense at the Canadian federal and provincial substantively enacted income tax rate of 32.0% (2008 – 32.0%) | $ | **28.3** | $ | 32.1 |
| Increase (decrease) in income tax expense due to the following: | | | | |
| De-recognition of tax asset | | **—** | | 1.6 |
| Change in statutory tax rates | | **(1.9)** | | — |
| Other | | **1.1** | | 1.1 |
| Total | $ | **27.5** | $ | 34.8 |

The major components of income tax expense include the following:

| (Millions) | | 2009 | | 2008 |
|---|---|---|---|---|
| Current tax expense | $ | **23.7** | $ | 16.5 |
| Future tax expense | | **3.8** | | 18.3 |
| Total | $ | **27.5** | $ | 34.8 |

**PREFERRED SHARES**

At December 31, 2009, we had $381.7 million of preferred equity outstanding, consistent with the balance at December 31, 2008. 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 | | 2009 | | 2008 |
|---|---|---|---|---|---|---|
| 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, 2009, we paid preferred dividends of $5.7 million (compared to $14.3 million in 2008), due to a decrease in interest rates on which the dividend rates are based.

**COMMON EQUITY**

On November 3, 2009, the Board of Directors approved a three-for-one stock split in the form of a stock dividend. The stock dividend was issued on December 31, 2009, to shareholders of record at the close of business on December 8, 2009. Fractional shares were paid in cash at the prevailing market price. The common shares of the Company began trading on a post-stock split basis on the Toronto Stock Exchange on December 4, 2009. Prior period comparatives have been adjusted to reflect the stock split.

Total common shares issued and outstanding at December 31, 2009, totaled 85.0 million shares (compared to 85.0 million on December 31, 2008), which included 65.0 million non-voting equity shares (compared to 65.0 million on December 31, 2008).

During the year, BPO Properties renewed its normal course issuer bid. During the twelve month period commencing September 22, 2009, and ending September 21, 2010, we may purchase on the Toronto Stock Exchange up to 997,230 common shares (on a post-split basis), representing approximately 5% of our issued and outstanding common shares.

During the year, we repurchased 36,000 common shares (on a post-stock split basis) for $0.5 million at an average price of $14.79 per share. The amount paid in excess of the book value, $0.5 million, was recorded as a reduction to retained earnings.

We paid regular common share dividends of $25.5 million for the year ended December 31, 2009 (compared to $17.1 million in 2008). The increase is due to a 100% increase in the ongoing quarterly common share dividend commencing in the third quarter of 2009.

A $140.2 million special common share dividend was paid during the second quarter of 2009, compared to $206.5 million during the same period in 2008 (or $1.65 and $2.42 per common share, respectively).

The book value per common share at December 31, 2009, was $4.33 (compared to $5.63 on December 31, 2008).

At December 31, 2009, the book value of our common equity was $368.2 million ($478.7 million on December 31, 2008), compared with a market equity capitalization of approximately $1,661.8 million ($680.0 million on December 31, 2008), calculated as total common shares outstanding multiplied by $19.55 per share, the closing price per common share on the Toronto Stock Exchange on December 31, 2009 (compared to $8.00 per share on December 31, 2008).

Like most commercial real estate companies within our peer group, our share price traded down materially leading up to the latter part of 2008 as did most major indices. Commercial real estate was hit particularly hard as a result of perceived pressures on balance sheet liquidity from financing risk and companies with tenant exposure concentrated in financial service focused markets, like Toronto, experienced additional share price pressure. Since the beginning of 2009, although we have seen continued downward pressure on the market values of commercial real estate, we have seen a trend in a positive direction with market prices of shares in commercial real estate companies generally back on the rise and we feel a sense of optimism that the economy may be in early stages of a recovery. At December 31, 2009, our market value per common share increased by approximately 144% since the beginning of the year to $19.55 and is in excess of our book value per common share of $4.33.

**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 those capital expenditures deemed mandatory, including tenant improvements;
- fund current development costs not covered under construction loans; and
- fund investing activities which could include:
  - discretionary capital expenditures;
  - repurchase of our stock; and
  - property acquisitions.

We believe that our liquidity needs will be satisfied using cash on hand, cash flows generated from operating and financing activities, as well as proceeds from new joint-venture opportunities or funds. Rental revenue, recoveries from tenants, interest and other income, available cash balances, draws on our 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 by controlling operating expenses. Another source of cash flow includes third-party fees generated by our asset management, leasing and development businesses. 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 year are for development costs, scheduled debt maturities and non-recurring capital expenditures. We plan to meet these needs with one or more of the following:

- cash flows from operations;
- construction loans;
- proceeds from sales of partial interests in our wholly-owned assets; and
- refinancing opportunities.

Our commercial property debt is primarily fixed-rate and non-recourse to the Company. These investment-grade financings are typically structured on a loan-to-appraised-value basis of between 55% and 65% as market conditions permit. 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.

Most of our borrowings are in the form of long-term property-specific financings with recourse only to the specific assets. Limiting recourse to specific assets ensures that poor performance within one area does not compromise our ability to finance the balance of our operations. Our maturity schedule is fairly diversified so that financing requirements in any given year are manageable.

Our focus on structuring financings with investment-grade characteristics ensures that debt levels on any particular asset can typically be maintained throughout a business cycle, and so enables us to limit covenants and other performance requirements, thereby reducing the risk of early payment requirements or restrictions on the distribution of cash from the assets being financed.

To help ensure we are able to react to investment opportunities quickly and on a value basis, we attempt to maintain a high level of liquidity. Our primary sources of liquidity consist of cash and cash equivalents. In addition, we structure our affairs to facilitate monetization of longer-duration assets through financings, co-investor participations or refinancings.

At December 31, 2009, we had approximately $140.7 million of liquidity consisting of $55.7 million of cash and an $85.0 million on-demand deposit with BPC.

**Cost of capital**

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

At December 31, 2009, our weighted-average cost of capital, assuming a 12.0% return on equity, was 7.3% (compared to 6.2% on December 31, 2008). Our cost of capital is lower than many of our peers because of the greater amount of investment-grade financing that can be placed on our assets, which is a function of the high-quality nature of both the assets and the tenant base that compose our portfolio. The increase over the prior year is due to an increase in our market capitalization.

The following schedule details the capitalization of the Company at the end of 2009 and 2008 and the related costs thereof:

| | Cost of Capital[1] | | Underlying Value[2] | |
|---|---|---|---|---|
| (Millions, except cost of capital data) | **Dec. 31, 2009** | Dec. 31, 2008 | **Dec. 31, 2009** | Dec. 31, 2008 |
| **Liabilities** | | | | |
| Commercial and development property debt | **4.9%** | 5.6% | **$ 1,447.7** | $ 1,255.3 |
| **Shareholders' equity** | | | | |
| Preferred shares | **1.5%** | 3.8% | **381.7** | 381.7 |
| Common shares[3] | **12.0%** | 12.0% | **1,661.8** | 679.2 |
| Total[4] | **7.3%** | 6.2% | **$ 3,491.2** | $ 2,316.2 |

*[1] As a percentage of average book value*

*[2] Underlying value of liabilities represents the cost to retire on maturity. Underlying value of common equity is based on the closing stock price of the Company's common shares at December 31, 2009 and 2008. Underlying value of preferred equity is based on the book value of preferred shares*

*[3] Determined on a market-value basis and assumes a 12% return on equity for 2009 and 2008*

*[4] In calculating the weighted-average cost of capital, the cost of debt has been tax-effected*

## OPERATING RESULTS

### Net Income

Our net income for the year ended December 31, 2009, was $61.5 million ($0.66 per common share) compared to $65.3 million ($0.60 per common share) in 2008.

The net decrease from the year ended December 31, 2008, to the year ended December 31, 2009, is largely a result of the following:

- a $11.4 million decrease in loans and investment income, net of taxes ($0.13 per share), primarily due to lower interest income from the repayment of a $125.0 million on-demand deposit with our parent company BPC during the first quarter of 2009 and the loan receivable repayment of $23.2 million (repaid in U.S. dollars of US$20.9 million) during the second quarter of 2009, and lower investment income from a residential joint-venture business;
- a $0.7 million increase in interest expense, net of taxes ($0.01 per share), primarily due to up-financing at Suncor Energy Centre of $220.0 million; and
- a $1.4 million increase in general and administrative expense, net of taxes ($0.02 per share), due to higher professional fees relating to non-recurring consulting and legal services; offset by
- a $5.0 million increase in commercial property net operating income, net of taxes ($0.06 per share), primarily due to continued growth in operating income and the transition of Bankers Court to commercial properties; and
- a $7.3 million decrease in income tax expense, primarily due to lower earnings before taxes and a reduction in income tax payable as a result of a change in statutory tax rates.

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) | **2009** | 2008 | 2007 |
|---|---|---|---|
| **Commercial properties** | | | |
| Revenue | **$ 350.9** | $ 345.1 | $ 328.2 |
| Expenses | **148.3** | 149.9 | 140.8 |
| | **202.6** | 195.2 | 187.4 |
| Loans and investment income | **3.8** | 20.5 | 12.3 |
| | **206.4** | 215.7 | 199.7 |
| **Expenses** | | | |
| Interest expense | **40.5** | 39.5 | 30.0 |
| General and administrative expenses | **24.5** | 22.5 | 20.2 |
| | **141.4** | 153.7 | 149.5 |
| Transaction costs | — | — | 4.0 |
| Depreciation and amortization | **52.4** | 53.6 | 58.5 |
| Income taxes | **27.5** | 34.8 | 28.2 |
| Net income from continuing operations | **61.5** | 65.3 | 58.8 |
| Discontinued operations | — | — | 80.0 |
| **Net income** | **$ 61.5** | $ 65.3 | $ 138.8 |
| **Net income per common share**[(1)] | | | |
| Continuing operations | **$ 0.66** | $ 0.60 | $ 0.47 |
| Property disposition gains | — | — | 0.89 |
| Discontinued operations | — | — | 0.05 |
| | **$ 0.66** | $ 0.60 | $ 1.41 |
| **Funds from operations and gains per common share**[(1)] | | | |
| Continuing operations | **$ 1.32** | $ 1.64 | $ 1.54 |
| Property disposition gains | — | — | 1.07 |
| Discontinued operations | — | — | 0.11 |
| | **$ 1.32** | $ 1.64 | $ 2.72 |

[(1)] *Prior year share information has been restated to reflect the three-for-one common stock split.*

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. This differs from those entities which operate as real estate investment trusts (“REITs”), as REITs are not subject to taxation provided they remain in compliance with specific tax codes.

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

| (Millions) | | **2009** | | 2008 | | 2007 |
|---|---|---|---|---|---|---|
| Net income | **$** | **61.5** | $ | 65.3 | $ | 138.8 |
| Preferred share dividends | | **(5.7)** | | (14.3) | | (18.2) |
| Net income available to common shareholders | **$** | **55.8** | $ | 51.0 | $ | 120.6 |
| Weighted-average shares outstanding[1] | | **85.0** | | 85.3 | | 85.6 |

[1] *Prior year share information has been restated to reflect the three-for-one common stock split.*

**RECONCILIATION OF NET INCOME TO FUNDS FROM OPERATIONS**

| (Millions) | | **2009** | | 2008 | | 2007 |
|---|---|---|---|---|---|---|
| **Net income** | **$** | **61.5** | $ | 65.3 | $ | 138.8 |
| Depreciation and amortization[1] | | **52.4** | | 53.6 | | 61.7 |
| Future income taxes [2][3] | | **3.8** | | 34.8 | | 46.0 |
| Transaction costs | | — | | — | | 4.0 |
| Funds from operations and gains | | **117.7** | | 153.7 | | 250.5 |
| Property disposition gains | | — | | — | | (91.2) |
| **Funds from operations** | **$** | **117.7** | $ | 153.7 | $ | 159.3 |

[1] *Includes depreciation and amortization from discontinued operations of $nil, $nil, and $3.2 million for the years ended December 31, 2009, 2008, and 2007, respectively*

[2] *Funds from operations was redefined in the first quarter of 2009 as net income prior to extraordinary items, one-time transaction costs, depreciation and amortization, future income taxes, and certain non-cash items. Comparatives have not been restated*

[3] *Includes income taxes from discontinued operations of $nil, $nil and $17.8 million for the years ended December 31, 2009, 2008, and 2007, 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) | | **2009** | | 2008 | | 2007 |
|---|---|---|---|---|---|---|
| Funds from operations | **$** | **117.7** | $ | 153.7 | $ | 159.3 |
| Preferred share dividends | | **(5.7)** | | (14.3) | | (18.2) |
| Funds from operations available to common shareholders | | **112.0** | | 139.4 | | 141.1 |
| Weighted-average shares outstanding[1] | | **85.0** | | 85.3 | | 85.6 |
| Funds from operations per share[1] | **$** | **1.32** | $ | 1.64 | $ | 1.65 |

[1] *Prior year share information has been restated to reflect the three-for-one common stock split.*

Funds from operations decreased to $1.32 per share during the year ended December 31, 2009 (compared to $1.64 per share in 2008). The decrease during the year is primarily due to a decrease in loan and investment income and inclusion of estimated current income tax expense in funds from operations this year, offset by an increase in commercial net operating income and lower preferred share dividends declared due to lower interest rates on which the dividends are based.

**REVENUE**

The components of revenue are as follows:

| (Millions) | | **2009** | | 2008 | | 2007 |
|---|---|---|---|---|---|---|
| Revenue from continuing operations | **$** | **337.4** | $ | 331.8 | $ | 315.6 |
| Fee income | | **13.5** | | 13.3 | | 12.6 |
| Revenue from discontinued operations | | — | | — | | 18.2 |
| Total commercial property revenue | | **350.9** | | 345.1 | | 346.4 |
| Loans and investment income | | **3.8** | | 20.5 | | 12.3 |
| Total | **$** | **354.7** | $ | 365.6 | $ | 358.7 |

**COMMERCIAL PROPERTY OPERATIONS**

Commercial property net operating income totaled $202.6 million in 2009 (compared to $195.2 million in 2008). The components of commercial property net operating income from continuing operations are as follows:

| (Millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Revenue from continuing operations and fee income | **$ 350.9** | $ 345.1 | $ 328.2 |
| Operating expenses | **148.3** | 149.9 | 140.8 |
| Total | **$ 202.6** | $ 195.2 | $ 187.4 |

| (Millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Net operating income – same property | **$ 183.7** | $ 178.5 | $ 169.2 |
| Net operating income – development transferred to commercial property | **2.3** | — | — |
| Recurring fee income | **13.5** | 13.3 | 12.6 |
| Nonrecurring fees and other income | **3.1** | 3.4 | 5.6 |
| Total | **$ 202.6** | $ 195.2 | $ 187.4 |

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

| (Millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Revenue from discontinued operations | **$ —** | $ 0.1 | $ 18.2 |
| Property operating expenses | **—** | (0.1) | (6.2) |
| Net operating income from discontinued operations | **$ —** | $ — | $ 12.0 |

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, along with our focus on executing long-term leases with strong credit rated tenants, has created one of Canada's most distinguished portfolios of office properties. In the past, this strategy has reduced our exposure to the cyclical nature of the real estate business, however, considering the severity of the global economic slowdown, we are at risk that major tenants are succumbing to financial pressures and are no longer having a need for all of their space, leading to increased supply through sublets or tenant defaults. To date, we have not been materially impacted by those financial institutions and professional service firms that have filed for bankruptcy or dissolved in recent months. We continue to reduce our lease expiry profile for the upcoming years and continue to have in-place net rents below market rents across most of our portfolio, which will continue to add stability to our results going forward.

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, property taxes and fee income. Revenue from commercial properties totaled $350.9 million during 2009 (compared to $345.1 million in 2008).

Our leases generally have clauses that provide for the collection of rental revenues in amounts that increase over the term of the lease, 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, 2009, we recognized $1.0 million in straight-line rental revenue (compared to $2.1 million in 2008).

Commercial property operating costs, which include real estate taxes, utilities, insurance, repairs and maintenance, cleaning, and other property-related expenses, were $148.3 million in 2009 (compared to $149.9 million in 2008).

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. Our total portfolio occupancy rate remained fairly stable at 98.6% at December 31, 2009, compared to 98.7% at December 31, 2008. At December 31, 2009, average in-place net rent throughout the portfolio was $23 per square foot, compared to $22 per square foot at December 30, 2008.

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, 2009:

| | Total 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 | 7,053 | 6 | $ 24 | $ 24 |
| Ottawa, Ontario | 2,775 | 4 | 18 | 22 |
| Calgary, Alberta | 6,912 | 9 | 26 | 30 |
| Edmonton, Alberta | 712 | 7 | 14 | 21 |
| Vancouver, B.C. | 853 | 10 | 17 | 26 |
| Other | 3 | 7 | 29 | 27 |
| Total[(1)] | 18,308 | 7 | $ 23 | $ 25 |

[(1)] *Excludes developments*

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

| | **2009** | | 2008 | |
|---|---|---|---|---|
| | **Total Area (000's Sq. Ft.)** | **% Leased** | Total Area (000's Sq. Ft.) | % Leased |
| Toronto, Ontario | **7,053** | **97.5** | 7,054 | 97.5 |
| Ottawa, Ontario | **2,775** | **99.9** | 2,780 | 99.5 |
| Calgary, Alberta | **6,912** | **99.8** | 6,704 | 99.9 |
| Edmonton, Alberta | **712** | **98.8** | 711 | 99.9 |
| Vancouver, B.C. | **853** | **94.1** | 853 | 96.9 |
| Other | **3** | **100.0** | 3 | 100.0 |
| Total[(1)] | **18,308** | **98.6** | 18,105 | 98.7 |

[(1)] *Excludes developments*

During 2009, we leased 1,296,000 square feet of space. This included 1,199,000 square feet of new leasing and renewals, and 97,000 square feet of development leasing, compared to expiries of 569,000 square feet and accelerated expiries of 652,000 square feet. For the year ended December 31, 2009, the average leasing net rent is $24, which is an increase of 20% over the average expiring net rent of $20.

The details of our leasing activity for 2009 are as follows:

| | Dec. 31, 2008 | | Activities during the year ended Dec. 31, 2009 | | | | | | **Dec. 31, 2009** | |
|---|---|---|---|---|---|---|---|---|---|---|
| (000's Sq. Ft.) | Total Area[(1)] | Leased | Expiries | Average Expiring Net Rent | Leasing | Year One[(2)] Leasing Net Rent | Average[(3)] Leasing Net Rent | Acq. (Disp.) | **Total Area[(1)]** | **Leased** |
| Toronto, Ontario | 7,054 | 6,897 | (745) | $ 19 | 744 | $ 19 | $ 20 | (1) | **7,053** | **6,896** |
| Ottawa, Ontario | 2,780 | 2,772 | (35) | 17 | 42 | 22 | 22 | (5) | **2,775** | **2,774** |
| Calgary, Alberta | 6,704 | 6,697 | (266) | 26 | 261 | 34 | 34 | 208 | **6,912** | **6,900** |
| Edmonton, Alberta | 711 | 710 | (126) | 13 | 120 | 23 | 23 | 1 | **712** | **705** |
| Vancouver, B.C. | 853 | 835 | (49) | 20 | 32 | 28 | 28 | — | **853** | **818** |
| Other | 3 | 3 | — | — | — | — | — | — | **3** | **3** |
| Total[(1)] | 18,105 | 17,914 | (1,221) | $ 20 | 1,199 | $ 23 | $ 24 | 203 | **18,308** | **18,096** |
| Development Pre-leasing | | | | | 97 | | | | | |
| Total Leasing | | | | | 1,296 | | | | | |

[(1)] *Excludes developments*
[(2)] *Represents net rent in the first year*
[(3)] *Represents average net rent over lease term*

**INTEREST AND OTHER INCOME**

Loans and investment income totaled $3.8 million in 2009 (compared to $20.5 million in 2008). The decrease primarily relates to a decrease in interest income due to the repayment of a $125.0 million on-demand deposit with our parent company BPC during the first quarter of 2009, the loan receivable repayment of $23.2 million (repaid in U.S. dollars of US$20.9 million) during the second quarter of 2009, and loan investment income from a residential joint-venture business.

**INTEREST EXPENSE**

Interest expense was $40.5 million in 2009 (compared to $39.5 million in 2008). The increase is due to an increase in interest expense relating to our up-financing of a fixed-rate debt at Suncor Energy Centre.

**GENERAL AND ADMINISTRATIVE EXPENSES**

General and administrative expenses were $24.5 million for year ended December 31, 2009 (compared to $22.5 million in 2008). The increase is due to higher professional fees related to non-recurring consulting and legal services.

**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 the year ended December 31, 2009, was $52.4 million (compared to $53.6 million in 2008).

**QUARTERLY RESULTS**

The 2009 and 2008 results by quarter are as follows:

| | 2009 | | | | 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| (Millions, except per-share amounts) | **Q4** | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Total Revenue | **$ 94.1** | $ 85.6 | $ 86.3 | $ 88.7 | $ 98.5 | $ 88.6 | $ 91.2 | $ 87.3 |
| **Net operating income** | | | | | | | | |
| Operating income from commercial properties | **52.9** | 49.6 | 50.1 | 50.0 | 49.5 | 49.2 | 48.8 | 47.7 |
| Loans and investment income | **0.7** | 0.2 | 1.0 | 1.9 | 8.1 | 4.0 | 4.8 | 3.6 |
| | **53.6** | 49.8 | 51.1 | 51.9 | 57.6 | 53.2 | 53.6 | 51.3 |
| **Expenses** | | | | | | | | |
| Interest expense | **10.8** | 10.6 | 10.0 | 9.1 | 11.4 | 9.5 | 9.8 | 8.8 |
| General and administrative expenses | **8.4** | 5.8 | 5.0 | 5.3 | 7.1 | 5.1 | 5.2 | 5.1 |
| | **34.4** | 33.4 | 36.1 | 37.5 | 39.1 | 38.6 | 38.6 | 37.4 |
| Depreciation and amortization | **13.3** | 13.0 | 12.8 | 13.3 | 14.8 | 13.3 | 13.0 | 12.5 |
| Income taxes | **4.3** | 7.0 | 8.0 | 8.2 | 9.6 | 9.9 | 7.8 | 7.5 |
| **Net income** | **$ 16.8** | $ 13.4 | $ 15.3 | $ 16.0 | $ 14.7 | $ 15.4 | $ 17.8 | $ 17.4 |
| **Net income per common share** [1] | **$ 0.18** | $ 0.15 | $ 0.17 | $ 0.16 | $ 0.14 | $ 0.14 | $ 0.16 | $ 0.16 |
| **Funds from operations per common share** [1] | **$ 0.32** | $ 0.30 | $ 0.35 | $ 0.35 | $ 0.42 | $ 0.43 | $ 0.41 | $ 0.38 |

*[1] Prior year share information has been restated to reflect the three-for-one common stock split.*

Operating income from commercial properties increased during the fourth quarter of 2009, compared to the previous quarters in 2009, primarily due to the transition of Bankers Court from a commercial development to a commercial property.

General and administrative expenses increased during the fourth quarter of 2009, compared to the previous quarters in 2009, primarily due to higher professional fees related to non-recurring consulting and legal services.

Loans and investment income decreased further during the third and fourth quarters of 2009, as compared to the previous quarters in 2009 and 2008, primarily due to a decrease in interest income as a result of the repayment of a $125.0 million on-demand deposit with our parent company BPC during the first quarter of 2009, and a loan receivable repayment of $23.2 million (repaid in U.S. dollars of US$20.9 million) during the second quarter of 2009, and lower investment income from a residential joint-venture business.

Interest expense increased during the fourth quarter of 2009, compared to the first half of 2009, primarily due to an increase in interest expense relating to our up-financing of a fixed-rate debt at Suncor Energy Centre.

Income tax expense decreased during the fourth quarter due to a change in statutory tax rates.

## 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 ensured 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 our 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 at www.bpoproperties.com or at www.sedar.com.

**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 26 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 17 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 30% of our outstanding commercial and development property debt at December 31, 2009, is floating-rate debt (December 31, 2008 – 37%) and subject to fluctuations in interest rates. The effect of a 100-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, net of taxes, of $2.9 million on an annual basis or approximately $0.03 per share. In addition, we have $85.0 million (compared to $125.0 million on December 31, 2008) of our loan receivable balances at December 31, 2009, subject to variable interest rates. The effect of a 100-basis-point decrease in interest rates on interest income relating to our variable-rate loan receivable, all else being equal, is a decrease in interest income, net of taxes, of $0.6 million on an annual basis or approximately $0.01 per share. 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.

We currently estimate our level of indebtedness to be less than 50% of the fair market value of our properties. This level of indebtedness is considered by the Company to be conservative and, based on this, the Company believes that all debts will be financed or refinanced as they come due in the foreseeable future.

**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 a business sector is lessened. Currently, no one tenant represents more than 12.8% of total leasable area or 23.2% of tenant receivables.

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 7 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] |
|---|---|---|---|---|---|
| Rated | | | | | |
| Government of Canada | Various | 2013 | 1,937 | 12.8 | AAA |
| Bank of Montreal/Nesbitt Burns | Toronto, Ottawa, Calgary | 2018 | 1,131 | 7.5 | A+ |
| Suncor Energy Inc. | Calgary | 2028 | 1,015 | 6.7 | BBB+ |
| Imperial Oil | Calgary | 2016 | 717 | 4.8 | AAA |
| Talisman Energy | Calgary | 2015 | 539 | 3.6 | BBB |
| Enbridge Inc. | Calgary, Edmonton | 2015 | 442 | 2.9 | A- |
| RBC Financial Group | Toronto, Calgary, Vancouver | 2024 | 438 | 2.9 | AA- |
| Canadian Natural Resources | Calgary | 2011 | 305 | 2.0 | BBB |
| CIBC | Toronto, Calgary | 2034 | 281 | 1.9 | A+ |
| EnCana Corporation | Calgary | 2014 | 241 | 1.6 | BBB+ |
| Manufacturers Life Insurance | Toronto | 2013 | 169 | 1.1 | AA+ |
| Lombard Insurance | Toronto | 2012 | 144 | 1.0 | A- |
| Westcoast Energy | Calgary, Vancouver | 2013 | 132 | 0.9 | BBB+ |
| National Bank of Canada | Toronto | 2013 | 121 | 0.8 | A |
| HSBC Of Canada | Toronto | 2011 | 109 | 0.7 | AA |
| Xstrata (Falconbridge) | Toronto | 2017 | 81 | 0.5 | BBB |
| Other investment-grade | Various | Various | 532 | 3.5 | BBB- or higher |
| | | | 8,334 | 55.2% | BBB- or higher |
| Bennett Jones | Toronto, Calgary | 2015 | 306 | 2.0 | |
| Osler, Hoskin & Harcourt | Toronto | 2014 | 270 | 1.8 | |
| Fraser Milner Casgrain | Toronto, Calgary | 2016 | 242 | 1.6 | |
| CI Investments Inc. | Toronto | 2014 | 220 | 1.5 | |
| The Hudson's Bay Company | Toronto | 2019 | 209 | 1.4 | |
| Toronto Stock Exchange | Toronto | 2018 | 179 | 1.2 | |
| Gowlings Canada Inc. | Toronto | 2020 | 170 | 1.1 | |
| Compton Petroleum Corporation | Calgary | 2019 | 151 | 1.0 | |
| Crescent Point Resources | Calgary | 2020 | 140 | 0.9 | |
| Davies Ward Philips Vineberg | Toronto | 2013 | 119 | 0.8 | |
| Citco (Canada) Inc. | Toronto | 2018 | 99 | 0.7 | |
| PriceWaterhouse Coopers | Calgary | 2015 | 95 | 0.6 | |
| Precision Drilling Corp. | Calgary | 2011 | 93 | 0.6 | |
| Other government agencies | Various | Various | 202 | 1.3 | |
| Total | | | 10,829 | 71.7% | |

[1] *Weighted average based on square feet*

[2] *Prior to considering partnership interests in partially owned properties and excludes parking*

[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. As at December 31, 2009, approximately 8.7% of our leases mature annually over the next five years (the majority of which is in 2013), with 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, 2009:

| (000's Sq. Ft.) | Currently Available | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 & Beyond | Leasable | Parking | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Toronto, Ontario | 157 | 518 | 313 | 553 | 1,416 | 235 | 455 | 473 | 2,105 | 6,225 | 828 | 7,053 |
| Ottawa, Ontario | 1 | 9 | 14 | 13 | 1,151 | 9 | 543 | 4 | 1 | 1,745 | 1,030 | 2,775 |
| Calgary, Alberta | 12 | 170 | 656 | 459 | 501 | 161 | 1,197 | 753 | 2,035 | 5,944 | 968 | 6,912 |
| Edmonton, Alberta | 7 | 33 | 55 | 7 | 9 | 27 | 148 | 20 | 285 | 591 | 121 | 712 |
| Vancouver, B.C | 35 | 20 | 71 | 62 | 84 | 7 | 61 | 25 | 224 | 589 | 264 | 853 |
| Other | — | — | — | — | 2 | — | — | — | 1 | 3 | — | 3 |
| Total | 212 | 750 | 1,109 | 1,094 | 3,163 | 439 | 2,404 | 1,275 | 4,651 | 15,097 | 3,211 | 18,308 |
| % of total | 1.4% | 5.0% | 7.3% | 7.2% | 21.0% | 2.9% | 15.9% | 8.4% | 30.9% | 100.0% | | 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 operations. 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 business, financial condition, or results of operations.

**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.

Taking into account the current state of the economy, 2010 likely will not provide the same level of increases in rental rates on renewals as compared to previous years. We are, however, substantially protected against short-term market conditions, as most of our leases are long-term in nature with an average term of seven years. As we continue to be in a state of recession, it is possible we will see downward pressure on overall occupancy levels and net effective rents, particularly in Calgary and Toronto.

The Company maintains insurance on its properties. The Company maintains all risk property insurance and rental value coverage (including coverage for the perils of flood and earthquake). The Company's all risk policy limit is $1.5 billion per occurrence. The Company's earthquake limit is $500.0 million per occurrence and in the annual aggregate, and is subject to a deductible, which is the greater of 3% of the value of the property insured or $250,000. This earthquake deductible applies to British Columbia only. All other locations in Canada have a flat $100,000 deductible for earthquakes. The flood limit is $500.0 million per occurrence and in the annual aggregate, and is subject to a deductible of $25,000 combined for all coverages.

The Company has insurance covering certain acts of terrorism for up to $1.0 billion 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.

**DERIVATIVE FINANCIAL INSTRUMENTS**

We utilize derivative financial instruments from time to time, 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 in offsetting an identified risk. Realized and unrealized gains and losses on derivative financial instruments designated as hedges of financial risks are included in income as an offset to the hedged item in the period the underlying asset, liability, or anticipated transaction to which they relate.

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

As of December 31, 2009, our use of derivative financial instruments was limited to forward gas contracts. Unrealized gains and losses, representing the fair value of such contracts, are determined in reference to the appropriate forward rate for each contract at December 31, 2009, and are reflected in receivables and other assets or accounts payable and other liabilities, as appropriate, on the consolidated balance sheet.

The Company has entered into fixed gas-purchase contracts with a third party gas supplier, which covers the period November 1, 2009, to October 31, 2010. As of December 31, 2009, the remaining commitment for the Company to purchase gas for its facilities was $2.3 million.

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 and gas prices. 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 – INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Company has been granted exemptive relief from the Canadian securities regulatory authorities to prepare its financial statements in accordance with International Financial Reporting Standards ("IFRS") for financial periods beginning on or after January 1, 2010, one year ahead of the mandatory conversion date for Canadian public companies. In light of the relief granted, the Company intends to adopt IFRS commencing with its interim financial statements for the three months ending March 31, 2010. These financial statements will also include comparative results for the three months ended March 31, 2009.

**IFRS Conversion Plan**

The Company has prepared a comprehensive IFRS conversion plan which addresses changes in accounting policies, the restatement of comparative periods, various education and training sessions on the adoption of IFRS as well as required changes to business processes and internal controls. The Company's finance and accounting staff have been informed of the Company's policies and procedures as they relate to IFRS. As a result of the training program and the preparation of a reconciliation of the Company's historical Canadian GAAP financial statements to IFRS financial statements, the Company believes that its applicable personnel have obtained an appropriate understanding of IFRS as it applies to the Company's financial reporting. While new controls are being put into place to address certain unique IFRS accounting and disclosure requirements, the Company does not anticipate comprehensive changes to its current accounting and consolidation systems, its internal controls nor its disclosure control process as a result of the conversion to IFRS.

**Impact of Adoption of IFRS**

IFRS are premised on a conceptual framework similar to Canadian GAAP, although significant differences exist in certain matters of recognition, measurement and disclosure. While the adoption of IFRS will not have an impact on the Company's reported net cash flows, the Company does expect it to have a material impact on its consolidated balance sheets and statements of income; the Company is continuing to evaluate the impact of IFRS to the presentation and classification in its statements of cash flow. In particular, the Company's opening balance sheet will reflect the revaluation of substantially all properties to fair value. In addition, the Company's intangible assets and liabilities will no longer be separately recognized. Also, certain joint-ventures, which are currently proportionately consolidated, will be recorded as investments accounted for following the equity method. Finally, all changes to the opening balance sheet will require that a corresponding tax asset or liability be established based on the resultant differences between the carried value of assets and liabilities and their associated tax bases. The Company currently expects that the impact of all of these differences on its January 1, 2009, opening balance sheet under IFRS compared to its December 31, 2008, balance sheet under Canadian GAAP will result in an increase in common equity from $478.7 million to approximately $1,683.2 million or $19.80 per share.

**IFRS 1: First-Time Adoption of IFRS**

The Company's adoption of IFRS will require the application of IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively. However, IFRS 1 does require certain mandatory exceptions and permits limited optional exemptions. The following is the optional exemption available under IFRS 1 which is significant to the Company and which the Company expects to be applied in preparation of its first financial statements under IFRS:

> *Business combinations*
>
> IFRS 1 states that a first-time adopter may elect not to apply IFRS 3, "Business Combinations" ("IFRS 3"), retrospectively to business combinations that occurred before the date of transition to IFRS. BPO Properties intends to make this election in order to only apply IFRS 3 to business combinations prospectively (i.e. to those that occur on or after January 1, 2009).

IFRS 1 allows for certain other optional exemptions; however, the Company does not expect such exemptions to be significant to its adoption of IFRS.

**Impact of IFRS on Financial Position**

The following paragraphs quantify and describe the expected impact of significant differences between the Company's December 31, 2008, balance sheet under Canadian GAAP and its January 1, 2009, opening balance sheet under IFRS. This discussion has been prepared using the standards and interpretations currently issued and expected to be effective at the end of the Company's first annual IFRS reporting period, which the Company expects will be December 31, 2010. Certain accounting policies expected to be adopted under IFRS may not be adopted and the application of such policies to certain transactions or circumstances may be modified and, as a result, the impact of the Company's conversion to IFRS may be different than its current expectation. The amounts have not been audited or subject to review by the Company's external auditor. The underlying values presented below are prepared using the procedures and assumptions that the Company intends to follow in preparing its opening balance sheet upon adoption of IFRS.

*Commercial Properties and Commercial Developments*

The Company considers its commercial properties and commercial developments to be investment properties under IAS 40, "Investment Property" ("IAS 40"). Investment property includes land and buildings held primarily to earn rental income or for capital appreciation or both, rather than for use in the production or supply of goods or for sale in the ordinary course of business. Similar to Canadian GAAP, investment property is initially recorded at cost under IAS 40. However, subsequent to initial recognition, IFRS requires that an entity choose either the cost or fair value model to account for its investment property. The Company expects to use the fair value model when preparing its financial statements under IFRS. The Company expects the fair value of its commercial and development property portfolio to be approximately $1,593.2 million greater than the carrying value under Canadian GAAP, inclusive of corresponding intangible assets and liabilities, free rent, deferred rent and straight-line rent recorded under Canadian GAAP. However, this increase will be offset by the deconsolidation of certain of the Company's properties, which is discussed further below (see *Investments*). The Company determined the fair value of each investment property based upon, among other things, rental income from current leases and assumptions about rental income from future leases reflecting market conditions at January 1, 2009, less future cash outflows in respect of such leases. Fair values were primarily determined by discounting the expected future cash flows, generally over a term of 10 years, and using weighted average discount and terminal capitalization rates of 7.4% and 6.6%, respectively.

Under IFRS, the capitalization period for commercial developments continues until the asset is capable of operating in the manner intended by management, whereas under Canadian GAAP, capitalization is allowed to continue until a specified occupancy level or productive capacity is achieved. The adoption to IFRS will effectively result in a shorter capitalization period for development properties.

*Investments*

The Company expects to have investments at January 1, 2009, of approximately $27.2 million under IFRS. These investments relate primarily to entities that are proportionately consolidated under Canadian GAAP that will be equity accounted for under IFRS and accordingly included in the investments account of the Company.

*Tenant Receivables and Other Assets*

Straight-line, free rent and tenant inducement receivables reflected in tenant receivables and other assets under Canadian GAAP will be included in the carrying amount of commercial properties in the Company's balance sheets under IFRS. The Company expects its tenant receivables and other assets balance to decrease by approximately $27.3 million under IFRS as a result of the reclassification of straight-line, free rent and tenant inducement receivable balances to commercial properties, as well as the impact of certain joint-ventures as investments.

*Intangible Assets and Liabilities*

With the adoption of IFRS, the Company will derecognize its intangible assets and liabilities that relate to assets or obligations otherwise considered in the determination of fair value of investment properties at January 1, 2009. The Company expects this will result in a decrease to intangible assets and liabilities of approximately $30.3 million and $71.9 million, respectively.

*Accounts Payable and Other Liabilities*

Deferred rents that arise from tenant build out delays on leases where the landlord has provided a tenant improvement allowance under Canadian GAAP will be included in the carrying amount of commercial properties in the Company's balance sheet under IFRS. The Company expects its accounts payable and other liabilities balance to decrease by approximately $0.5 million under IFRS as a result of the reclassification of deferred rent balances to commercial properties, as well as the impact of certain joint-ventures as investments.

*Future Income Tax Liability*

The Company expects its future income tax liability at January 1, 2009 to increase by approximately $396.7 million under IFRS compared to its future income tax liability determined in accordance with Canadian GAAP. This change primarily relates to an increase in future income tax liabilities associated with the increased carrying values of the Company's commercial properties. The future income tax liability under IFRS will generally be determined by applying tax rates applicable to business income to temporary differences based on the Company's general expectation that the method of realization will be through owning and operating its properties rather than through sale.

*Commercial Property Debt*

The Company expects the reported balances of property specific mortgages and subsidiary borrowings at January 1, 2009 to decrease by approximately $62.2 million under IFRS compared to balances reported in accordance with Canadian GAAP. The decrease primarily relates to the deconsolidation of debt held by entities that are proportionately consolidated under Canadian GAAP that will be equity accounted under IFRS.

**Impact of IFRS on Results of Operations**

The following paragraphs highlight the significant differences between Canadian GAAP and IFRS that affect net income for the year ended December 31, 2009. Such discussion has been prepared on a basis consistent with all known IFRS to Canadian GAAP differences using the accounting policies expected to be applied by the Company on its adoption of IFRS using the standards anticipated to be in effect at the time of transition. Consequently, to the extent the accounting policies expected to be applied by the Company on adoption of IFRS change, new standards are issued that are required to be adopted the Company, or to the extent the Company identifies additional differences as it completes its assessment of IFRS, the amounts and discussion below may be impacted. The Company has not finalized its selection of certain policies. The amounts have not been audited or subject to review by the Company's external auditor.

*Fair Value Changes*

IFRS permits the measurement of investment property using the fair value model under IAS 40, "Investment Property", which requires a gain or loss arising from a change in the fair value of investment property in the period to be recognized in income. Net income during any given period may be greater or less than as determined under Canadian GAAP depending on whether an increase or decrease in fair value occurs during the period of measurement.

*Depreciation and Amortization Expense*

Under the fair value model, depreciation of investment properties is not recorded. Additionally, the transition to IFRS in conjunction with the use of the fair value model would result in historic intangible balances established under Canadian GAAP in respect of business combinations to no longer be separately recognized, and accordingly, not amortized under IFRS. The impact of no longer amortizing historic intangible balances along with no longer recording depreciation expense on the Company's commercial properties would result in an increase to net income of approximately $51.0 million on an annualized basis.

*Revenue recognition*

IFRS requires rental revenue to be determined on a straight-line basis considering all rentals from the inception of the lease, whereas Canadian GAAP only required rental income to be recognized on a straight-line basis prospectively commencing January 1, 2004. The Company expects that this difference, applied retrospectively, would result in a reduction to net income under IFRS. For the year ended December 31, 2009, this reduction is expected to be insignificant. Also, as the Company will no longer separately account for intangible assets and liabilities relating to acquired above and below market tenant leases, the related amortization of these balances to commercial property revenue will be eliminated under IFRS. This difference would result in a reduction of revenue and net income under IFRS of approximately $8.8 million on an annualized basis.

*Incidental Operations*

Under IFRS, incidental income related to operations that are incidental to the construction of a development property are to be recognized into income, rather than recognized as part of the cost of an asset during the development period as permitted under Canadian GAAP. The impact of no longer adding incidental income to the cost of an asset during the development period will result in an increase to net income of approximately $1.9 million for the year ended December 31, 2009.

## PART V – 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").

**Goodwill and Intangible Assets**

Effective January 1, 2009, the Company adopted CICA Handbook Section 3064, "Goodwill and Intangible Assets." Section 3064 replaces Sections 3062, "Goodwill and Other Intangible Assets," and 3450, "Research and Development Costs." Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Standards concerning goodwill are unchanged from those included in the previous Section 3062. In addition, various changes have been made to other sections of the CICA Handbook for consistency purposes. As a result of the related amendments to Section 1000, "Financial Statement Concepts," any expenses deferred pursuant to previously existing "matching" concepts and which do not otherwise meet the definition of an asset, are no longer eligible for capitalization as an asset. The Company adopted the new standards relating to Section 3064 on January 1, 2009, retrospectively with restatement. The comparative figures have been reclassified as follows:

| December 31 (Millions) | | 2008 |
|---|---|---|
| **Retained earnings** | | |
| Opening balance at January 1, 2008, as previously reported | $ | 580.0 |
| Cumulative impact of changes in accounting policy[1] | | (0.5) |
| Opening balance at January 1, 2008 – as restated | $ | 579.5 |
| | | |
| Ending balance at December 31, 2008, as previously reported | $ | 401.0 |
| Cumulative impact of changes in accounting policy[2] | | (0.7) |
| Ending balance at December 31, 2008 – as restated | $ | 400.3 |

*[1] A decrease of $0.5 million to opening retained earnings, representing changes to recoverable expenditures prior to January 1, 2008, that do not qualify as an asset under Section 3064*

*[2] A decrease of $0.2 million to retained earnings, representing a reduction of $0.1 million in depreciation and amortization and an increase of $0.3 million to operating expenses was recorded during the year ended December 31, 2008*

| December 31 (Millions) | | 2008 |
|---|---|---|
| **Commercial properties** | | |
| Balance at December 31, 2008, as previously reported | $ | 1,338.7 |
| Cumulative impact of changes in accounting policy | | (0.7) |
| Balance at December 31, 2008 – as restated | $ | 1,338.0 |

**Credit Risk and the Fair Value of Financial Assets and Financial Liabilities**

In January 2009, the EIC issued Abstract No. 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". EIC 173 provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. EIC 173 is applicable to the annual consolidated financial statements for the year-ended December 31, 2009. The adoption of EIC 173 did not have a material impact on the Company's consolidated financial statements.

**Financial Instruments**

In June 2009, the CICA issued amendments to Section 3862, "Financial Instruments – Disclosures," and Section 3863, "Financial Instruments – Presentation," effective for the Company's December 31, 2009, financial statements. Specifically, the Company will classify and disclose financial statements presented at fair value on the balance sheets based on a three-level fair value hierarchy that distinguishes between market value data obtained from independent sources and the Company's own assumptions about market value: Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities; Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities or valuation techniques where significant inputs are based on observable market data; and Level 3 – Valuation techniques for which any significant inputs are not based on observable market data. The Sections have also been amended to require additional liquidity risk disclosures.

Also in June 2009, the CICA issued amendments to Section 3855, "Financial Instruments – Recognition and Measurement," effective for the Company's December 31, 2009, financial statements. The amendments clarified Section 3855 with respect to the effective interest method, reclassification of financial instruments with embedded derivatives and eliminated the distinction between debt securities and other debt instruments and changed the categories to which debt instruments are required or are permitted to be classified.

These amendments did not have a significant impact on the consolidated financial statements.

## FUTURE ACCOUNTING POLICY CHANGES

### Business Combinations and Consolidated Financial Statements

In January 2009, the CICA issued two new accounting standards, Section 1582, "Business Combinations," and Section 1601, "Consolidated Financial Statements." Section 1582 provides clarification as to what an acquirer must measure when it obtains control of a business, the basis of valuation and the date at which the valuation should be determined. Acquisition-related costs must be accounted for as expenses in the periods they are incurred, except for costs incurred to issue debt or share capital. This new standard will be applicable for acquisitions completed on or after November 1, 2011, although adoption in 2010 is permitted to facilitate the transition to IFRS in 2011.

Section 1601 establishes standards for preparing consolidated financial statements after the acquisition date and must be adopted concurrently with Section 1582.

## 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 in-place operating 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 in-place operating leases at their fair values, using a discount rate that reflects the risks associated with the leases acquired. The fair values are 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.

Our lease agreements generally provide for payments by the landlord to the tenant in the form of tenant improvement allowances, which are amounts paid by the Company pursuant to such lease provisions and are characterized as either the purchase of tenant improvements owned by the landlord, or tenant inducements. When the payment is determined to be for tenant improvements owned by the Company, then the improvements are accounted for as an addition to commercial properties and depreciated over their estimated useful lives. If the Company determines that it is not the owner of the tenant improvements, then the property subject to the lease is the unimproved space and any payments made to the tenant under the lease are treated as tenant inducements, which reduce revenue over the term of the lease.

### 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.

There were no impairments recorded for the years ended December 31, 2009, and December 31, 2008.

### Revenue Recognition
Base rental revenue, representing the total amount of contractual rent to be received from a lease, is reported on a straight-line basis over the term of each lease. Revenue recognition under a lease begins when the tenant takes possession of, or controls, the physical use of the property subject to the lease. Generally, this occurs on the lease commencement date or, where we are required to make additions to the property in the form of tenant improvements, upon substantial completion of those improvements. A free-rent or straight-line rent receivable is recorded for 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.

In accordance with EIC 140, we also recognize rental revenue of acquired in-place above- and below-market leases at their fair value over the terms of the respective leases.

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.

Revenue and expenses related to commercial developments are recognized in income when the development is substantially complete. This is also the point at which the property is reclassified from commercial developments to commercial properties. The Company considers a commercial development to be substantially complete upon the earlier of attaining an occupancy that results in break-even income after debt servicing or the expiration of a reasonable maximum period of time, but no later than two years after substantial completion of the building. Prior to substantial completion, revenues and expenses related to commercial developments are capitalized to the property. To the extent a development or redevelopment property is leased and the tenant begins to occupy the space as construction is substantially complete in phases, we would recognize revenue and expenses in accordance with those respective phases.

### 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.

The fair values of derivative instruments are calculated using generally accepted pricing models.

### 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 de-recognized $nil (compared to $1.6 million in 2008) 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.

**RELATED-PARTY TRANSACTIONS**

In the normal course of operations, the Company enters into various transactions on market terms with related parties which 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 Olympia & York 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 $11.6 million during 2009 (compared to $13.0 million in 2008). 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 2009 totaled $1.3 million (compared to $0.8 million in 2008). These costs have been included in general and administrative expenses.

The Company has certain arrangements with a subsidiary of Brookfield Asset Management Inc. (“BAM”), the ultimate parent of the Company, and BPC to provide various information technology services and with BPC to provide various administrative services including accounts payable processing and accounts receivable collection. The costs for these services amounted to $9.0 million for the year ended December 31, 2009 (compared to $8.2 million during 2008), consisting of $6.1 million in operating costs and $2.9 in capital costs, and are charged to the Company on a cost recovery basis. These operating costs have been included in general and administrative expenses and capital costs have been capitalized to other assets and are being amortized over their estimated useful life.

Included in loans receivable at December 31, 2009, is a $85.0 million (compared to $125.0 million on December 31, 2008) on-demand deposit placed with BPC. During the first quarter of 2009, BPC repaid the $125.0 million on-demand deposit and during the fourth quarter of 2009, a new $85.0 million on-demand deposit was placed with BPC. For the year ended December 31, 2009, interest income of $0.3 million was recorded on these deposits (compared to $7.0 million in 2008).

Included in rental revenues during the year ended December 31, 2009, are amounts received from BAM and its affiliates of $0.3 million (compared to $0.4 million in 2008). In addition, the Company has certain arrangements with BAM and its affiliates to acquire insurance in the normal course and at market rates or at cost. These fees are based on a percentage of the annual premiums paid.

## PART VI – BUSINESS ENVIRONMENT AND OUTLOOK

### OPERATING ENVIRONMENT AND OUTLOOK

The consequences of the downturn in the economy, including a rise in unemployment, a drop in consumer and business confidence and spending, and nearly non-existent debt markets, had an adverse impact on the real estate industry through the first half of the year. Leasing demand in most of our markets tempered and vacancy rates began to rise, which put downward pressure on rents and economic fundamentals. However, the second half of the year started to show signs of improvement as leasing activity accelerated and leasing economics stabilized. Despite increasing vacancy across our markets, our portfolio ended the year at 98.6% occupied, which speaks to the high quality of our properties and tenants relative to others. With only 5% of the space within our portfolio scheduled to come off lease in 2010, our strong tenant lease profile, low vacancies, low lease roll-over exposure and rental rates in most properties substantially below current market rates, we have a high level of confidence that we can achieve our operating targets in 2010.

We remain committed to commercial property development and redevelopment opportunities in these current market conditions. Any new development will have to provide appropriate risk-adjusted returns, have substantial pre-lease commitments and be financeable before we would be willing to proceed.

Looking longer term, with a solid platform consisting of a strong balance sheet, a well-leased portfolio with below-market net rents, a 5.4 million square foot development and redevelopment pipeline and financial flexibility, BPO Properties is well-positioned to continue to deliver on its commitments to shareholders.

On February 26, 2010, we announced a proposal to create a real estate investment trust (REIT), which will acquire a significant portion of the assets of BPO Properties and will also acquire BPC's interest in Brookfield Place located in Toronto, Ontario. As part of the transaction, holders of the Company's common shares will receive one REIT unit in exchange for their existing shares. Select assets of the Company and certain development properties, as well as certain assets which are not permitted to be owned by the REIT, will be retained by the Company. If the necessary approvals are obtained, it is anticipated that the transaction will be completed in mid-April 2010. Management is currently assessing the impact of the proposed transaction on the financial statements of the Company.

### 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 National Instrument 52-109) as of December 31, 2009. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that such disclosure controls and procedures as of December 31, 2009, are effective 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

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the President and Chief Executive Officer and the Chief Financial Officer and effected by the Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Management assessed both the design and operating effectiveness of the Company's internal control over financial reporting as at December 31, 2009, based on criteria established by the COSO control framework and National Instrument 52-109. Based on this assessment, management believes that, as at December 31, 2009, the Company's internal control over financial reporting is effective.

Due to its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements on a timely basis. Also, projections of any evaluation to the effectiveness of internal control over the financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management took appropriate steps that enabled it to conclude that during the fiscal year ended December 31, 2009, 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.

*Bryan Davis*
*Senior Vice President and Chief Financial Officer*
*February 26, 2010*

**DISTRIBUTIONS**

Distributions paid by the Company during the year ended December 31, 2009, and the past three fiscal years are as follows:

| | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|
| Common shares[(1)(2)(3)] | **$ 0.30** | $ 0.20 | $ 0.20 | $ 0.20 |
| Preferred shares | | | | |
| Series G | **0.56** | 0.97 | 1.05 | 0.92 |
| Series J | **0.50** | 0.94 | 1.06 | 0.95 |
| Series K | **5,311.78** | 19,202.33 | 24,662.88 | 22,194.65 |
| Series M | **0.50** | 0.94 | 1.06 | 0.95 |
| Series N | **0.27** | 0.96 | 1.23 | 1.11 |

(1) *Excludes the special common share dividend of $1.65 and $2.42 per share for the second quarter of 2009 and 2008, respectively*

(2) *The ongoing quarterly dividend was increased by 100% to $0.10 per common share with the first increase paid on Sept. 30, 2009, to shareholders of record at end of business day Sept. 1, 2009*

(3) *Prior year share information has been restated to reflect the three-for-one common stock split.*

**ADDITIONAL INFORMATION**

A supplementary information package with more detailed financial information is posted on BPO Properties' website at www.bpoproperties.com and should be read in conjunction with this annual report.

# Management's Responsibility for the Financial Statements

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

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

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

*Thomas F. Farley*
*President and Chief Executive Officer*
*February 26, 2010*

*Bryan Davis*
*Senior Vice President and Chief Financial Officer*

# Auditors' Report

To the Shareholders of BPO Properties Ltd.

We have audited the consolidated balance sheets of BPO Properties Ltd. as at December 31, 2009 and 2008 and the consolidated statements of income and comprehensive income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*Toronto, Canada*
*February 22, 2010, except as to Note 20 which is as of February 26, 2010*

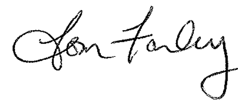
*Chartered Accountants*
*Licensed Public Accountants*

# Consolidated Balance Sheets

| December 31 (Millions) | Notes | **2009** | 2008 (Restated-Note 2) |
|---|---|---|---|
| **Assets** | | | |
| Commercial properties | 4 | **$ 1,384.4** | $ 1,338.0 |
| Commercial developments | 5 | **744.0** | 689.1 |
| Loans receivable | 6 | **85.0** | 150.6 |
| Intangible assets | 7 | **23.9** | 30.3 |
| Tenant receivables and other assets | 8 | **113.2** | 82.3 |
| Cash and cash equivalents | 9 | **55.7** | 61.5 |
| | | **$ 2,406.2** | $ 2,351.8 |
| **Liabilities** | | | |
| Commercial and development property debt | 10 | **$ 1,447.7** | $ 1,255.3 |
| Intangible liabilities | 11 | **62.8** | 71.9 |
| Accounts payable and other liabilities | 12 | **115.1** | 135.6 |
| Future income tax liabilities | 13 | **30.7** | 28.6 |
| **Shareholders' equity** | 14 | **749.9** | 860.4 |
| | | **$ 2,406.2** | $ 2,351.8 |

*See accompanying notes to the consolidated financial statements*

On behalf of the Board,



Richard B. Clark
Chairman

Thomas F. Farley
President and Chief Executive Officer

# Consolidated Statements of Income and Comprehensive Income

| December 31 (Millions, except per-share amounts) | Notes | | **2009** | | 2008 (Restated-Note 2) |
|---|---|---|---|---|---|
| **Commercial Properties** | | | | | |
| Revenue | | **$** | **350.9** | $ | 345.1 |
| Expenses | | | **148.3** | | 149.9 |
| | | | **202.6** | | 195.2 |
| Loans and investment income | | | **3.8** | | 20.5 |
| | | | **206.4** | | 215.7 |
| **Expenses** | | | | | |
| Interest expense | 10 | | **40.5** | | 39.5 |
| General and administrative expenses | | | **24.5** | | 22.5 |
| | | | **141.4** | | 153.7 |
| Depreciation and amortization | | | **52.4** | | 53.6 |
| Income taxes | 13 | | **27.5** | | 34.8 |
| **Net income and comprehensive income** | | **$** | **61.5** | $ | 65.3 |
| **Net income per common share**[1] | 14 | **$** | **0.66** | $ | 0.60 |

*See accompanying notes to the consolidated financial statements*

[1] *Prior year share information has been restated to reflect the three-for-one common stock split (see note 14).*

# Consolidated Statements of Changes in Shareholders' Equity

| December 31 (Millions) | Notes | 2009 | 2008 (Restated-Note 2) |
|---|---|---|---|
| **Preferred shares** | | | |
| Balance at beginning and end of year | | **$ 381.7** | $ 381.7 |
| **Common shares** | | | |
| Balance at beginning of year | | **78.4** | 78.8 |
| Share repurchases | 14 | **(0.1)** | (0.4) |
| Balance at end of year | | **78.3** | 78.4 |
| **Retained earnings** | | | |
| Balance at beginning of year | | **400.3** | 579.5 |
| Net income | | **61.5** | 65.3 |
| Preferred share dividends | 14 | **(5.7)** | (14.3) |
| Common share dividends | 14 | **(165.7)** | (223.6) |
| Amount paid in excess of the book value of common shares repurchased | 14 | **(0.5)** | (6.6) |
| Balance at end of year | | **289.9** | 400.3 |
| **Accumulated other comprehensive income ("AOCI")** | | **—** | — |
| **Retained earnings and AOCI** | | **289.9** | 400.3 |
| **Shareholders' equity at end of year** | | **$ 749.9** | $ 860.4 |

*See accompanying notes to the consolidated financial statements*

# Consolidated Statements of Cash Flows

| December 31 (Millions) | Notes | 2009 | 2008 (Restated-Note 2) |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | | **$ 61.5** | $ 65.3 |
| Add (deduct): | | | |
| Depreciation and amortization | | **52.4** | 53.6 |
| Future income taxes | | **3.8** | 18.3 |
| Amortization of intangible operating leases | | **(6.1)** | (10.2) |
| Amortization of above market ground leases | | **(2.5)** | (2.7) |
| Amortization of deferred debt financing costs | | **4.2** | 3.7 |
| Loan receivable - foreign exchange | | **2.4** | (4.7) |
| Deferred leasing costs | | **(3.1)** | (3.7) |
| Increase in straight-line rent receivables | | **(1.0)** | (2.1) |
| Increase in receivables | | **(5.0)** | (10.6) |
| Increase in other assets | | **(11.6)** | (2.4) |
| (Decrease) increase in accounts payable and other liabilities | | **(20.7)** | 5.4 |
| **Cash flows provided by operating activities** | | **74.3** | 109.9 |
| **Investing activities** | | | |
| Development and redevelopment expenditures | | **(119.9)** | (237.8) |
| Capital expenditures | | **(15.0)** | (20.2) |
| Commercial property tenant improvements | | **(9.8)** | (7.3) |
| Dispositions of properties, net | | **—** | 3.3 |
| Restricted cash and deposits | | **(14.8)** | — |
| Advances to related parties | 6 | **(85.0)** | (125.0) |
| Repayments from related parties | 6 | **125.0** | 220.3 |
| Loans receivable – collections | | **23.2** | 41.8 |
| **Cash flows used in investing activities** | | **(96.3)** | (124.9) |
| **Financing activities** | | | |
| Commercial and development property debt amortization | | **(17.5)** | (15.6) |
| Commercial and development property debt repayments | | **(209.9)** | (358.9) |
| Commercial and development property debt arranged | | **417.8** | 660.5 |
| Amortization of debt premiums | | **(2.3)** | (2.3) |
| Repurchase of common shares | 14 | **(0.5)** | (7.0) |
| Common share dividends paid | | **(165.7)** | (223.6) |
| Preferred share dividends paid | | **(5.7)** | (14.3) |
| **Cash flows provided by financing activities** | | **16.2** | 38.8 |
| **(Decrease) increase in cash and cash equivalents** | | **(5.8)** | 23.8 |
| Cash and cash equivalents, beginning of year | | **61.5** | 37.7 |
| **Cash and cash equivalents, end of year** | | **$ 55.7** | $ 61.5 |

*See accompanying notes to the consolidated financial statements and supplemental cash flow information in note 19*

# Notes to the Consolidated Financial Statements

## NOTE 1: SUMMARY OF ACCOUNTING POLICIES

### (a) General

The consolidated financial statements of BPO Properties Ltd. ("the Company", or "BPO") are prepared in accordance with generally accepted accounting principles ("GAAP") as prescribed by the Canadian Institute of Chartered Accountants ("CICA").

### (b) Principles of consolidation

The consolidated financial statements include the accounts of all of the Company's subsidiaries and its proportionate share of assets, liabilities, revenues, and expenses of joint-ventures. All intercompany balances have been eliminated.

### (c) Properties

(i) Commercial properties

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

Depreciation on buildings is provided on a straight-line basis over the useful lives of the properties to a maximum of 60 years. Depreciation is determined with reference to each rental property's carried value, remaining estimated useful life and residual value. Depreciation on buildings is recorded in depreciation and amortization expense.

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

(ii) Commercial developments

Commercial developments consist of properties for which a major repositioning program is being conducted and properties that are under construction. These properties are recorded at cost, including predevelopment expenditures. For commercial developments, an impairment loss is recognized when a property's carrying value exceeds its undiscounted future net cash flow.

Properties are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. The impairment is measured as the amount by which the carrying value exceeds the estimated fair value. Projections of future cash flow take into account the specific business plan for each property and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

(iii) Discontinued operations

Commercial properties that qualify as "held for sale" pursuant to the criteria of CICA Handbook Section 3475, "Disposal of Long-Lived Assets and Discontinued Operations," are classified as held for sale. Such properties 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 related to any property that has been identified as held for sale are reported separately as discontinued operations if the Company will not have any significant continuing involvement in the operations of the property after the disposal transaction. Comparative amounts are also restated.

### (d) Capitalized costs

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

**(e) Leasing costs**

Leasing costs include the following:

i) Tenant improvements, in which lease agreements generally provide for payments by the landlord to the tenant in the form of tenant improvement allowances, are amounts paid by the Company pursuant to such lease provisions and are characterized as either the purchase of tenant improvements owned by the landlord or as tenant inducements. When the payment is determined to be for tenant improvements owned by the Company, the improvements are accounted for as an addition to commercial properties and depreciated over their estimated useful life. If the Company determines that it is not the owner of the tenant improvements, any payments made to the tenant under the lease are treated as tenant inducements, which are amortized to revenues over the term of the lease on a straight-line basis; and

ii) Leasing fees, which include third-party brokerage fees and legal costs incurred in the successful negotiation of leases. These fees are amortized on a straight-line basis over the term of the applicable lease to amortization expense. The unamortized balance is included in commercial properties.

**(f) Intangible assets and liabilities**

Intangible assets and liabilities include the value of above- and below-market in-place operating leases, lease-origination costs, tenant relationships, and above-market ground-lease obligations. Intangible assets and liabilities are stated at historic cost less accumulated amortization and impairment charges, if any.

The values of above- and below-market in-place operating leases are amortized on a straight-line basis to commercial properties revenue over the remaining term of the associated lease. Lease-origination costs are amortized on a straight-line basis to amortization expense over the remaining term of the applicable lease. The value of tenant relationships is amortized on a straight-line basis to amortization expense over the remaining term of the lease plus an estimated renewal term. In the event that a tenant vacates the leased space prior to the contractual termination of the lease or does not exercise their renewal and no rental payments are being made on the lease, any unamortized balance of the related intangible will be expensed.

**(g) Revenue recognition**

i) Commercial properties

The Company has retained substantially all of the risks and benefits of ownership of its rental properties and therefore accounts for leases with its tenants as operating leases. Revenue recognition under a lease begins when the tenant takes possession of, or controls, the physical use of the property subject to the lease. Generally, this occurs on the lease commencement date or, where the Company is required to make additions to the property in the form of tenant improvements, upon substantial completion of those improvements. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease; a straight-line rent receivable is recorded for the difference between the rental revenue recorded and the contractual amount received. Rental revenue also includes percentage participating rents and recoveries of operating expenses, including property and capital taxes. Percentage participating rents are recognized when tenants' specified sales targets have been met. Operating expense recoveries are recognized in the period that recoverable costs are chargeable to tenants.

Revenue and expenses related to commercial developments are recognized in income when the development is substantially complete. This is also the point at which the property is reclassified from commercial developments to commercial properties. The Company considers a commercial development to be substantially complete upon the earlier of attaining an occupancy that results in break-even income after debt servicing or the expiration of a reasonable maximum period of time, but no later than one year after substantial completion of the building. Prior to substantial completion, revenues and expenses related to commercial developments are capitalized to the property.

ii) Performance and management fee revenue

The Company is entitled to management fees and performance fees on the management of properties for third parties. The Company recognizes management fees in accordance with its agreements as incurred. The Company recognizes performance fees in revenue when the amount receivable from its fund partners is determinable at the end of a contractually specified term.

**(h) Income taxes**

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

**(i) Reporting currency and foreign currency translation**

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

**(j) Use of estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires estimates and assumptions that affect the carried amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. 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 fair values, the allocation of the purchase prices to components of commercial properties and businesses acquired, the useful lives and residual value for depreciation and amortization, the Company's ability to utilize tax losses and the rates at which those losses and timing differences will be realized, the selection of discount and capitalization rates used to fair value assets, the effectiveness of hedges, and the fair value of financial instruments for disclosure purposes.

**(k) Financial instruments and derivatives**

Financial assets and financial liabilities, including derivatives, are measured at fair value on initial recognition in the consolidated balance sheets. Measurement subsequent to initial recognition depends on the financial instrument's classification, which is determined by the purpose for which the instrument was acquired or issued, the instrument's characteristics and the Company's designation of the instrument. Financial instruments are classified as held for trading, available-for-sale, held to maturity, loans and receivables, or other financial liabilities.

Financial assets and financial liabilities classified as held for trading are measured at fair value with changes in those fair values recognized in net income. Financial assets and liabilities classified as 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. 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. Available-for-sale financial assets are measured at fair value with changes therein, together with foreign currency translation gains and losses, recognized in Other Comprehensive Income ("OCI"). The Company did not hold any financial instruments that are classified as available-for-sale as at December 31, 2009 and 2008.

Derivative instruments are recorded on the consolidated balance sheets at fair value, including those derivatives that are embedded in financial or non-financial contracts and 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 an effective cash flow hedge.

The Company presents financial assets on the consolidated balance sheets in tenant and other receivables, loans receivable, and cash and cash equivalents. Non-derivative financial assets presented in tenant and other receivables and loans receivable are classified as loans and receivables and are carried at amortized cost. Derivatives and embedded derivatives with a favourable fair value to the Company are presented in tenant and other receivables and loans receivable at fair value. Cash and cash equivalents are classified as held for trading and measured at fair value at the balance sheet date.

The Company presents financial liabilities in commercial and development property debt, and accounts payable and other liabilities. All of the Company's non-derivative financial liabilities are classified as other liabilities and measured at amortized cost following the effective-interest method. Derivatives and embedded derivatives with an unfavourable fair value to the Company are presented in accounts payable and other liabilities at fair value.

The Company utilizes derivative financial instruments primarily to manage financial risks, including interest rate, commodity and foreign-exchange risks. The use of derivative contracts is governed by documented risk-management policies and approved limits.

The Company applies hedge accounting to derivative financial instruments in cash flow hedging relationships. Hedge accounting is discontinued prospectively when the hedge relationship is terminated or no longer qualifies as a hedge, or when the hedged or hedging item is sold or terminated.

In cash flow hedging relationships, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI while the ineffective portion is recognized in net income. When hedge accounting is discontinued, the amounts previously recognized in Accumulated Other Comprehensive Income ("AOCI") are reclassified to net income in the periods when the variability in the cash flows of the hedged item affects net income. Gains and losses on derivatives are reclassified immediately to net income when the hedged item is sold or terminated or when it is determined a hedged forecasted transaction is no longer probable.

Derivative 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 net income in the period the changes occur. Realized and unrealized gains and losses on other derivatives not designated as hedges are recorded in interest and other income.

### (l) Cash and cash equivalents

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

## NOTE 2: CHANGES IN ACCOUNTING POLICIES

### Goodwill and Intangible Assets

Effective January 1, 2009, the Company adopted CICA Handbook Section 3064, "Goodwill and Intangible Assets." Section 3064 replaces Sections 3062, "Goodwill and Other Intangible Assets," and 3450, "Research and Development Costs." Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Standards concerning goodwill are unchanged from those included in the previous Section 3062. In addition, various changes have been made to other sections of the CICA Handbook for consistency purposes. As a result of the related amendments to Section 1000, "Financial Statement Concepts," any expenses deferred pursuant to previously existing "matching" concepts and which do not otherwise meet the definition of an asset, are no longer eligible for capitalization as an asset. The Company adopted the new standards relating to Section 3064 on January 1, 2009, retrospectively with restatement. The comparative figures have been restated as follows:

| December 31 (Millions) | | 2008 |
|---|---|---|
| **Retained earnings** | | |
| Opening balance at January 1, 2008, as previously reported | $ | 580.0 |
| Cumulative impact of changes in accounting policy[1] | | (0.5) |
| Opening balance at January 1, 2008 – as restated | $ | 579.5 |
| | | |
| Ending balance at December 31, 2008, as previously reported | $ | 401.0 |
| Cumulative impact of changes in accounting policy[2] | | (0.7) |
| Ending balance at December 31, 2008 – as restated | $ | 400.3 |

*[1] A decrease of $0.5 million to opening retained earnings, representing changes to recoverable expenditures prior to January 1, 2008, that do not qualify as an asset under CICA Handbook Section 3064*

*[2] A decrease of $0.2 million to retained earnings, representing a reduction of $0.1 million in depreciation and amortization and an increase of $0.3 million to operating expenses was recorded during the year ended December 31, 2008*

| December 31 (Millions) | | 2008 |
|---|---|---|
| **Commercial properties** | | |
| Balance at December 31, 2008, as previously reported | $ | 1,338.7 |
| Cumulative impact of changes in accounting policy | | (0.7) |
| Balance at December 31, 2008 – as restated | $ | 1,338.0 |

### Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

In January 2009, the EIC issued Abstract No. 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". EIC 173 provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. EIC 173 is applicable to the annual consolidated financial statements for the year ended December 31, 2009. The adoption of EIC 173 did not have a material impact on the Company's consolidated financial statements.

### Financial Instruments

In June 2009, the CICA issued amendments to Section 3862, "Financial Instruments – Disclosures," and Section 3863, "Financial Instruments – Presentation," effective for the Company's December 31, 2009, financial statements. Specifically, the Company will classify and disclose financial instruments presented at fair value on the balance sheets based on a three-level fair value hierarchy that distinguishes between market value data obtained from independent sources and the Company's own assumptions about market value: Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities; Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities or valuation techniques where significant inputs are based on observable market data; and Level 3 – Valuation techniques for which any significant inputs are not based on observable market data. The Sections have also been amended to require additional liquidity risk disclosures.

Also in June 2009, the CICA issued amendments to Section 3855, "Financial Instruments – Recognition and Measurement," effective for the Company's December 31, 2009, financial statements. The amendments clarified Section 3855 with respect to the effective-interest method, reclassification of financial instruments with embedded derivatives and eliminated the distinction between debt securities and other debt instruments and changed the categories to which debt instruments are required or are permitted to be classified.

These amendments did not have a significant impact on the consolidated financial statements.

## NOTE 3: FUTURE ACCOUNTING POLICY CHANGES

**Business Combinations and Consolidated Financial Statements**

In January 2009, the CICA issued two new accounting standards, Section 1582, "Business Combinations," and Section 1601, "Consolidated Financial Statements." Section 1582 provides clarification as to what an acquirer must measure when it obtains control of a business, the basis of valuation and the date at which the valuation should be determined. Acquisition-related costs must be accounted for as expenses in the periods they are incurred, except for costs incurred to issue debt or share capital. This new standard will be applicable for acquisitions completed on or after November 1, 2011, although adoption in 2010 is permitted to facilitate the transition to International Financial Reporting Standards ("IFRS") in 2011.

Section 1601 establishes standards for preparing consolidated financial statements after the acquisition date and must be adopted concurrently with Section 1582.

**International Financial Reporting Standards**

The Canadian Accounting Standards Board has determined that profit-oriented publicly accountable enterprises will be required to adopt International Financial Reporting Standards. IFRS will replace current Canadian GAAP for those enterprises. The Company has elected to early-adopt IFRS effective for interim and annual periods commencing January 1, 2010, including the preparation and reporting of one year of comparative figures.

## NOTE 4: COMMERCIAL PROPERTIES

A breakdown of commercial properties is as follows:

| (Millions) | **2009** | 2008 (Restated Note 2) |
|---|---|---|
| Commercial properties | | |
| Land | **$ 159.1** | $ 153.5 |
| Building and improvements | **1,471.5** | 1,399.1 |
| Total commercial properties | **1,630.6** | 1,552.6 |
| Less: accumulated depreciation | **(246.2)** | (214.6) |
| Total | **$ 1,384.4** | $ 1,338.0 |

(a) At December 31, 2009, commercial properties with a net book value of approximately $533.1 million (compared to $539.7 million on December 31, 2008) are situated on land held under leases or other agreements largely expiring after the year 2115. Minimum rental payments in respect of ground leases related to commercial real estate properties are approximately $4.5 million annually for the next five years and $382.5 million in total on an undiscounted basis.

(b) Depreciation on commercial properties for the year ended December 31, 2009, was $44.7 million (compared to $43.1 million in 2008).

(c) During the year ended December 31, 2009, approximately $13.1 million of fully depreciated building and improvements and the corresponding accumulated depreciation were written off.

(d) The following amounts represent the Company's proportionate interest in incorporated and unincorporated joint-ventures and partnerships, reflected in the Company's commercial and development properties:

| (Millions) | **2009** | 2008 (Restated Note 2) |
|---|---|---|
| Assets | **$ 1,109.4** | $ 1,104.1 |
| Liabilities | **824.6** | 773.6 |
| Operating revenues | **239.0** | 233.8 |
| Operating expenses | **100.6** | 103.7 |
| Net income[1] | **65.3** | 63.9 |
| Cash flows provided by operating activities | **100.4** | 81.7 |
| Cash flows provided by financing activities | **89.7** | 108.6 |
| Cash flows used in investing activities | **(31.2)** | (41.0) |

[1] *Income taxes are not reflected here as they are recorded at the corporate level*

## NOTE 5: COMMERCIAL DEVELOPMENTS

Commercial developments include commercial land which represents developable land, and construction costs. The Company capitalizes development costs, interest, net operating income, tenant improvements and property taxes and other to commercial developments. At December 31, 2009, commercial developments had a book value of $744.0 million (compared to $689.1 million on December 31, 2008). During 2009, the Company capitalized costs totaling $114.5 million (compared to $238.4 million in 2008). Included in this amount is $54.8 million of construction and related costs (compared to $195.0 million in 2008), $30.4 million of interest capitalized (compared to $27.3 million in 2008), $13.1 million of tenant improvements (compared to $nil in 2008), $21.4 million of property taxes and other (compared to $20.3 million in 2008); offset by $5.2 million of net operating income capitalized (compared to $4.2 million in 2008) for the year ended December 31, 2009. Bankers Court development was transitioned from a commercial development to a commercial property on August 1, 2009, at a book value of $59.6 million.

## NOTE 6: LOANS RECEIVABLE

The components of loans receivable are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Loans receivable | **$ 85.0** | $ 150.5 |
| Accrued interest | — | 0.1 |
| Total | **$ 85.0** | $ 150.6 |

At December 31, 2009, an unsecured on-demand deposit of $85.0 million (December 31, 2008 - $125.0 million) was outstanding with the Company's parent, Brookfield Properties Corporation ("BPC"). This deposit bears interest at the bank overnight lending rate plus 100 basis points. In the first quarter of 2009, BPC repaid the $125.0 million on-demand deposit that was issued in the second quarter of 2008, and a new $85.0 million on-demand deposit was placed with BPC during December 2009. During the year ended December 31, 2009, interest income of $0.3 million was recorded on these deposits (compared to $7.0 million in 2008).

During the second quarter of 2009, a loan receivable (at par value plus accrued interest) of $23.2 million (December 31, 2008 – $25.5 million) was repaid in U.S. dollars of US$20.9 million. The Company also recorded a gain on settlement of its quarterly hedge resulting in a gain of $1.5 million in the second quarter, which offset the weakening of the U.S. dollar since December 31, 2008. During the year ended December 31, 2009, interest income related to this loan of $1.2 million was recorded (compared to $2.6 million during 2008).

Credit risk related to loans receivable arises from the possibility that borrowers may default on the repayment of their loans. Because the Company invests in loans and mortgages from time to time, credit risks arise in the event that borrowers default on the repayment of their loans and mortgages to the Company.

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity prices. The Company utilizes derivative financial instruments primarily to manage these 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 arise. The effect of a 100-basis-point decrease in interest rates, all else being equal, is a decrease in interest income, net of taxes, of $0.6 million on an annual basis or approximately $0.01 per share.

## NOTE 7: INTANGIBLE ASSETS

Intangible assets are lease origination costs, tenant relationships and above-market in-place operating leases assumed on acquisitions, net of related accumulated amortization. The components of intangible assets are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Intangible assets | | |
| Lease-origination costs | **$ 37.4** | $ 40.4 |
| Tenant relationships | **6.3** | 6.5 |
| Above-market in-place operating leases | **2.0** | 2.0 |
| | **45.7** | 48.9 |
| Less accumulated amortization | | |
| Lease-origination costs | **(18.5)** | (16.2) |
| Tenant relationships | **(2.2)** | (1.6) |
| Above-market in-place operating leases | **(1.1)** | (0.8) |
| Total | **$ 23.9** | $ 30.3 |

Amortization on intangible assets for the year ended December 31, 2009, was $6.4 million (compared to $9.9 million on December 31, 2008). Approximately $3.2 million of fully amortized intangible assets and the corresponding accumulated amortization were written off during the year ended December 31, 2009 (compared to $18.1 million during 2008).

## NOTE 8: TENANT RECEIVABLES AND OTHER ASSETS

The breakdown of tenant receivables and other assets are as follows:

| (Millions) | 2009 | 2008 |
|---|---|---|
| Tenant and other receivables | **$ 49.3** | $ 44.4 |
| Straight-line rent receivable | **19.3** | 18.3 |
| Prepaid expenses and other assets | **28.7** | 18.5 |
| Restricted cash | **15.9** | 1.1 |
| Total | **$ 113.2** | $ 82.3 |

These receivables are generally short-term receivables of a trade nature. The carrying value of tenant and other receivables approximates fair value due to their short-term nature.

During the year ended December 31, 2009, the Company recorded $0.2 million (compared to $0.6 million on December 31, 2008) as a reserve against uncollectible tenant and other receivables.

As of December 31, 2009, approximately $0.5 million of the Company's balance of tenant and other receivables is over 90 days due (compared to approximately $0.8 million on December 31, 2008).

Credit risk related to tenant and other receivables, including straight-line rent receivable, arises from the possibility that tenants may be unable to fulfill their lease commitments. The Company mitigates this risk by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant. Currently, no one tenant represents more than 12.8% of total leasable area and 23.2% of tenant receivables. This risk is further mitigated by signing long-term leases with tenants who have investment-grade credit ratings. Over the next three years, the Company has a lease expiry profile of 5% in 2010, 7% in 2011 and 7% in 2012.

Cash and deposits are considered restricted when they are subject to contingent rights of third parties. It also includes cash as collateral against letters of credit issued for performance under certain contracts and cash reserved for revenue-enhancing capital expenditures. As of December 31, 2009, restricted cash was $15.9 million (compared to $1.1 million on December 31, 2008).

## NOTE 9: CASH AND CASH EQUIVALENTS

For the year ended December 31, 2009, interest income of $0.8 million was recorded on cash and cash equivalents (compared to $2.5 million in 2008). Cash and cash equivalents invested in overnight term deposits earned an average interest rate of 0.6% during the year. At December 31, 2009, the Company had $2.7 million of cash placed in term deposits (December 31, 2008 - $nil).

## NOTE 10: COMMERCIAL AND DEVELOPMENT PROPERTY DEBT

Commercial and development property debt totaled $1,413.3 million at December 31, 2009, (compared to $1,255.3 million at December 31, 2008) of debt that is secured by commercial properties and commercial developments, and $34.4 million at December 31, 2009, (compared to $nil at December 31, 2008) that is not secured.

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

| (Millions, except interest data) | Scheduled Amortization | Maturities | Total | Weighted-Average Interest Rate (%) at Dec. 31, 2009 |
|---|---|---|---|---|
| 2010 | $ 18.3 | $ 436.5 | $ 454.8 | 1.8% |
| 2011 | 19.7 | 97.3 | 117.0 | 7.5% |
| 2012 | 16.0 | 195.6 | 211.6 | 5.9% |
| 2013 | 11.8 | 276.8 | 288.6 | 6.3% |
| 2014 | 4.6 | 267.7 | 272.3 | 6.1% |
| 2015 and thereafter | 5.4 | 98.0 | 103.4 | 6.0% |
| Total | $ 75.8 | $ 1,371.9 | $ 1,447.7 | 4.9% |

The weighted-average interest rate at December 31, 2009, was 4.9% (compared to 5.6% on December 31, 2008). The details and terms of the financing transactions completed in 2009 are as follows:

| (Millions) | | | New Proceeds | Repayments | Net Proceeds Generated For BPO[2] | Interest Rate (%) | Mortgage Details | Maturity |
|---|---|---|---|---|---|---|---|---|
| Enbridge Tower | Q2 | Refinancing | $ 6.3 | $ (2.2) | $ 4.1 | 6.50% | Non-recourse | July 2019 |
| Suncor Energy Centre[1] | Q2 | New financing | 220.0 | (150.0) | 70.0 | 6.38% | Limited recourse | June 2014 |
| First Canadian Place | Q4 | Refinancing | 77.5 | (57.7) | 19.8 | 5.37% | Non-recourse | December 2014 |

[1] *This loan includes a $35.0 million unsecured loan from an affiliate of the property's joint-venture partner*

[2] *Excludes financing costs*

Included in commercial and development property debt at December 31, 2009, are $6.3 million of net deferred financing costs (compared to $7.3 million on December 31, 2008) and $1.8 million of premiums related to mortgages assumed upon acquisition (compared to $4.1 million on December 31, 2008).

For the year ended December 31, 2009, interest expense of $70.9 million (compared to $66.8 million in 2008) was incurred on commercial and development property debt, of which $30.4 million (compared to $27.3 million in 2008) was capitalized to commercial developments.

Approximately 30% of the Company's outstanding commercial and development property debt at December 31, 2009, is floating-rate debt (compared to 37% on December 31, 2008). The effect of a 100-basis-point increase in interest rates relating to floating rate debt, all else being equal, is an increase in interest expense, net of taxes, of $2.9 million on an annual basis or approximately $0.03 per share.

The fair value of commercial and development property debt is determined by discounting contractual principal and interest payments at estimated current market interest rates for the instrument. Current market interest rates are determined with reference to current benchmark rates for a similar term and current credit spreads for debt with similar terms and risk. As of December 31, 2009, the fair value of commercial and development property debt exceeds the principal loan value of these obligations by $34.5 million (compared to an excess of $30.3 million on December 31, 2008).

Interest rate risk arises when the fair value or future cash flows of commercial and development property debt fluctuate because of changes in market interest rates. Financing risk arises when lenders will not refinance maturing debt on terms and conditions acceptable to the Company, or on any terms at all. The Company attempts to stagger the maturities of its borrowings as well as obtain fixed-rate debt as the means of managing interest rate risk. The Company has an ongoing obligation to access debt markets to refinance maturing debt as it comes due. The Company's strategy to stagger its borrowing maturities also helps to mitigate the Company's exposure to excessive amounts of debt maturing in any one year. With respect to the 2010 year, the Company has debt totaling $49.8 million maturing, representing 3.4% of the Company's total debt outstanding at December 31, 2009. The Company also has development debt at Bay Adelaide Centre of $386.7 million which has two one-year extension options at maturity, and the criteria to exercise the first option to 2011 has been met at December 31, 2009.

**NOTE 11: INTANGIBLE LIABILITIES**

Included in intangible liabilities are below-market tenant leases and above-market ground leases assumed on acquisitions, net of related accumulated amortization. The components of intangible liabilities are as follows:

| (Millions) | **2009** | 2008 |
|---|---|---|
| Intangible liabilities | | |
| Below-market in-place operating leases | **$ 44.4** | $ 56.8 |
| Above-market ground lease obligations | **45.8** | 45.8 |
| | **90.2** | 102.6 |
| Less accumulated amortization | | |
| Below-market in-place operating leases | **(16.8)** | (22.6) |
| Above-market ground lease obligations | **(10.6)** | (8.1) |
| Total | **$ 62.8** | $ 71.9 |

Amortization on intangible liabilities for the year ended December 31, 2009, was $9.1 million (compared to $13.1 million on December 31, 2008). Approximately $12.4 million of fully amortized intangible liabilities and the corresponding accumulated amortization were written off during the year ended December 31, 2009 (compared to $11.5 million during 2008).

### NOTE 12: ACCOUNTS PAYABLE AND OTHER LIABILITIES

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

| (Millions) | 2009 | 2008 |
|---|---|---|
| Accounts payable and accrued liabilities | $ 110.0 | $ 131.3 |
| Accrued interest | 5.1 | 4.3 |
| Total | $ 115.1 | $ 135.6 |

These payables are generally short-term payables of a trade nature. The carrying value of accounts payable and other liabilities approximates fair value due to their short-term nature.

### NOTE 13: INCOME TAXES

Future income tax liabilities consist of the following:

| (Millions) | 2009 | 2008 |
|---|---|---|
| Future income tax assets related to operating and capital losses | $ (11.3) | $ (13.7) |
| Future income tax liabilities related to differences between tax and book basis | 42.0 | 42.3 |
| Total | $ 30.7 | $ 28.6 |

At December 31, 2009, the Company had net operating loss carryforwards of $33.4 million (compared to $34.7 million on December 31, 2008), which are available to reduce taxable income over the next 20 years.

Income tax expense is calculated as follows:

| (Millions) | 2009 | 2008 |
|---|---|---|
| Income tax expense at the Canadian federal and provincial substantively enacted income tax rate of 32.0% (2008 – 32.0%) | $ 28.3 | $ 32.1 |
| Increase (decrease) in income tax expense due to the following: | | |
| De-recognition of tax asset | — | 1.6 |
| Change in statutory tax rates | (1.9) | — |
| Other | 1.1 | 1.1 |
| Total | $ 27.5 | $ 34.8 |

The major components of income tax expense include the following:

| (Millions) | 2009 | 2008 |
|---|---|---|
| Current tax expense | $ 23.7 | $ 16.5 |
| Future tax expense | 3.8 | 18.3 |
| Total | $ 27.5 | $ 34.8 |

### NOTE 14: SHAREHOLDERS' EQUITY

The components of shareholders' equity are as follows:

| (Millions) | 2009 | 2008 (Restated Note 2) |
|---|---|---|
| Preferred shares | $ 381.7 | $ 381.7 |
| Common shares | 78.3 | 78.4 |
| Retained earnings | 289.9 | 400.3 |
| AOCI | — | — |
| Total | $ 749.9 | $ 860.4 |

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

**(a) Preferred shares**

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

| (Millions, except share information) | Shares Outstanding | Cumulative Dividend Rate | 2009 | 2008 |
|---|---|---|---|---|
| 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 the Company 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 2009, preferred dividends of $5.7 million were paid, compared to $14.3 million in 2008.

**(b) Common equity**

On November 3, 2009, the Board of Directors approved a three-for-one stock split in the form of a stock dividend. The stock dividend was issued on December 31, 2009, to shareholders of record at the close of business on December 8, 2009. Fractional shares were paid in cash at the prevailing market price. The commons shares of the Company began trading on a post-stock split basis on the Toronto Stock Exchange on December 4, 2009. Prior period comparatives have been adjusted to reflect the stock split.

Total common shares issued and outstanding at December 31, 2009, totaled 85.0 million shares (compared to 85.0 million on December 31, 2008), which included 65.0 million non-voting equity shares (compared to 65.0 million on December 31, 2008).

During the year, BPO Properties renewed its normal course issuer bid. During the twelve month period commencing September 22, 2009, and ending September 21, 2010, BPO may purchase on the Toronto Stock Exchange up to 997,230 common shares (on a post-split basis), representing approximately 5% of its issued and outstanding common shares.

During the year, we repurchased 36,000 common shares (on a post-stock split basis) for $0.5 million at an average price of $14.79 per share. The amount paid in excess of the book value, $0.5 million, was recorded as a reduction to retained earnings.

The Company paid regular common share dividends of $25.5 million for the year ended December 31, 2009 (compared to $17.1 million in 2008). The increase is due to a 100% increase in the ongoing quarterly common share dividend effective in the third quarter of 2009.

A $140.2 million special common share dividend was paid during the second quarter of 2009, compared to $206.5 million during the same period in 2008 (or $1.65 and $2.42 per common share, respectively).

**(c) Earnings per share**

Net income available to common shareholders and weighted-average common shares outstanding are calculated as follows:

| (Millions - except per share amounts) | | 2009 | | 2008 (Restated Note 2) |
|---|---|---|---|---|
| Net income | **$** | **61.5** | $ | 65.3 |
| Preferred share dividends | | **(5.7)** | | (14.3) |
| Net income available to common shareholders | | **55.8** | | 51.0 |
| Weighted-average shares outstanding[1] | | **85.0** | | 85.3 |
| Net income per common share[1] | **$** | **0.66** | $ | 0.60 |

[1] *Prior year share information has been restated to reflect the three-for-one common stock split*

There were no dilutive instruments outstanding.

## NOTE 15: GUARANTEES, CONTINGENCIES, AND OTHER

(a) In the normal course of operations, the Company and its consolidated subsidiaries execute agreements that provide for indemnification and guarantees to third parties in transactions such as business dispositions, business acquisitions, lease-up of development properties, sales of assets, and sales of services.

(b) As of December 31, 2009, the Company has commitments totaling $20.0 million to third parties for the First Canadian Place re-cladding and re-positioning project in Toronto.

(c) The Company has entered into fixed gas-purchase contracts with a third-party gas supplier, which cover the period November 1, 2009, to October 31, 2010. As of December 31, 2009, the remaining commitment for the Company to purchase gas for its facilities was $2.3 million.

(d) The Company currently has guaranteed up to $60.0 million of a $420.0 million credit facility related to construction financing for the Bay Adelaide Centre.

(e) The Company currently has limited recourse liability of up to $15.0 million related to the Hudson's Bay Centre debt and $35.0 million related to the Suncor Energy Centre debt.

(f) The Company and its operating subsidiaries are contingently liable with respect to litigation and claims that arise from time to time in the normal course of business or otherwise. A specific litigation is being pursued against one of the Company's subsidiaries related to security on a defaulted loan. At this time, the estimated contingent liability related to litigation and claims currently being pursued against the Company is not determinable.

(g) The Company maintains insurance on its properties. The Company maintains all risk property insurance and rental value coverage (including coverage for the perils of flood and earthquake). The Company's all risk policy limit is $1.5 billion per occurrence. The Company's earthquake limit is $500.0 million per occurrence and in the annual aggregate, and is subject to a deductible, which is the greater of 3% of the value of the property insured or $250,000. This earthquake deductible applies to British Columbia only. All other locations in Canada have a flat $100,000 deductible for earthquakes. The flood limit is $500.0 million per occurrence and in the annual aggregate, and is subject to a deductible of $25,000 combined for all coverages.

The Company has insurance covering certain acts of terrorism for up to $1.0 billion 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.

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

## NOTE 16: SEGMENTED INFORMATION

The Company has only one business segment: the ownership, development and management of commercial properties.

## NOTE 17: RELATED-PARTY TRANSACTIONS

In the normal course of operations, the Company enters into various transactions on market terms with related parties which 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 Olympia & York ("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 $11.6 million during 2009 (compared to $13.0 million in 2008). 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 2009 totaled $1.3 million (compared to $0.8 million in 2008). These costs have been included in general and administrative expenses.

The Company has certain arrangements with a subsidiary of Brookfield Asset Management Inc. ("BAM"), the ultimate parent of the Company, and BPC to provide various information technology services and with BPC to provide various administrative services including accounts payable processing and accounts receivable collection. The costs for these services amounted to $9.0 million for the year ended December 31, 2009 (compared to $8.2 million during 2008), consisting of $6.1 million in operating costs and $2.9 in capital costs, and are charged to the Company on a cost recovery basis. These operating costs have been included in general and administrative expenses and capital costs have been capitalized to other assets and are being amortized over their estimated useful life.

Included in loans receivable at December 31, 2009, is a $85.0 million (compared to $125.0 million on December 31, 2008) unsecured on-demand deposit placed with BPC. During the first quarter of 2009, BPC repaid the original $125.0 million on-demand deposit and during the fourth quarter of 2009, a new $85.0 million unsecured on-demand deposit was placed with BPC. For the year ended December 31, 2009, interest income of $0.3 million was recorded on these deposits (compared to $7.0 million in 2008). These amounts have been included in loans and investment income.

Included in rental revenues during the year ended December 31, 2009, are amounts received from BAM and its affiliates of $0.3 million (compared to $0.4 million in 2008). In addition, the Company has certain arrangements with BAM and its affiliates to acquire insurance in the normal course and at market rates or at cost. These fees are based on a percentage of the annual premiums paid.

## NOTE 18: CAPITAL MANAGEMENT AND LIQUIDITY

The Company employs a broad range of financing strategies to facilitate growth and manage financial risk.

The Company continually strives to reduce its weighted-average cost of capital and improve common shareholders' equity returns through value enhancement initiatives and the consistent monitoring of the balance between debt and equity financing. As of December 31, 2009, the Company's weighted-average cost of capital, assuming a 12.0% return on equity, was 7.3%. The following schedule details the components of the Company's capital as of December 31, 2009, and the related costs thereof:

| | Cost of Capital[1] | | Underlying Value[2] | |
|---|---|---|---|---|
| December 31 (Millions, except cost of capital data) | **2009** | 2008 | **2009** | 2008 |
| **Liabilities** | | | | |
| Commercial and development property debt | **4.9%** | 5.6% | **$ 1,447.7** | $ 1,255.3 |
| **Shareholders' equity** | | | | |
| Preferred shares | **1.5%** | 3.8% | **381.7** | 381.7 |
| Common shares[3] | **12.0%** | 12.0% | **1,661.8** | 679.2 |
| Total[4] | **7.3%** | 6.2% | **$ 3,491.2** | $ 2,316.2 |

[1] *As a percentage of average book value*

[2] *Underlying value of liabilities represents the cost to retire on maturity. Underlying value of common equity is based on the closing stock price of the Company's common shares at December 31, 2009. Underlying value of preferred equity is based on the book value of preferred shares*

[3] *Determined on a market-value basis and assumes a 12% return on equity for 2009 and 2008*

[4] *In calculating the weighted-average cost of capital, the cost of debt has been tax-effected*

At December 31, 2009, a 1.0% decrease in return on equity results in a weighted-average cost of capital decrease of 0.5% (compared to 0.3% on December 31, 2008).

**Commercial and development property debt**

The Company's commercial property debt is primarily fixed-rate and non-recourse to the Company, thereby reducing the overall financial risk to the Company. These financings are typically structured on a loan-to-appraised value basis of between 55% and 65% when the market permits. 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 equity requirements to finance commercial property, and enhances equity returns.

The Company is subject to certain covenants on its borrowings, including debt service coverage and loan to value thresholds. As of December 31, 2009, the Company was in compliance with all of its covenants.

The Company's strategy is to satisfy its liquidity needs using cash on hand, cash flows generated from operating activities and provided by financing activities, as well as proceeds from asset sales. Rental revenue, recoveries from tenants, interest and other income, available cash balances, draws on credit facilities and refinancings, including upward refinancings, of maturing indebtedness are the Company's principal sources of capital used to pay operating expenses, dividends, debt service and recurring capital and leasing costs in its commercial property portfolio. The Company finances its development operations and ongoing working capital requirements with development debt and accounts payable. Another source of cash flow includes third-party fees generated by the Company's asset management, leasing and development activities. Consequently, the Company plans to meet its short-term liquidity needs with revenue along with proceeds from financing activities.

The principal liquidity needs for periods beyond the next twelve months are for development costs, scheduled debt maturities and non-recurring capital expenditures. The Company's strategy is to meet these needs with one or more of the following:

- cash flow from operations;
- construction loans;
- proceeds from sales of assets; and
- refinancing opportunities.

The Company attempts to match the maturity of its commercial and development property debt portfolio with the average lease terms of its properties. At December 31, 2009, the average term to maturity of the Company's commercial and development property debt portfolio was four years and the Company's average lease term of its properties was approximately seven years. The Company will continue to make efforts to match the maturity of the commercial property debt portfolio with the average lease term of its properties.

The following table presents the contractual maturities of the Company's financial liabilities:

| | | Payments Due By Period | | | |
|---|---|---|---|---|---|
| (Millions) | Total | 1 year | 2 - 3 Years | 4 - 5 Years | After 5 Years |
| Commercial property debt[(1)(2)] | $ 1,691.1 | $ 515.7 | $ 431.3 | $ 612.3 | $ 131.8 |
| Accounts payable and other liabilities | 115.1 | 115.1 | — | — | — |

*[(1)] Net of transaction costs*

*[(2)] Includes repayment of principal and interest*

## NOTE 19: OTHER INFORMATION

Supplemental cash flow information

| (Millions) | **2009** | 2008 |
|---|---|---|
| Cash taxes paid [(1)] | **$ 20.7** | $ 18.0 |
| Cash interest paid | **$ 68.1** | $ 69.9 |

*[(1)] Included in cash taxes paid is $3.0 million and $14.0 million reimbursed to BPC for taxes paid to the tax authorities on its behalf during the years ended December 31, 2009 and 2008, respectively.*

## NOTE 20: SUBSEQUENT EVENTS

On February 26, 2010, the Company announced a proposal to create a real estate investment trust (REIT), which will acquire a significant portion of the assets of the Company and will also acquire BPC's interest in Brookfield Place located in Toronto, Ontario. As part of the transaction, holders of the Company's common shares will receive one REIT unit in exchange for their existing shares. Select assets of the Company and certain development properties, as well as certain assets which are not permitted to be owned by the REIT, will be retained by the Company. If the necessary approvals are obtained, it is anticipated that the transaction will be completed in mid-April 2010. Management is currently assessing the impact of the proposed transaction on the financial statements of the Company.

# Selected Financial Information

| December 31 (Millions, except for share information) | **2009** | 2008[6] | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| **Financial results** | | | | | |
| Commercial property net operating income[1] | **$ 202.6** | $ 195.2 | $ 199.7 | $ 197.9 | $ 121.8 |
| Funds from operations[2] | **117.7** | 153.7 | 159.3 | 155.0 | 104.4 |
| Net income | **61.5** | 65.3 | 138.8 | 72.7 | 68.2 |
| Total assets | **2,406.2** | 2,351.8 | 2,235.7 | 2,098.6 | 2,026.3 |
| Shareholders' equity | **749.9** | 860.4 | 1,040.5 | 939.0 | 899.4 |
| **Per common share**[3] | | | | | |
| Common shares outstanding | **85.0** | 85.0 | 85.5 | 85.6 | 85.6 |
| Funds from operations and gains | **$ 1.32** | $ 1.64 | $ 2.72 | $ 1.81 | $ 1.08 |
| Funds from operations excluding gains | **1.32** | 1.64 | 1.65 | 1.63 | 1.08 |
| Net income | **0.66** | 0.60 | 1.41 | 0.66 | 0.66 |
| Dividends paid [4][5] | **0.30** | 0.20 | 0.20 | 0.20 | 0.20 |
| Shareholders' equity – book value | **8.82** | 10.12 | 12.17 | 10.97 | 10.51 |
| Common share price at year end | **19.55** | 8.00 | 20.10 | 23.31 | 13.23 |
| **Operating data** | | | | | |
| Number of commercial properties | **28** | 27 | 36 | 43 | 50 |
| Rentable area (millions of sq. ft.) | **23.7** | 23.8 | 24.0 | 27.1 | 27.2 |
| Effective interest (millions of sq. ft.) | **13.3** | 13.3 | 13.5 | 14.4 | 12.8 |
| Average occupancy (%) | **98.6** | 98.7 | 98.4 | 97.2 | 96.1 |

(1) *Includes net operating income from discontinued operations*

(2) *Includes funds from operations from discontinued operations*

(3) *Prior year share information has been restated to reflect the three-for-one common stock split.*

(4) *Excludes the special common share dividend of $1.65 and $2.42 per share in 2009 and 2008,respectively*

(5) *The ongoing quarterly dividend was increased by 100% to $0.10 per common share with the first increase paid on Sept. 30, 2009, to shareholders of record at end of business day Sept. 1, 2009*

(6) *Restated for the adoption of CICA Handbook section 3064 effective January 1, 2009 (See Note 2 of the financial statements)*

## Board of Directors

**Richard B. Clark**
**Chairman of the Board**
Chief Executive Officer
Brookfield Properties Corporation

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

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

**Robert J. McGavin**
Corporate Director

**Michael F.B. Nesbitt**
Chairman, Montrose Mortgage Corporation Ltd.

## Officers

**Thomas F. Farley**
President and Chief Executive Officer

**T. Jan Sucharda**
Chief Operating Officer

**Bryan Davis**
Senior Vice President and Chief Financial Officer

**Stefan J. Dembinski**
Senior Vice President, Asset Management, Eastern

**Ian D. Parker**
Senior Vice President, Asset Management, Western

**Deborah R. Rogers**
Senior Vice President, Legal Counsel, Eastern
Secretary

**Ryk Stryland**
Senior Vice President, Development

**T. Nga Trinh**
Senior Vice President, Investments

**D. Cameron Black**
Vice President, Legal Counsel, Western

**Melissa J. Coley**
Vice President, Investor Relations and Communications

**Ricky Tang**
Vice President and Controller

**Elliott Feintuch**
Associate Counsel

**Brett M. Fox**
Assistant Secretary

**Michelle Campbell**
Assistant Secretary