



Second Quarter Report  
2014

GRANITE REIT

## GRANITE ANNOUNCES 2014 SECOND QUARTER RESULTS

**August 6, 2014, Toronto, Ontario, Canada — Granite Real Estate Investment Trust and Granite REIT Inc. (TSX: GRT.UN; NYSE: GRPU)** (“Granite” or the “Trust”) today announced their combined results for the three and six month periods ended June 30, 2014.

### HIGHLIGHTS

Highlights for the three month period ended June 30, 2014, including events subsequent to the quarter, are set out below:

- Revenue for the second quarter was up 13% to \$52.2 million compared to the prior year period. The increase was primarily attributable to the acquisitions completed during the fourth quarter of 2013 and favourable foreign exchange rates relative to last year;
- Due to the increased revenue and lower current income taxes resulting from the favourable outcome of certain tax audits, comparable FFO per unit<sup>(2)</sup> was up 12% in comparison to the same quarter last year;
- On June 26, 2014, Granite completed the disposition of its portfolio of Mexican properties to a subsidiary of Magna International Inc. for net cash proceeds before income taxes of \$108.6 million;
- On July 3, 2014, Granite issued at par \$250 million of 3.788% Series 2 senior debentures due July 5, 2021 and concurrently entered into a cross currency interest rate swap to exchange the 3.788% Canadian dollar interest payments to euro denominated payments at 2.68%; and
- On August 5, 2014, Granite redeemed all of the outstanding debentures due December 2016 for \$294.7 million, which included a redemption premium of \$27.7 million and accrued and unpaid interest to the redemption date of \$2.0 million.

Granite’s results for the three and six month periods ended June 30, 2014 and 2013 are summarized below (all figures are in Canadian dollars):

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
<i>(in thousands, except per unit figures)</i>				
Revenues . . . . .	\$ 52,160	\$ 46,151	\$ 105,093	\$ 91,097
Net income from continuing operations . . . . .	26,416	38,919	38,591	127,977
Net income from discontinued operations . . . . .	4,369	4,475	6,757	9,811
Net income . . . . .	\$ 30,785	\$ 43,394	\$ 45,348	\$ 137,788
Funds from operations (“FFO”) <sup>(1)</sup> . . . . .	\$ 39,870	\$ 31,258	\$ 78,874	\$ 65,264
Comparable funds from operations <sup>(2)</sup> . . . . .	\$ 39,870	\$ 35,478	\$ 78,874	\$ 69,484
Basic and diluted FFO per stapled unit <sup>(1)</sup> . . . . .	\$ 0.85	\$ 0.67	\$ 1.68	\$ 1.39
Basic and diluted comparable FFO per stapled unit <sup>(2)</sup> . . . . .	\$ 0.85	\$ 0.76	\$ 1.68	\$ 1.48
Fair value of investment properties <sup>(3)</sup> . . . . .			\$2,246,600	\$2,113,717

Readers are cautioned that certain terms used in this press release such as FFO and any related per unit amounts used by management to measure, compare and explain the operating results and financial performance of the Trust do not have standardized meanings prescribed under International Financial Reporting Standards (“IFRS”) and, therefore, should not be construed as alternatives to net income, cash flow from operating activities or revenue, as appropriate, calculated in accordance with IFRS. Additionally, because these terms do not have a standardized meaning prescribed by IFRS they may not be comparable to similarly titled measures presented by other publicly traded entities.

- (1) FFO is defined as net income attributable to stapled unitholders prior to fair value gains (losses), gains (losses) on sale of investment properties, acquisition transaction costs, deferred income taxes and certain other non-cash items, adjusted for non-controlling interests in such items. The Trust's determination of FFO follows the definition prescribed by the Real Estate Property Association of Canada ("REALPAC") and is a widely used measure by analysts and investors in evaluating the performance of real estate entities. Granite considers FFO to be a meaningful supplemental measure that can be used to determine the Trust's ability to service debt, finance capital expenditures and provide distributions to stapled unitholders. FFO is reconciled to net income, which is the most directly comparable IFRS measure (see "*Reconciliation of Funds from Operations to Net Income Attributable to Stapled Unitholders*"). FFO does not represent or approximate cash generated from operating activities determined in accordance with IFRS and is not reconciled to cash flow from operating activities as the calculation of FFO does not consider changes in working capital items or adjust for certain other non-cash items that are included in the determination of cash flow from operating activities in accordance with IFRS.
- (2) Comparable FFO currently excludes \$4.2 million of current income tax expense associated with withholding taxes paid in the second quarter of 2013 related to the repatriation of prior years' earnings from foreign jurisdictions primarily associated with certain planned internal reorganizations undertaken post the REIT conversion. As the \$4.2 million withholding tax payment is a result of a significant earnings repatriation that is not expected to recur at a similar level of magnitude, it has been added to FFO to arrive at a comparable FFO amount to current and prior periods. In the future, other large unusual items that are not expected to be of a recurring nature may also be considered when determining comparable FFO and will be explicitly described and quantified. For a reconciliation of FFO to comparable FFO, please refer to the section titled "*Reconciliation of Funds from Operations to Net Income Attributable to Stapled Unitholders*".
- (3) At period end.

## **GRANITE'S COMBINED FINANCIAL RESULTS**

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During the three month period ended June 30, 2014, Granite disposed of its portfolio of Mexican properties. As the Mexican properties represented a significant geographical area of operations, the Trust has presented the income and expenses associated with the Mexican portfolio as discontinued operations on a retroactive basis to prior reporting periods. Discontinued operations are reported separately from income and expenses from continuing operations in the condensed combined financial statements.

### **Three month period ended June 30, 2014**

For the three month period ended June 30, 2014, rental revenue increased by \$6.0 million, from \$46.2 million in the second quarter of 2013 to \$52.2 million in the second quarter of 2014, primarily due to the acquisition of eight properties in Europe and one in the United States during the latter half of 2013 and the favourable effects of changes in foreign currency exchange rates, in particular, the euro.

Granite's net income from continuing operations in the second quarter of 2014 was \$26.4 million, down from the \$38.9 million of net income from continuing operations reported for the second quarter of 2013. Net income from continuing operations decreased primarily due to (i) net fair value losses on investment properties of \$5.6 million compared to \$8.1 million in net fair value gains in the prior year period, (ii) \$2.2 million in additional net interest expense and (iii) a \$2.3 million increase in income tax expense due to a higher deferred component, partially offset by (iv) a \$6.0 million increase in rental revenue.

Granite's net income from discontinued operations for the second quarter of 2014 was \$4.4 million compared to \$4.5 million in the second quarter of 2013. Net income from discontinued operations in the second quarter of 2014 includes a \$5.0 million loss on disposal which was comprised of a \$4.6 million closing adjustment and \$0.4 million in selling costs related to the disposition that was more than offset by the classification of net foreign currency translation gains of \$5.7 million previously accounted in other comprehensive income.

Comparable FFO for the second quarter of 2014 was \$39.9 million and comprises \$37.1 million from continuing operations and \$2.8 million from discontinued operations. Comparable FFO for the second quarter of 2013 was \$35.5 million and comprises \$32.7 million from continuing operations and \$2.8 million from discontinued operations. The increase in total comparable FFO of \$4.4 million to \$39.9 million from \$35.5 million in the prior year period was primarily due to continuing operations where increased rental revenue of \$6.0 million and a \$2.5 million increase in current income tax recoveries were partially offset by an increase in interest expense and other financing charges of \$2.2 million, a \$0.8 million increase in property costs and a \$0.6 million increase in foreign exchange losses.

### **Six month period ended June 30, 2014**

For the six month period ended June 30, 2014, rental revenue increased by \$14.0 million, from \$91.1 million in the six month period ended June 30, 2013 to \$105.1 million in the six month period ended June 30, 2014, primarily due to the acquisition of 12 properties in Europe and the United States during 2013 and the favourable effects of changes in foreign currency exchange rates, in particular, the euro.

Granite's net income from continuing operations in the six month period ended June 30, 2014 was \$38.6 million and compares with \$128.0 million reported for the six month period ended June 30, 2013. Net income from continuing operations decreased primarily due to (i) net fair value losses on investment properties of \$29.1 million compared to \$23.2 million in net fair value gains in the prior year period, (ii) a \$39.9 million increase in income tax expense, which includes the reversal of \$41.9 million in Canadian deferred income tax liabilities in the prior year period as a result of converting to a REIT on January 3, 2013, (iii) a \$5.1 million gain in the prior year period on the settlement of the Meadows holdback and (iv) \$4.6 million in additional net interest expense, partially offset by (v) a \$14.0 million increase in rental revenue and (vi) decreased acquisition transaction costs of \$0.8 million.

Granite's net income from discontinued operations for the six month period ended June 30, 2014 was \$6.8 million compared to \$9.8 million in the comparable prior year period. The reduction in net income is due to the fair value gains on investment properties in the six month period ended June 30, 2013 which were partially offset by a corresponding increase to deferred income tax expense in the same period.

Comparable FFO for the six month period ended June 30, 2014 was \$78.9 million and comprises \$73.0 million from continuing operations and \$5.9 million from discontinued operations. Comparable FFO for the six month period ended June 30, 2013 was \$69.5 million and comprises \$64.1 million from continuing operations and \$5.4 million from discontinued operations. The increase in total comparable FFO of \$9.4 million to \$78.9 million from \$69.5 million in the prior year period was primarily due to continuing operations where increased rental revenue of \$14.0 million and lower current income tax expense of \$1.5 million were partially offset by an increase in interest expense and other financing charges of \$4.6 million, a \$1.5 million increase in property operating costs and a \$0.7 million increase in net foreign exchange losses.

A more detailed discussion of Granite's combined financial results for the three and six month periods ended June 30, 2014 and 2013 is contained in Granite's Management's Discussion and Analysis of Results of Operations and Financial Position and the unaudited condensed combined financial statements for those periods and the notes thereto, which are available through the internet on Canadian Securities Administrators' Systems for Electronic Document Analysis and Retrieval ("SEDAR") and can be accessed at [www.sedar.com](http://www.sedar.com) and on the United States Securities and Exchange Commission's (the "SEC") Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") which can be accessed at [www.sec.gov](http://www.sec.gov).

## RECONCILIATION OF FUNDS FROM OPERATIONS TO NET INCOME ATTRIBUTABLE TO STAPLED UNITHOLDERS

<i>(in thousands, except per unit information)</i>	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income attributable to stapled unitholders . . .	<b>\$30,668</b>	\$43,548	<b>\$45,123</b>	\$137,839
Add (deduct):				
Fair value losses (gains) on investment properties . . . . .	<b>5,570</b>	(8,122)	<b>29,123</b>	(23,152)
Fair value losses (gains) on financial instruments . . . . .	<b>(377)</b>	643	<b>(339)</b>	148
Gain on Meadows holdback . . . . .	—	—	—	(5,143)
Acquisition transaction costs . . . . .	—	382	—	793
Loss on sale of investment properties . . . . .	—	328	<b>182</b>	328
Current income tax expense associated with the sale of an investment property . . . . .	—	—	<b>1,099</b>	—
Deferred income taxes . . . . .	<b>5,541</b>	(3,624)	<b>4,490</b>	(40,946)
Non-controlling interests relating to the above . . . . .	<b>34</b>	(260)	<b>44</b>	(206)
Discontinued operations relating to the above . . . . .	<b>(1,566)</b>	(1,637)	<b>(848)</b>	(4,397)
<b>FFO</b> . . . . .	<b>\$39,870</b>	\$31,258	<b>\$78,874</b>	\$ 65,264
Withholding tax payment . . . . .	—	4,220	—	4,220
<b>Comparable FFO</b> . . . . .	<b>\$39,870</b>	\$35,478	<b>\$78,874</b>	\$ 69,484
<b>Basic and diluted FFO per stapled unit</b> . . . . .	<b>\$ 0.85</b>	\$ 0.67	<b>\$ 1.68</b>	\$ 1.39
<b>Basic and diluted comparable FFO per stapled unit</b> . . . . .	<b>\$ 0.85</b>	\$ 0.76	<b>\$ 1.68</b>	\$ 1.48
<b>Basic number of stapled units outstanding</b> . . . . .	<b>47,014</b>	46,932	<b>46,988</b>	46,907
<b>Diluted number of stapled units outstanding</b> . . . . .	<b>47,070</b>	46,948	<b>47,029</b>	46,929

## CONFERENCE CALL

Granite will hold a conference call on Thursday, August 7, 2014 at 8:30 a.m. Eastern time. The number to use for this call is 1-800-952-6697. Overseas callers should use +1-416-981-9018. Please call in at least 10 minutes prior to start time. The conference call will be chaired by Tom Heslip, Chief Executive Officer. For anyone unable to listen to the scheduled call, the rebroadcast numbers will be: North America—1-800-558-5253 and Overseas—+1-416-626-4100 (enter reservation number 21727553) and will be available until Monday, August 18, 2014.

## ABOUT GRANITE

Granite is a Canadian-based REIT engaged in the ownership and management of predominantly industrial, warehouse and logistics properties in North America and Europe. Granite owns approximately 30 million square feet in over 100 rental income properties. Our tenant base currently includes Magna International Inc. and its operating subsidiaries as our largest tenants, together with tenants from other industries.

For further information, please contact Tom Heslip, Chief Executive Officer, at 647-925-7539 or Michael Forsayeth, Chief Financial Officer, at 647-925-7600.

## OTHER INFORMATION

Additional property statistics have been posted to our website at <http://www.granitereit.com/propertystatistics/view-property-statistics>. Copies of financial data and other publicly filed documents are available through the internet on SEDAR which can be accessed at [www.sedar.com](http://www.sedar.com) and on EDGAR which can be accessed at [www.sec.gov](http://www.sec.gov).

## FORWARD-LOOKING STATEMENTS

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This press release may contain statements that, to the extent they are not recitations of historical fact, constitute “forward-looking statements” or “forward-looking information” within the meaning of applicable securities legislation, including the United States Securities Act of 1933, as amended and the United States Securities Exchange Act of 1934, as amended, and applicable Canadian securities legislation. Forward-looking statements and forward-looking information may include, among others, statements regarding the Trust’s future plans, goals, strategies, intentions, beliefs, estimates, costs, objectives, capital structure, cost of capital, tenant base, tax consequences, economic performance or expectations, or the assumptions underlying any of the foregoing. Words such as “may”, “would”, “could”, “will”, “likely”, “expect”, “anticipate”, “believe”, “intend”, “plan”, “forecast”, “project”, “estimate”, “seek” and similar expressions are used to identify forward-looking statements and forward-looking information. Forward-looking statements and forward-looking information should not be read as guarantees of future events, performance or results and will not necessarily be accurate indications of whether or the times at or by which such future performance will be achieved. Undue reliance should not be placed on such statements. There can be no assurance that the intended developments in Granite’s relationships with its tenants, the expansion and diversification of Granite’s real estate portfolio, the expected cost of development and re-development projects and the expected sources of funding and increases in leverage can be achieved in a timely manner, with the expected impact or at all. Forward-looking statements and forward-looking information are based on information available at the time and/or management’s good faith assumptions and analyses made in light of our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances, and are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond the Trust’s control, that could cause actual events or results to differ materially from such forward-looking statements and forward-looking information. Important factors that could cause such differences include, but are not limited to, the risk of changes to tax or other laws that may adversely affect Granite Real Estate Investment Trust’s mutual fund trust status under the *Income Tax Act* (Canada) or the effective tax rate in other jurisdictions in which Granite operates; economic, market and competitive conditions and other risks that may adversely affect Granite’s ability to achieve desired developments in its relationships with its tenants, expand and diversify its real estate portfolio and increase its leverage; and the risks set forth in the “Risk Factors” section in Granite’s Annual Information Form for 2013, filed on SEDAR at [www.sedar.com](http://www.sedar.com) and attached as Exhibit 1 to the Trust’s Annual Report on Form 40-F for the year ended December 31, 2013, filed with the SEC and available online on EDGAR at [www.sec.gov](http://www.sec.gov), all of which investors are strongly advised to review. The “Risk Factors” section also contains information about the material factors or assumptions underlying such forward-looking statements and forward-looking information. Forward-looking statements and forward-looking information speak only as of the date the statements were made and unless otherwise required by applicable securities laws, the Trust expressly disclaims any intention and undertakes no obligation to update or revise any forward-looking statements and forward-looking information contained in this press release to reflect subsequent information, events or circumstances or otherwise.

# Management's Discussion and Analysis of Results of Operations and Financial Position

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## ***For the three and six month periods ended June 30, 2014***

Management's Discussion and Analysis of Results of Operations and Financial Position ("MD&A") of Granite Real Estate Investment Trust ("Granite REIT") and Granite REIT Inc. ("Granite GP") summarizes the significant factors affecting the combined operating results, financial condition, liquidity and cash flows of Granite REIT, Granite GP and their subsidiaries (collectively "Granite" or the "Trust") for the three and six month periods ended June 30, 2014. Unless otherwise noted, all amounts are in Canadian dollars ("Cdn. dollars") and all tabular amounts are in millions of Cdn. dollars. This MD&A should be read in conjunction with the accompanying unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014 and the audited combined financial statements for the year ended December 31, 2013. This MD&A is prepared as at August 6, 2014. Additional information relating to Granite, including the Annual Information Form ("AIF") for fiscal 2013 can be obtained from the Trust's website at [www.granitereit.com](http://www.granitereit.com), on SEDAR at [www.sedar.com](http://www.sedar.com) and on EDGAR at [www.sec.gov](http://www.sec.gov).

## **OVERVIEW**

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Granite is a Canadian-based real estate investment trust ("REIT") engaged in the ownership and management of predominantly industrial, warehouse and logistics properties in North America and Europe. Granite owns approximately 30.0 million square feet in over 100 rental income properties. Our tenant base currently includes Magna International Inc. and its operating subsidiaries (collectively "Magna") as our largest tenant, together with tenants from other industries.

Granite's investment properties consist of income-producing properties and properties and land under development (see "*INVESTMENT PROPERTIES*"). Our income-producing properties consist of light industrial properties, heavy industrial manufacturing facilities, corporate offices, warehouse and logistics properties, product development and engineering centres and test facilities in eight countries: Canada, the United States, Austria, Germany, the Netherlands, the Czech Republic, the United Kingdom and Spain. The lease payments are primarily denominated in three currencies: the Cdn. dollar, the U.S. dollar and the euro.

## **SIGNIFICANT MATTERS**

### **Sale of Mexican Properties Portfolio**

On June 26, 2014, Granite completed the disposition of its portfolio of Mexican properties to Magna for net cash proceeds before income taxes of \$108.6 million. The loss on disposal of \$5.1 million included a \$4.6 million closing adjustment and \$0.5 million in selling costs related to the disposition. Prior to the disposition, the 2.4 million square foot portfolio of properties was leased to Magna and had annualized lease payments of approximately \$14.4 million. As the Mexican properties represented a significant geographical area of operations, the associated income and expenses have been reported, on a retroactive basis, as discontinued operations, which are presented separately from income and expenses from continuing operations in the unaudited condensed combined statements of income for the three and six month periods ended June 30, 2014.

### **Series 2 Senior Debentures**

On July 3, 2014, Granite REIT Holdings Limited Partnership ("Granite LP"), a wholly owned subsidiary of the Trust, issued at par \$250.0 million of 3.788% Series 2 senior debentures due July 5, 2021 (the "2021 Debentures"). Interest on the 2021 Debentures is payable semi-annually in arrears on January 5 and July 5 of each year, commencing on January 5, 2015. The 2021 Debentures rank equally with all of the Trust's existing and future unsubordinated and unsecured indebtedness and are guaranteed by Granite REIT and Granite GP.

On July 3, 2014, the Trust entered into a cross currency interest rate swap to exchange the 3.788% Cdn. dollar interest payments from the 2021 Debentures to euro denominated payments at 2.68%. In addition, under the terms of the swap, the Trust will pay principal proceeds of euro 171.9 million for \$250.0 million on July 5, 2021.

The proceeds from the 2021 Debentures, together with other available funds, were used to redeem the \$265.0 million debentures due in 2016 (the “2016 Debentures”).

### Redemption of 2016 Debentures

On July 3, 2014, Granite LP issued a notice of redemption to the registered holders of the 2016 Debentures for redemption of all of the outstanding 2016 Debentures on August 5, 2014 (the “Redemption Date”). The 2016 Debentures have been redeemed for an aggregate redemption price of \$294.7 million, being the higher of the principal amount, and the Canada Yield Price calculated in accordance with the trust indenture governing the 2016 Debentures, together in each case with accrued and unpaid interest to the Redemption Date of \$2.0 million. The redemption price also included a redemption premium of \$27.7 million.

### Foreign Currencies

Fluctuations in the Cdn. dollar relative to other currencies will result in fluctuations in the reported Cdn. dollar value of revenues, expenses, cash flows, assets and liabilities. At June 30, 2014, approximately 69% of Granite’s rental revenues are denominated in currencies other than the Cdn. dollar (see “*LEASING PROFILE — Annualized Lease Payments*”). As such, material changes in the value of the Cdn. dollar relative to these foreign currencies (primarily the euro and U.S. dollar) may have a significant impact on the Trust’s financial results.

The following tables reflect the changes in the average exchange rates during the three and six month periods ended June 30, 2014 and 2013, as well as the exchange rates as at June 30, 2014, March 31, 2014 and December 31, 2013, between the most common currencies in which the Trust conducts business and the Cdn. dollar.

	Average Exchange Rates					
	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013	Change	2014	2013	Change
1 U.S. dollar equals Cdn. dollars . . . . .	<b>1.091</b>	1.023	7%	<b>1.097</b>	1.016	8%
1 euro equals Cdn. dollars . . . . .	<b>1.496</b>	<u>1.337</u>	<u>12%</u>	<b>1.504</b>	<u>1.335</u>	<u>13%</u>

	Exchange Rates as at				
	June 30, 2014	March 31, 2014	Change from March 31, 2014	December 31, 2013	Change from December 31, 2013
1 U.S. dollar equals Cdn. dollars . . . . .	<b>1.068</b>	1.105	(3)%	1.064	—%
1 euro equals Cdn. dollars . . . . .	<b>1.462</b>	<u>1.523</u>	<u>(4)%</u>	<u>1.466</u>	<u>—%</u>

The results of operations and financial position of all U.S. and most European operations are translated into Cdn. dollars using the exchange rates shown in the preceding table. The changes in these foreign exchange rates impacted the reported Cdn. dollar amounts of the Trust’s revenues, expenses, assets and liabilities. From time to time, Granite may enter into derivative financial arrangements for currency hedging purposes, but the Trust’s policy is not to utilize such arrangements for speculative purposes. Throughout this MD&A, reference is made, where significant, to the impact of foreign exchange fluctuations on reported Cdn. dollar amounts.



## PERFORMANCE MEASUREMENT

In addition to using performance measures determined in accordance with International Financial Reporting Standards (“IFRS”), Granite also measures its performance using certain additional IFRS and non-IFRS measures and believes that these performance measures are also useful to the reader. These are:

- Income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes;
- Funds from operations (“FFO”);
- Comparable FFO;
- FFO payout ratio; and
- Annualized lease payments (“ALP”).

Readers are cautioned that certain terms used in this MD&A such as FFO and ALP and any related per unit amounts used by management to measure, compare and explain the operating results and financial performance of the Trust do not have standardized meanings prescribed under IFRS and, therefore, should not be construed as alternatives to net income, cash flow from operating activities or revenue, as appropriate, calculated in accordance with IFRS. Additionally, because these terms do not have standardized meanings prescribed by IFRS they may not be comparable to similarly titled measures presented by other publicly traded entities. These terms are defined in the following paragraphs and cross referenced, where appropriate, to a reconciliation elsewhere in the MD&A to the most comparable IFRS measure in the Trust’s combined financial statements for the three and six month periods ended June 30, 2014.

### ***Income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes***

Granite refers to income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes, which is an additional IFRS measure and is presented on the combined statements of income for the three and six month periods ended June 30, 2014. Granite believes it is a useful measure for investors to assess the Trust’s sustainable performance without these non-operating components.

### ***Funds from operations***

FFO is defined as net income attributable to stapled unitholders prior to fair value gains (losses), gains (losses) on sale of investment properties, acquisition transaction costs, deferred income taxes and certain other non-cash items, adjusted for non-controlling interests in such items. The Trust’s determination of FFO follows the definition prescribed by the Real Estate Property Association of Canada (“REALPAC”) and is a widely used measure by analysts and investors in evaluating the performance of real estate entities. Granite considers FFO to be a meaningful supplemental measure that can be used to determine the Trust’s ability to service debt, finance capital expenditures and provide distributions to stapled unitholders. FFO is reconciled to net income, which is the most directly comparable IFRS measure (see “*RESULTS OF OPERATIONS FOR THE THREE MONTH PERIOD ENDED JUNE 30, 2014 — Funds From Operations and RESULTS OF OPERATIONS FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2014 — Funds From Operations*”). FFO does not represent or approximate cash generated from operating activities determined in accordance with IFRS and is not reconciled to cash flow from operating activities as the calculation of FFO does not consider changes in working capital items or adjust for certain other non-cash items that are included in the determination of cash flow from operating activities in accordance with IFRS.

### ***Comparable funds from operations***

Comparable FFO currently excludes \$4.2 million of current income tax expense associated with withholding taxes paid in the second quarter of 2013 related to the repatriation of prior years’ earnings from foreign jurisdictions primarily associated with certain planned internal reorganizations undertaken post the REIT conversion. As the \$4.2 million withholding tax payment is a result of a significant earnings repatriation that is

not expected to recur at a similar level of magnitude, it has been added to FFO to arrive at a comparable FFO amount to current and prior periods. In the future, other large unusual items that are not expected to be of a recurring nature may also be considered when determining comparable FFO and will be explicitly described and quantified.

### **FFO payout ratio**

The FFO payout ratio is calculated as distributions declared to unitholders divided by comparable FFO in a period and is a supplemental measure widely used by analysts and investors in evaluating the sustainability of the Trust's distributions to stapled unitholders.

### **Annualized lease payments**

ALP represents Granite's total annual rent assuming that contractual lease payments in place at the last day of the reporting period were in place for an entire year or less than a year if non-renewal or termination notices have been provided. Accordingly, any revenue changes from future contractual rent adjustments, renewal and re-leasing activities or expansion and improvement projects to be completed are not reflected in ALP as at any given period end. In addition, rents denominated in foreign currencies are converted to Cdn. dollars based on exchange rates in effect at the last day of the reporting period (see "SIGNIFICANT MATTERS — Foreign Currencies"). Granite considers annualized lease payments to be a useful indicator of rental revenue (excluding tenant recoveries) anticipated in the upcoming 12 month period. ALP is also a measure that is used by analysts in evaluating the outlook for real estate entities as it provides a forward-looking estimate of revenue using the present trends and foreign exchange rates in effect at the last day of the reporting period. ALP is not reconciled to any IFRS measure as it is an indicator of anticipated revenue and therefore not comparable to any measure in the combined financial statements.

## **INVESTMENT PROPERTIES**

Granite's investment properties consist of income-producing properties, properties and land under development and land held for development. The fair values of the investment properties are as follows:

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Income-producing properties . . . . .	<b>\$2,237.6</b>	\$2,325.6
Properties and land under development . . . . .	<b>9.0</b>	18.1
Land held for development . . . . .	<b>—</b>	8.2
Investment properties . . . . .	<b><u>\$2,246.6</u></b>	<b><u>\$2,351.9</u></b>

During the six month period ended June 30, 2014, investment properties decreased by \$105.3 million primarily as a result of (i) a decrease of \$134.7 million related to the disposal of properties which included \$113.7 million for the disposition of our Mexican portfolio of properties and \$21.0 million related to the disposal of two properties located in the United States and Germany and (ii) net fair value losses of \$29.1 million which resulted from changes described below. These decreases were partially offset by (i) an increase of \$44.5 million due to tenant allowances incurred with respect to the extension of two leases for properties in Graz, Austria and (ii) capital expenditures totaling \$15.2 million.

During the six months ended June 30, 2014, net fair value losses totaled \$29.1 million. The net fair value losses were primarily attributable to changes to leasing assumptions in Canada and Austria and increases in discount and terminal capitalization rates of certain properties in Austria and Germany, partially offset by a compression in discount and terminal capitalization rates and changes to leasing assumptions in the United States.

### *Income-Producing Properties*

At June 30, 2014, Granite had over 100 income-producing properties representing approximately 30.0 million square feet of rentable space. The portfolio also includes some office buildings that comprise 1% of the total square footage of the income-producing properties.

The fair value of the income-producing portfolio by country as at June 30, 2014 and December 31, 2013 was as follows:

	<u>June 30, 2014</u>		<u>December 31, 2013</u>	
	<u>Fair Value</u>	<u>Percent of Total</u>	<u>Fair Value</u>	<u>Percent of Total</u>
Austria . . . . .	\$ 705.3	31%	\$ 674.6	29%
Canada . . . . .	684.0	31	701.1	30
U.S. . . . .	446.9	20	425.2	18
Germany . . . . .	263.7	12	276.2	12
Netherlands . . . . .	101.2	4	101.5	4
Mexico . . . . .	—	—	111.7	5
Other . . . . .	36.5	2	35.3	2
	<u>\$2,237.6</u>	<u>100%</u>	<u>\$2,325.6</u>	<u>100%</u>

Fair values were primarily determined by discounting the expected future cash flows, generally over a term of 10 years, including a terminal value based on the application of a capitalization rate to estimated year 11 cash flows. The Trust measures its income-producing properties and properties under development using valuations prepared by management. The Trust does not measure its investment properties based on valuations prepared by external appraisers but uses such appraisals as data points, together with other external market information accumulated by management, in arriving at its own conclusions on values. The key valuation metrics for Granite's investment properties are summarized in note 3 to the unaudited condensed combined financial statements for the six month period ended June 30, 2014.

At June 30, 2014, Granite had 13 active improvement projects in North America for roof and pavement replacements as well as other minor leasehold improvements and one expansion project at an income-producing property in Austria. The total estimated cost of these projects is approximately \$19.0 million of which \$9.0 million had been spent as at June 30, 2014 with the remaining cost to be funded during the remainder of the year using cash from operations.

### *Properties and Land Under Development*

At June 30, 2014, the Trust had one property under development: an 89.2 acre land site located in Bethel Township, Pennsylvania which is being developed into a 0.75 million square foot industrial facility. As at June 30, 2014, \$1.1 million had been incurred with respect to the project which is expected to be completed in the second quarter of 2015. Contractual commitments related to the project were \$7.8 million at June 30, 2014. On June 20, 2014, the Trust entered into a secured construction loan (the "2017 Construction Loan") for U.S. \$26.2 million relating to funding for this project (see "*LIQUIDITY AND CAPITAL RESOURCES — Bank and Debenture Financing*"). As at June 30, 2014, no amounts had been drawn under the 2017 Construction Loan.

During the six month period ended June 30, 2014, the construction of a 0.6 million square foot multipurpose facility on a 35.9 acre land site located at Settlers Point Business Park in Shepherdsville, Kentucky was completed and the property is being actively marketed for lease. The project was primarily funded by a secured construction loan for U.S. \$17.0 million (the "2016 Construction Loan"), which was entered into on July 25, 2013. At June 30, 2014, \$11.9 million had been drawn under the 2016 Construction Loan (see "*LIQUIDITY AND CAPITAL RESOURCES — Bank and Debenture Financing*").

## LEASING PROFILE

### Magna, Our Largest Tenant

At June 30, 2014, Magna is the tenant at 74 of Granite's income-producing properties comprising 84% of Granite's annualized lease payments. Magna is a diversified global automotive supplier that designs, develops and manufactures technologically advanced automotive systems, assemblies, modules and components, and engineers and assembles complete vehicles, primarily for sale to original equipment manufacturers of cars and light trucks. Magna's product capabilities span a number of major automotive areas, including interior systems, seating systems, closure systems, body and chassis systems, vision systems, electronic systems, exterior systems, powertrain systems, roof systems, hybrid electric vehicles/systems and complete vehicle engineering and assembly.

Granite's relationship with Magna is an arm's length landlord and tenant relationship governed by the terms of Granite's leases with Magna. The terms of the lease arrangements with Magna generally provide for the following:

- the obligation of Magna to pay for costs of occupancy, including operating costs, property taxes and maintenance and repair costs;
- rent escalations based on either fixed-rate steps or inflation;
- renewal options tied to market rental rates or inflation;
- environmental indemnities from the tenant; and
- a right of first refusal in favour of Magna on the sale of a property.

Renewal terms, rates and conditions are typically set out in our leases with Magna and form the basis for tenancies that continue beyond the expiries of the initial lease terms.

According to its public disclosure, Magna's success is primarily dependent upon the levels of car and light truck production by Magna's customers, the relative amount of content Magna has in the various programs and its operating costs in the various countries in which it operates. Granite management expects Magna to continuously seek to optimize its global manufacturing footprint and consequently, Magna may not renew leases for facilities currently under lease at their expiries.

### Annualized Lease Payments

ALP for the three and six month periods ended June 30, 2014 decreased by \$14.4 million due to the disposition of the Mexican property portfolio. Granite's annualized lease payments as at June 30, 2014, including the change from December 31, 2013 to June 30, 2014, are as follows:

	<b>Three Months Ended June 30, 2014</b>	<b>Six Months Ended June 30, 2014</b>
Annualized lease payments, beginning of period . . . . .	\$226.6	\$221.9
Contractual rent adjustments . . . . .	0.2	1.0
Completed projects on-stream . . . . .	—	0.1
Disposals . . . . .	(14.4)	(15.7)
Vacancies . . . . .	(0.5)	(1.2)
Renewals . . . . .	0.1	(0.3)
Re-leasing . . . . .	1.4	1.4
Effect of changes in foreign currency exchange rates . .	(5.9)	0.3
<b>Annualized lease payments, as at June 30, 2014 . . . .</b>	<b><u>\$207.5</u></b>	<b><u>\$207.5</u></b>

During the second quarter of 2014, annualized lease payments decreased by \$19.1 million from \$226.6 million at March 31, 2014 to \$207.5 million at June 30, 2014. Contractual rent adjustments increased annualized lease payments by \$0.2 million from Consumer Price Index ("CPI") based increases and other contractual rent

increases. Annualized lease payments were negatively impacted by (i) \$14.4 million due to the disposal of the 2.4 million square foot portfolio of properties in Mexico and (ii) \$0.5 million related to two vacancies in the United States and Germany, representing an aggregate of 0.3 million square feet of leaseable area, partially offset by (iii) \$1.4 million from the re-leasing of two vacant properties in Canada and the United States representing 0.3 million square feet of leaseable property and (iv) \$0.1 million from the extension of a lease representing 0.3 million square feet of leaseable area in Canada. The weakening of the euro and U.S. dollar against the Cdn. dollar during the second quarter of 2014 resulted in decreases in annualized lease payments of \$4.3 million and \$1.6 million, respectively.

On a year to date basis, annualized lease payments decreased by \$14.4 million from \$221.9 million at December 31, 2013 to \$207.5 million at June 30, 2014. Contractual rent adjustments increased annualized lease payments by \$1.0 million primarily from CPI based increases on properties representing 6.2 million square feet of leaseable area in Canada, the United States and Germany. The completion of an improvement project in the United States increased annualized lease payments by \$0.1 million. Annualized lease payments were negatively impacted by (i) \$15.7 million due to the disposal of a 0.1 million square foot property in the United States and the portfolio of Mexican properties as noted above, (ii) \$1.2 million related to three vacancies in the United States and Germany, representing a combined 0.7 million square feet of leaseable area and (iii) a net \$0.3 million due to the renewal or extension of seven leases representing 4.8 million square feet of leaseable area in North America, Austria and the United Kingdom at rental rates which were overall lower than the expiring lease rates in place. The re-leasing of two vacant properties in Canada and the United States as noted above contributed \$1.4 million to annualized lease payments. The weakening of the euro against the Cdn. dollar resulted in a decrease in annualized lease payments of \$0.3 million while the strengthening of the U.S. dollar against the Cdn. dollar resulted in increases in annualized lease payments of \$0.6 million.

The annualized lease payments by currency at June 30, 2014 and December 31, 2013 were as follows:

	June 30, 2014		December 31, 2013	
Euro . . . . .	<b>\$100.3</b>	<b>48%</b>	\$100.9	45%
Cdn. dollar . . . . .	<b>64.9</b>	<b>31</b>	64.0	29
U.S. dollar . . . . .	<b>41.5</b>	<b>20</b>	55.9	25
Other . . . . .	<b>0.8</b>	<b>1</b>	1.1	1
	<b><u>\$207.5</u></b>	<b><u>100%</u></b>	<b><u>\$221.9</u></b>	<b><u>100%</u></b>

## Leasing Activity

### 2014 Lease Expiries

	Number of leases	Square Footage <i>(in thousands)</i>	ALP <i>(in millions)</i>
Renewed leases . . . . .	3	433	\$2.3
Leases with short termination notices . . . . .	2	312	1.0
Negotiations in-progress . . . . .	2	346	1.7
Potential disposition . . . . .	1	114	0.1
Non-renewals . . . . .	2	396	0.8
	<b><u>10</u></b>	<b><u>1,601</u></b>	<b><u>\$5.9</u></b>

There were ten leases which had expiry dates in the 2014 fiscal year. To date, three of the leases have been renewed or extended. A lease with a Magna tenant for a 0.3 million square foot property in Canada was extended to April 2019, a lease for a 0.1 million square foot property in Spain leased to Magna was renewed to

August 2019 and a lease with a non-Magna tenant for a property in the United States was extended to August 2016.

Of the remaining seven leases, (i) two leases have short termination notice periods, (ii) negotiations are in progress for two of the leases, (iii) one property is expected to be sold, subject to certain closing conditions, and (iv) two leases have not been renewed and the premises have either been vacated or are expected to be vacated in 2014.

#### *New Leases and Extensions*

On January 30, 2014, Magna agreed to a lease extension at the Thondorf facility in Graz, Austria. The lease expiry for the 3.9 million square foot facility has been extended from December 31, 2017 to January 31, 2024. In connection with the extension, the current rental rate will remain fixed for the balance of the term and Granite paid a one-time tenant allowance in the amount of \$37.8 million (euro 25.0 million) in the first quarter of 2014.

On March 28, 2014, Magna agreed to a lease extension at the Eurostar facility in Graz, Austria. The Eurostar facility is adjacent to the Thondorf facility noted above and its lease expiry has been extended from December 31, 2017 to January 31, 2024, to be coterminous with the Thondorf facility. In connection with the extension, in January 2018 contractual rents will increase based on a modified CPI formula and, at that time, Granite will pay a one-time tenant allowance in the amount of euro 6.0 million. As set out in note 7 to the unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014, this obligation has been recorded at its discounted value on the combined balance sheet.

During the first quarter of 2014, Granite executed an 11 year lease of a property in the United States that became vacant in 2013. The tenant took possession of the 0.2 million square foot facility in the second quarter of 2014. In addition, during the second quarter of 2014, Granite entered into a six year lease with a tenant who took possession of a 0.2 million square foot previously vacant property in Canada. Subsequent to June 30, 2014, Granite extended three leases with Magna which had expiry dates of January 2015. Two leases, with an aggregate square footage of 0.2 million were extended to January 2018 and one lease for 0.2 million square feet was extended to January 2020.

#### **Lease Expiration**

As at June 30, 2014, Granite's portfolio had a weighted average lease term by square footage of 5.5 years with lease expiries by square footage (in thousands) and related annualized lease payments (in millions) set out in the table below:

	Total Rental Area	Vacant Sq Ft	2014		2015		2016		2017		2018		2019		2020 and Beyond	
			Sq Ft	ALP \$	Sq Ft	ALP \$	Sq Ft	ALP \$	Sq Ft	ALP \$	Sq Ft	ALP \$	Sq Ft	ALP \$	Sq Ft	ALP \$
Canada . . . . .	7,834	94	—	—	631	5.1	369	3.5	3,581	37.2	1,656	8.8	435	2.5	1,068	7.8
U.S. . . . .	7,669	946	396	1.3	314	1.2	364	1.2	644	7.4	931	4.2	1,389	10.8	2,685	15.5
Austria . . . . .	8,085	88	—	—	—	—	381	2.7	—	—	1,495	11.5	380	3.5	5,741	45.6
Germany . . . . .	4,385	62	725	1.9	—	—	965	3.6	—	—	596	4.3	303	1.7	1,734	12.6
Netherlands . . . . .	1,441	—	—	—	314	2.1	—	—	—	—	—	—	500	3.1	627	4.3
Other . . . . .	434	—	—	—	—	—	—	—	—	—	90	0.8	90	0.7	254	2.6
<b>Total . . . . .</b>	<b>29,848</b>	<b>1,190</b>	<b>1,121</b>	<b>3.2</b>	<b>1,259</b>	<b>8.4</b>	<b>2,079</b>	<b>11.0</b>	<b>4,225</b>	<b>44.6</b>	<b>4,768</b>	<b>29.6</b>	<b>3,097</b>	<b>22.3</b>	<b>12,109</b>	<b>88.4</b>
% of portfolio . . . . .	100%	4%	4%		4%		7%		14%		16%		10%		41%	

#### **Leasing Costs and Lease Incentives**

Direct leasing costs include broker commissions incurred in negotiating and arranging tenant leases. Lease incentives include the cost of leasehold improvements to tenant spaces or cash allowances provided to tenants for leasehold improvement costs. For the three and six month periods ended June 30, 2014, the Trust incurred leasing costs and lease incentives of \$0.1 million and \$44.9 million respectively, which includes the

tenant allowances related to the extension of two leases for properties in Graz, Austria (see “*LEASING PROFILE — New Leases and Extensions*”).

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2014

### Highlights

<i>(in millions, except per unit information)</i>	Three months ended June 30,		
	2014	2013	Change
Rental revenue and tenant recoveries . . . . .	\$52.2	\$46.2	13%
Income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes	36.2	34.4	5%
Net income from continuing operations . . . . .	26.4	38.9	(32)%
Net income attributable to stapled unitholders . . . . .	30.7	43.5	(29)%
Funds from Operations <sup>(1)</sup> . . . . .	39.9	31.3	28%
Comparable Funds from Operations <sup>(2)</sup> . . . . .	39.9	35.5	12%
Diluted FFO per stapled unit <sup>(1)</sup> . . . . .	\$0.85	\$0.67	27%
Diluted comparable FFO per stapled unit <sup>(2)</sup> . . . . .	\$0.85	\$0.76	12%
FFO payout ratio <sup>(2)</sup> . . . . .	65%	69%	(4)%

(1) See “Results of Operations for the Three Months Ended June 30, 2014 — Funds from Operations”.

(2) Excludes \$4.2 million (\$0.09 per stapled unit) of withholding taxes paid in the second quarter of 2013 related to the repatriation of prior years’ earnings from foreign jurisdictions (See “*PERFORMANCE MEASUREMENT — Comparable funds from operations*”).

### Rental Revenue and Tenant Recoveries

Rental revenue for the three month period ended June 30, 2014 increased \$6.0 million to \$52.2 million from \$46.2 million in the prior year period. The change in rental revenue is discussed below:

Rental revenue, three months ended June 30, 2013 . . . . .	\$46.2
Acquisitions . . . . .	4.7
Contractual rent adjustments . . . . .	0.6
Completed projects on-stream . . . . .	0.5
Renewals and re-leasing of income-producing properties . . . . .	(1.1)
Vacancies and disposals of income-producing properties . . . . .	(1.5)
Effect of changes in foreign currency exchange rates . . . . .	3.1
Other, including straight-line adjustments to rental revenue . . . . .	(0.3)
<b>Rental revenue, three months ended June 30, 2014 . . . . .</b>	<b>\$52.2</b>

Rental revenue for the three months ended June 30, 2014 increased by approximately 13% compared to the second quarter of 2013 mainly due to the acquisitions completed in 2013 and favourable foreign exchange rates with additional details discussed below.

The acquisition of nine income-producing properties in 2013, representing 3.2 million square feet of leaseable area, contributed \$4.7 million to rental revenue for the three month period ended June 30, 2014.

The \$0.6 million increase in revenue from contractual rent adjustments includes (i) \$0.2 million from annual CPI based increases implemented in 2014 on properties representing 5.9 million square feet of leaseable area, (ii) \$0.2 million from cumulative CPI based increases (being increases that occur every five years or once a specified cumulative increase in CPI has occurred) implemented in 2013 and 2014 on properties representing 10.2 million square feet of leaseable area, and (iii) \$0.2 million from fixed contract adjustments on properties representing 2.2 million square feet of leaseable area.

The completion of four Magna expansion or improvement projects in Germany, the Czech Republic, Canada and the United States in 2013 and 2014, and one non-Magna improvement project in Canada, which added a combined 0.1 million square feet of leaseable area, contributed an incremental \$0.5 million to rental revenue for the three month period ended June 30, 2014.

Renewals and re-leasing had a \$1.1 million net negative impact on revenues compared to the prior year period. This decrease was primarily due to the renewal or extension of 19 leases representing 9.0 million square feet of leaseable area in Canada, the United States, Germany, Austria and the United Kingdom most of which were negotiated at rental rates lower than the expiring lease rates in place.

Rental revenue for the three month period ended June 30, 2014 was also negatively impacted by \$1.5 million primarily due to vacancies resulting from the non-renewal by Magna of four expired leases representing 0.5 million square feet of leaseable area in the United States and Austria and the sale of four income-producing properties in the United States, Poland and Germany.

Foreign exchange had a \$3.1 million positive impact on reported rental revenues as the weakening of the Cdn. dollar against the euro and U.S. dollar denominated rents resulted in an increase in rental revenue of \$2.4 million and \$0.7 million, respectively.

### **Property Operating Costs**

Property operating costs, which include real estate taxes, utilities, insurance, repairs and maintenance, legal and other property-related expenses, were \$2.1 million for the three month period ended June 30, 2014 in comparison to \$1.3 million in the prior year period. The increase of \$0.8 million primarily comprised a \$0.4 million increase of property costs recoverable from tenants, a \$0.2 million increase in legal and consulting costs related to the settlement of a municipal land matter for three income-producing properties in Canada and other property administration costs and \$0.2 million of ground lease costs, which are related to acquisitions in the fourth quarter of 2013.

### **General and Administrative Expenses**

General and administrative expenses for the three month periods ended June 30, 2014 and 2013 were \$6.4 million and \$6.0 million, respectively. The \$0.4 million increase primarily consists of (i) \$0.7 million in higher compensation costs that include the impact of additional grants awarded under Granite's unit-based compensation plans and to a lesser extent, the increased valuation of the units outstanding under those plans due to the appreciation of the market price of the stapled units, increased staffing levels and the impact of higher foreign exchange rates, (ii) \$0.2 million of increased advisory costs and (iii) \$0.1 million related to the increased valuation of the grants issued to Granite's directors under the director unit-based compensation plan. These increases were partially offset by a \$0.6 million decrease in advisory costs related to the conversion to a REIT and related internal reorganizations incurred in the three month period ended June 30, 2013.

### **Depreciation and Amortization**

Depreciation and amortization expense is related to the amortization of fixed assets relating to our offices in Toronto, Canada and Vienna, Austria.

### **Interest Expense and Other Financing Costs, Net**

Net interest expense and other financing costs were \$6.9 million in the three month period ended June 30, 2014 compared to \$4.7 million in the prior year period. The increase of \$2.2 million consists of \$2.0 million of interest and associated costs related to the unsecured senior debentures which were issued in October 2013 and \$0.2 million of additional interest costs (U.S. dollar denominated) related to the outstanding mortgage debts and draws on the revolving credit facility with respect to the acquisitions that occurred in 2013.



### **Foreign Exchange Losses (Gains), Net**

Granite recognized net foreign exchange losses of \$0.3 million in the three month period ended June 30, 2014 compared to net foreign exchange gains of \$0.3 million in the prior year period. Net foreign exchange losses for the three month period ended June 30, 2014 included \$0.6 million in net foreign exchange losses due to the re-measurement of certain assets and liabilities held by Granite and certain of its subsidiaries that are denominated in U.S. dollars and euros, partially offset by \$0.3 million realized foreign exchange gains on derivative financial instruments such as foreign exchange forward contracts. The net foreign exchange gains in the three month period ended June 30, 2013 primarily related to the re-measurement of certain assets and liabilities held by Granite and certain of its subsidiaries that are denominated in U.S. dollars and euros.

### **Fair Value Gains (Losses) on Investment Properties, Net**

Net fair value losses on investment properties were \$5.6 million in the three month period ended June 30, 2014 compared to net fair value gains on investment properties of \$8.1 million in the prior year period. In the three month period ended June 30, 2014, the net fair value losses were attributable to changes in leasing assumptions in Canada primarily relating to decreases in market rents, partially offset by a compression in discount and terminal capitalization rates in the United States as well as changes in leasing assumptions in the United States relating primarily to market rent increases. The net fair value gains in the three month period ended June 30, 2013 primarily relate to changes in leasing assumptions and the amount and timing of cash flows related to capital expenditure spending.

### **Fair Value Gains (Losses) on Financial Instruments**

Granite recognized net fair value gains on financial instruments of \$0.4 million in the three month period ended June 30, 2014 compared to net fair value losses of \$0.6 million in the prior year period. Net fair value gains for the three months ended June 30, 2014 include \$0.6 million related to foreign exchange contracts outstanding at the end of the period, partially offset by \$0.2 million related to the decrease in fair value of the interest rate caps associated with the mortgages payable. Net fair value losses for the three months ended June 30, 2013 included \$0.8 million of fair value losses related to foreign exchange forward contracts outstanding at the end of the period, partially offset by a \$0.2 million gain related to the increase in the fair value of the interest rate caps associated with the mortgages payable (see note 12 to the unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014).

### **Acquisition Transaction Costs**

In the second quarter of 2013, Granite incurred \$0.4 million in transaction costs primarily associated with the acquisition of an income-producing property in the United States that was accounted for as a business combination.

### **Loss on Sale of Investment Properties**

In the second quarter of 2013, the Trust disposed of a 0.1 million square foot investment property for net proceeds of \$10.3 million. The loss on sale of \$0.3 million represents the selling costs of disposal.

### **Income Tax Expense (Recovery)**

Income tax expense for the second quarter of 2014 was \$4.6 million. The current portion of the income tax expense is a recovery of \$0.9 million comprising: \$0.7 million income tax expense which relates to foreign operations; a net decrease in unrecognized tax benefits of approximately \$2.2 million primarily due to the release of a tax reserve of \$2.9 million on the successful completion of a federal income tax audit in Canada; and a withholding tax expense of \$0.6 million related to the repatriation of tax paid earnings of prior years from foreign operations that is fully offset by the reversal of the deferred tax expense recorded in prior periods. The deferred tax portion of the income tax expense is \$5.5 million and relates to the net changes in the fair values of investment properties, foreign operations including related withholdings taxes and Canadian corporate entities subject to tax.

The effective income tax rate for the second quarter of 2014 was 14.9% compared to the effective income tax rate of 5.5% in the second quarter of 2013. The effective income tax rate for the second quarter is higher than the prior year period primarily due to fair value losses and other expenses in entities that do not record deferred taxes.

The Trust is structured with the objective of optimizing after-tax distributions it receives from its various taxable subsidiary entities. Income tax related legislative changes, including those pertaining to withholding taxes, may affect the level of distributions made to the Trust by its subsidiary entities and may impact the level of taxable income earned by the Trust and the source of income distributed by the Trust.

### Net Income from Continuing Operations

For the three month period ended June 30, 2014, net income from continuing operations was \$26.4 million compared to \$38.9 million in the prior year period. The \$12.5 million decrease was primarily due to net fair value losses on investment properties of \$5.6 million compared to net fair value gains of \$8.1 million in the prior year period, increased net interest expense of \$2.2 million and increased income tax expense of \$2.3 million. The net decrease was partially offset by a \$6.0 million increase in rental revenue and tenant recoveries.

### Net Income from Discontinued Operations

On June 26, 2014, Granite completed the disposition of its portfolio of Mexican properties to Magna for net cash proceeds before income taxes of \$108.6 million. Net after tax cash proceeds are estimated to be approximately \$95.0 million. In the three month period ended June 30, 2014, Granite incurred a loss on disposal of \$5.0 million which consists of a \$4.6 million closing adjustment and \$0.4 million in selling costs related to the disposition. As a result of the disposition of the Mexican operation, net cumulative foreign currency translation gains of \$5.7 million, which had been recorded in other comprehensive income, were reclassified from equity and recorded in net income.

Net income from discontinued operations and related net gain on sale consist of the following:

<i>(in thousands)</i>	<b>Three months ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Rental revenue</b> . . . . .	<b>\$3,431</b>	\$3,325
Operating costs and expenses . . . . .	<b>82</b>	425
Fair value gains on investment properties, net . . . . .	<b>—</b>	(2,805)
Income before income taxes . . . . .	<b>3,349</b>	5,705
Income tax expense . . . . .	<b>(546)</b>	(1,230)
<b>Income from discontinued operations before gain on sale of disposed properties</b> . . . . .	<b>2,803</b>	4,475
Loss on sale of investment properties . . . . .	<b>(4,979)</b>	—
Reclassification adjustment relating to foreign operation disposed of in the period . . . . .	<b>5,722</b>	—
Income tax recovery . . . . .	<b>823</b>	—
<b>Net gain on sale of disposed properties</b> . . . . .	<b>1,566</b>	—
<b>Net income from discontinued operations</b> . . . . .	<b>\$4,369</b>	\$4,475

### Net Income

Net income was \$30.8 million in the three month period ended June 30, 2014 compared to \$43.4 million in the prior year period. The decrease of \$12.6 million was primarily due to a \$12.5 million decrease in net income from continuing operations.

## Funds From Operations

	Three Months Ended June 30,		
	2014	2013	Change
<i>(in thousands, except per unit information)</i>			
<b>Net income attributable to stapled unitholders</b> . . . . .	<b>\$30,668</b>	\$43,548	(30)%
Add (deduct):			
Fair value losses (gains) on investment properties . . . . .	<b>5,570</b>	(8,122)	(169)%
Fair value losses (gains) on financial instruments . . . . .	<b>(377)</b>	643	(159)%
Acquisition transaction costs . . . . .	—	382	N/A
Loss on sale of investment properties . . . . .	—	328	N/A
Deferred income taxes . . . . .	<b>5,541</b>	(3,624)	(253)%
Non-controlling interests relating to the above . . . . .	<b>34</b>	(260)	(113)%
Discontinued operations relating to the above . . . . .	<b>(1,566)</b>	(1,637)	(4)%
<b>FFO</b> . . . . .	<b>39,870</b>	31,258	28%
Withholding tax payment . . . . .	—	4,220	N/A
<b>Comparable FFO</b> . . . . .	<b>\$39,870</b>	\$35,478	12%
<b>Basic and diluted FFO per stapled unit</b> . . . . .	<b>\$ 0.85</b>	\$ 0.67	27%
<b>Basic and diluted comparable FFO per stapled unit</b> . . . . .	<b>\$ 0.85</b>	\$ 0.76	12%
<b>Basic number of stapled units outstanding</b> . . . . .	<b>47,014</b>	46,932	
<b>Diluted number of stapled units outstanding</b> . . . . .	<b>47,070</b>	46,948	

N/A — not applicable

Comparable FFO for the second quarter of 2014 was \$39.9 million and comprises \$37.1 million from continuing operations and \$2.8 million from discontinued operations. Comparable FFO for the second quarter of 2013 was \$35.5 million and comprises \$32.7 million from continuing operations and \$2.8 million from discontinued operations. The \$4.4 million increase in total comparable FFO is primarily due to a \$6.0 million increase in rental revenue and a \$2.5 million increase in current income tax recoveries, partially offset by increased interest expense of \$2.2 million, a \$0.8 million increase in property costs and a \$0.6 million increase in foreign exchange losses.

## RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2014

### Highlights

	Six Months Ended June 30,		
	2014	2013	Change
<i>(in millions, except per unit information)</i>			
Rental revenue and tenant recoveries . . . . .	<b>\$105.1</b>	\$ 91.1	15%
Income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes . . . . .	<b>73.4</b>	66.9	10%
Net income from continuing operations . . . . .	<b>38.6</b>	128.0	(70)%
Net income attributable to stapled unitholders . . . . .	<b>45.1</b>	137.8	(67)%
Funds from Operations <sup>(1)</sup> . . . . .	<b>78.9</b>	65.3	21%
Comparable Funds from Operations <sup>(2)</sup> . . . . .	<b>78.9</b>	69.5	14%
Diluted FFO per stapled unit <sup>(1)</sup> . . . . .	<b>\$ 1.68</b>	\$ 1.39	21%
Diluted comparable FFO per stapled unit <sup>(2)</sup> . . . . .	<b>\$ 1.68</b>	\$ 1.48	14%
FFO payout ratio <sup>(2)</sup> . . . . .	<b>65%</b>	71%	(6)%

(1) See “Results of Operations for the Six Months Ended June 30, 2014 — Funds from Operations”.

(2) Excludes \$4.2 million (\$0.09 per stapled unit) of withholding taxes paid in the second quarter of 2013 related to the repatriation of prior years’ earnings from foreign jurisdictions (See “PERFORMANCE MEASUREMENT — Comparable funds from operations”).

## Highlights (continued)

<i>(in millions, except number of properties)</i>	<b>June 30, 2014</b>	December 31, 2013	Change
Number of income-producing properties . . . . .	<b>104</b>	112	(7)%
Leaseable area (sq. ft.) . . . . .	<b>29.8</b>	31.9	(7)%
Annualized lease payments . . . . .	<b>\$ 207.5</b>	\$ 221.9	(6)%
Investment properties, fair value . . . . .	<b><u>\$2,246.6</u></b>	<u>\$2,351.9</u>	<u>(4)%</u>

### Rental Revenue and Tenant Recoveries

Rental revenue for the six month period ended June 30, 2014 increased \$14.0 million to \$105.1 million from \$91.1 million in the prior year period. The change in rental revenue is discussed below:

Rental revenue, six months ended June 30, 2013 . . . . .	\$ 91.1
Acquisitions . . . . .	10.5
Contractual rent adjustments . . . . .	1.2
Completed projects on-stream . . . . .	1.1
Renewals and re-leasing of income-producing properties . . . . .	(2.3)
Vacancies and disposals of income-producing properties . . . . .	(3.0)
Effect of changes in foreign currency exchange rates . . . . .	6.7
Other, including straight-line adjustments to rental revenue . . . . .	<u>(0.2)</u>
<b>Rental revenue, six months ended June 30, 2014 . . . . .</b>	<b><u>\$105.1</u></b>

Rental revenue for the six months ended June 30, 2014 increased by approximately 15% compared to the prior year period mainly due to the acquisitions completed in 2013 and favourable foreign exchange rates with additional details discussed below.

The acquisition of 12 income-producing properties in 2013, representing 4.2 million square feet of leaseable area, contributed \$10.5 million to rental revenue for the six month period ended June 30, 2014.

The \$1.2 million increase in revenue from contractual rent adjustments includes (i) \$0.4 million from annual CPI based increases implemented in 2014 on properties representing 5.9 million square feet of leaseable area, (ii) \$0.4 million from cumulative CPI based increases (being increases that occur every five years or once a specified cumulative increase in CPI has occurred) implemented in 2013 and 2014 on properties representing 10.3 million square feet of leaseable area and (iii) \$0.4 million from fixed contract adjustments on properties representing 2.2 million square feet of leaseable area.

The completion of six Magna expansion or improvement projects in Germany, the Czech Republic, Canada and the United States in 2013 and 2014 and one non-Magna improvement project in Canada, which added a combined 0.2 million square feet of leaseable area, contributed an incremental \$1.1 million to rental revenue for the six month period ended June 30, 2014.

Renewals and re-leasing had a \$2.3 million net negative impact on revenues compared to the prior year period. This decrease was primarily due to the renewal or extension of 20 leases representing 9.2 million square feet of leaseable area in Canada, the United States, Austria, Germany and the United Kingdom most of which were negotiated at rental rates lower than the expiring lease rates in place.

Rental revenue for the six month period ended June 30, 2014 was also negatively impacted by \$3.0 million primarily due to vacancies resulting from the non-renewal by Magna of four expired leases representing 0.5 million square feet of leaseable area in the United States and Austria and the sale of four income-producing properties in the United States, Poland and Germany.

Foreign exchange had a \$6.7 million positive impact on reported rental revenues as the weakening of the Cdn. dollar against the euro and U.S. dollar denominated rents resulted in an increase in rental revenue of \$5.2 million and \$1.5 million, respectively.

### **Property Operating Costs**

Property operating costs, which include real estate taxes, utilities, insurance, repairs and maintenance, legal and other property-related expenses, were \$3.9 million for the six month period ended June 30, 2014 in comparison to \$2.4 million in the prior year period. The increase of \$1.5 million primarily comprised a \$0.8 million increase of property costs recoverable from tenants, a \$0.2 million increase in legal and consulting costs related to the settlement of a municipal land matter for three income-producing properties in Canada and other property administration costs and \$0.3 million of ground lease costs, which are related to acquisitions in the fourth quarter of 2013.

### **General and Administrative Expenses**

General and administrative expenses for the six month periods ended June 30, 2014 and 2013 were \$13.7 million and \$13.1 million, respectively. The \$0.6 million increase primarily consists of (i) \$1.8 million in higher compensation costs that include additional grants awarded under Granite's unit-based compensation plans, the increased valuation of the units outstanding under those plans due to the appreciation of the market price of the stapled units and to a lesser extent increased staffing levels and the impact of higher foreign exchange rates, (ii) \$0.6 million of increased advisory costs largely related to establishing incremental procedures associated with the nature of the stapled unit structure of Granite and (iii) \$0.2 million related to the increased valuation of the grants issued to Granite's directors under the director unit-based compensation plan. These increases were offset by a \$2.0 million decrease in advisory costs related to the conversion to a REIT and related internal reorganizations incurred in the six month period ended June 30, 2013.

### **Depreciation and Amortization**

Depreciation and amortization expense is related to the amortization of fixed assets relating to our offices in Toronto, Canada and Vienna, Austria.

### **Interest Expense and Other Financing Costs, Net**

Net interest expense and other financing costs were \$13.8 million in the six month period ended June 30, 2014 compared to \$9.2 million in the prior year period. The increase of \$4.6 million consists of \$4.0 million of interest and associated costs related to the unsecured senior debentures which were issued in October 2013 and \$0.7 million of additional interest costs (U.S. dollar denominated) related to the outstanding mortgage debts and draws on the revolving credit facility with respect to the acquisitions that occurred in 2013. These increases were partially offset by a \$0.2 million decrease from the accelerated amortization of deferred financing costs related to the credit facility that was replaced in February 2013.

### **Foreign Exchange Losses (Gains), Net**

Granite recognized net foreign exchange losses of \$0.1 million in the six month period ended June 30, 2014 compared to net foreign exchange gains of \$0.7 million in the prior year period. Net foreign exchange gains and losses for the six month periods ended June 30, 2014 and 2013 primarily related to the re-measurement of certain assets and liabilities held by Granite and certain of its subsidiaries that are denominated in U.S. dollars and euros.

### **Fair Value Gains (Losses) on Investment Properties, Net**

Net fair value losses on investment properties were \$29.1 million in the six month period ended June 30, 2014 compared to net fair value gains on investment properties of \$23.2 million in the prior year period. In the six month period ended June 30, 2014, the net fair value losses were attributable to changes in leasing assumptions in Canada and Austria and an increase in discount and terminal capitalization rates of certain properties in Austria and Germany, partially offset by a compression in discount and terminal capitalization

rates and changes in leasing assumptions in the United States as noted earlier. The net fair value gains in the six month period ended June 30, 2013 of \$23.2 million primarily resulted from a compression in discount and terminal capitalization rates in Canada and the United States.

### **Fair Value Gains (Losses) on Financial Instruments**

Granite recognized net fair value gains on financial instruments of \$0.3 million in the six month period ended June 30, 2014 compared to net fair value losses of \$0.1 million in the prior year period. Net fair value gains for the six months ended June 30, 2014 include \$0.6 million related to foreign exchange contracts outstanding at the end of the period, partially offset by \$0.3 million of fair value losses relating to interest rate caps associated with the mortgages payable. Net fair value losses for the six months ended June 30, 2013 included \$0.3 million of fair value losses related to foreign exchange forward contracts outstanding at the end of the period, partially offset by a \$0.2 million gain related to the increase in the fair value of the interest rate caps associated with the mortgages payable (see note 12 to the unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014).

### **Acquisition Transaction Costs**

In the six months ended June 30, 2013, Granite incurred \$0.8 million in transaction costs primarily associated with the acquisition of three income-producing properties in the United States that were accounted for as business combinations.

### **Gain on Meadows Holdback**

In the first quarter of 2013, the Trust entered into a settlement agreement pursuant to which the Trust received U.S. \$5.0 million relating to a holdback receivable of a former subsidiary's sale of a property in 2006. The settlement proceeds comprised a cash payment of U.S. \$1.5 million and a non-interest bearing promissory note of U.S. \$3.5 million payable in U.S. \$0.5 million monthly instalments which commenced March 31, 2013 and concluded with the final instalment received in October 2013.

### **Loss on Sale of Investment Properties**

In the six months ended June 30, 2013, the Trust disposed of a 0.1 million square foot investment property for net proceeds of \$10.3 million. The loss on sale of \$0.3 million represents the selling costs of disposal.

### **Income Tax Expense (Recovery)**

Income tax expense for the six months ended June 30, 2014 was \$5.8 million. The current portion of the income tax expense is \$1.4 million comprising \$1.6 million income tax expense which relates to foreign operations; a net decrease in unrecognized tax benefits of approximately \$1.9 million primarily due to the release of a tax reserve of \$2.9 million on the successful completion of a federal income tax audit in Canada; a withholding tax expense of \$0.6 million related to the repatriation of tax paid earnings of prior years from a foreign operation that is fully offset by the reversal of the deferred tax expense recorded in prior periods; and \$1.1 million related to the sale of a German property. The deferred tax portion of the income tax expense is \$4.5 million and relates to the net changes in the fair values of investment properties, foreign operations including related withholding taxes, and Canadian corporate entities subject to tax.

The effective income tax rate for the six months ended June 30, 2014 was 13.1% compared to an effective income tax rate of 8.3% for the six months ended June 30, 2013, excluding a \$41.9 million reversal of the Canadian deferred tax liabilities recorded prior to the January 3, 2013 REIT conversion. The effective tax rate for the six month period is higher than the prior year period primarily due to fair value losses and other expenses in entities that do not record deferred taxes.

The Trust is structured with the objective of optimizing after-tax distributions it receives from its various taxable subsidiary entities. Income tax related legislative changes, including those pertaining to withholding taxes, may affect the level of distributions made to the Trust by its subsidiary entities and may impact the level of taxable income earned by the Trust and the source of income distributed by the Trust.

## Net Income from Continuing Operations

For the six month period ended June 30, 2014, net income from continuing operations was \$38.6 million compared to \$128.0 million in the prior year period. The decrease of \$89.4 million was primarily due to net fair value losses on investment properties of \$29.1 million compared to net fair value gains of \$23.2 million in the prior year period, a \$39.9 million increase in income tax expense, primarily deferred tax expense, a decrease in the \$5.1 million gain on settlement of the Meadows holdback and a \$4.6 million increase in net interest expense, partially offset by increased rental revenue and tenant recoveries of \$14.0 million and decreased acquisition transaction costs of \$0.8 million.

## Net Income from Discontinued Operations

On June 26, 2014, Granite completed the disposition of its portfolio of Mexican properties to Magna for net cash proceeds of \$108.6 million. In the six month period ended June 30, 2014, Granite incurred a loss on disposal of \$5.1 million which included a \$4.6 million closing adjustment and \$0.5 million in selling costs related to the disposition. As a result of the disposition of the Mexican operation, net cumulative foreign currency translation gains of \$5.7 million, which had been recorded in other comprehensive income, were reclassified from equity and recorded in net income.

Net income from discontinued operations and related net gain on sale is comprised of the following:

<i>(in thousands)</i>	<b>Six months ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Rental revenue</b> . . . . .	<b>\$ 7,079</b>	\$ 6,503
Operating costs and expenses . . . . .	<b>90</b>	194
Fair value (gains) losses on investment properties, net . . . . .	<b>4</b>	(6,509)
Income before income taxes . . . . .	<b>6,985</b>	12,818
Income tax expense . . . . .	<b>(1,702)</b>	(3,007)
<b>Income from discontinued operations before gain on sale of disposed properties</b> . . . . .	<b>5,283</b>	9,811
Loss on sale of investment properties . . . . .	<b>(5,071)</b>	—
Reclassification adjustment relating to foreign operation disposed of in the period . . .	<b>5,722</b>	—
Income tax recovery . . . . .	<b>823</b>	—
<b>Net gain on sale of disposed properties</b> . . . . .	<b>1,474</b>	—
<b>Net income from discontinued operations</b> . . . . .	<b>\$ 6,757</b>	<b>\$ 9,811</b>

## Net Income

Net income was \$45.3 million in the six month period ended June 30, 2014 in comparison to \$137.8 million in the prior year period. The \$92.5 million decrease was due to the \$89.4 million decrease in net income from continuing operations and a \$3.1 million decrease in net income from discontinued operations.

## Funds From Operations

<i>(in thousands, except per unit information)</i>	<b>Six Months Ended June 30,</b>		
	<b>2014</b>	2013	Change
<b>Net income attributable to stapled unitholders</b> . . . . .	<b>\$45,123</b>	\$137,839	(67)%
Add (deduct):			
Fair value losses (gains) on investment properties . . . . .	<b>29,123</b>	(23,152)	(226)%
Fair value losses (gains) on financial instruments . . . . .	<b>(339)</b>	148	(329)%
Gain on Meadows holdback . . . . .	—	(5,143)	N/A
Acquisition transaction costs . . . . .	—	793	N/A
Loss on sale of investment properties . . . . .	<b>182</b>	328	(45)%
Current income tax expense associated with the sale of an investment property . . . . .	<b>1,099</b>	—	N/A
Deferred income taxes . . . . .	<b>4,490</b>	(40,946)	(111)%
Non-controlling interests relating to the above . . . . .	<b>44</b>	(206)	(121)%
Discontinued operations relating to the above . . . . .	<b>(848)</b>	(4,397)	(81)%
<b>FFO</b> . . . . .	<b>78,874</b>	65,264	21%
Withholding tax payment . . . . .	—	4,220	N/A
<b>Comparable FFO</b> . . . . .	<b>\$78,874</b>	\$ 69,484	14%
<b>Basic and diluted FFO per stapled unit</b> . . . . .	<b>\$ 1.68</b>	\$ 1.39	21%
<b>Basic and diluted comparable FFO per stapled unit</b> . . . . .	<b>\$ 1.68</b>	\$ 1.48	14%
<b>Basic number of stapled units outstanding</b> . . . . .	<b>46,988</b>	46,907	
<b>Diluted number of stapled units outstanding</b> . . . . .	<b>47,029</b>	46,929	

N/A — not applicable

Comparable FFO for the six month period ended June 30, 2014 was \$78.9 million and comprises \$73.0 million from continuing operations and \$5.9 million from discontinued operations. Comparable FFO for the six month period ended June 30, 2013 was \$69.5 million and comprises \$64.1 million from continuing operations and \$5.4 million from discontinued operations. The \$9.4 million increase in total comparable FFO is primarily due to increased rental revenue of \$14.0 million and lower current income tax expense of \$1.5 million, partially offset by a \$4.6 million increase in net interest expense, increased property costs of \$1.5 million and increased net foreign exchange losses of \$0.7 million.



## LIQUIDITY AND CAPITAL RESOURCES

Operating activities of continuing operations generated cash of \$37.5 million and \$28.7 million in the three and six month periods ended June 30, 2014, respectively. At June 30, 2014, the Trust had cash and cash equivalents of \$205.7 million and unitholders' equity of \$1.7 billion.

### Cash Flows

#### Operating Activities

<i>(in millions)</i>	Three Months Ended June 30,		
	2014	2013	Change
<b>Net income</b> . . . . .	<b>\$ 26.4</b>	\$ 38.9	(32)%
Items not involving current cash flows . . . . .	<b>13.0</b>	(9.3)	(240)%
Current income tax expense (recovery) . . . . .	<b>(0.9)</b>	5.8	(116)%
Income taxes paid . . . . .	<b>(2.0)</b>	(9.0)	(78)%
Interest expense . . . . .	<b>6.4</b>	4.6	39%
Interest paid . . . . .	<b>(13.1)</b>	(8.6)	52%
Changes in working capital balances . . . . .	<b>7.7</b>	0.4	NM
<b>Cash provided by operating activities from continuing operations</b> . . . . .	<b>37.5</b>	22.8	64%
Cash provided by operating activities from discontinued operations . . . . .	<b>17.1</b>	2.2	NM
<b>Cash provided by operating activities</b> . . . . .	<b>\$ 54.6</b>	<b>\$ 25.0</b>	<b>118%</b>

NM — not meaningful

In the three month period ended June 30, 2014, operating activities from continuing operations generated cash of \$37.5 million compared to \$22.8 million in the prior year period. The increase of \$14.7 million is primarily due to a \$7.3 million increase in cash generated from changes in working capital balances and increased rental revenue of \$6.0 million.

In the three month period ended June 30, 2014, changes in working capital balances generated cash of \$7.7 million which comprised a \$6.9 million decrease in accounts receivable, primarily due to the receipt of value-added tax related to the tenant allowance for the Thondorf facility (see 'LEASING PROFILE — Leasing Activity'), a \$1.9 million increase in accounts payable and other accrued liabilities primarily due to an increase in accruals related to construction costs, partially offset by a \$1.2 million decrease in deferred revenue due to the timing of rental receipts.

For the three month period ended June 30, 2013, the change in working capital balances generated cash of \$0.4 million primarily due to a \$0.7 million increase in deferred revenue which was primarily related to the timing of rental receipts, a \$0.4 million decrease in prepaid expenses and a \$0.4 million decrease in restricted cash, partially offset by a \$0.7 million decrease in accounts payable and other accrued liabilities and a \$0.5 million increase in accounts receivable.

Cash provided by operating activities from discontinued operations for the three month period ended June 30, 2014 of \$17.1 million primarily consisted of \$14.4 million of value-added tax payable related to the disposition of the Mexican properties and \$3.4 million of operating income. Cash provided by operating activities from discontinued operations for the three month period ended June 30, 2013 of \$2.2 million was primarily related

to \$2.9 million of operating income and a \$0.6 million change in working capital balances, partially offset by \$1.3 million of income tax payments.

<i>(in millions)</i>	<b>Six Months Ended June 30,</b>		
	<b>2014</b>	<b>2013</b>	<b>Change</b>
<b>Net income</b> . . . . .	<b>\$ 38.6</b>	\$128.0	(70)%
Items not involving current cash flows . . . . .	<b>37.1</b>	(64.9)	(157)%
Tenant allowance . . . . .	<b>(37.8)</b>	—	N/A
Current income tax expense . . . . .	<b>1.4</b>	6.0	(77)%
Income taxes paid . . . . .	<b>(3.6)</b>	(10.9)	(67)%
Interest expense . . . . .	<b>13.1</b>	8.8	49%
Interest paid . . . . .	<b>(13.6)</b>	(8.8)	55%
Changes in working capital balances . . . . .	<b>(6.5)</b>	(4.3)	51%
<b>Cash provided by operating activities from continuing operations</b> . . . . .	<b>28.7</b>	53.9	(47)%
Cash provided by operating activities from discontinued operations . . . . .	<b>20.0</b>	4.4	355%
<b>Cash provided by operating activities</b> . . . . .	<b>\$ 48.7</b>	<b>\$ 58.3</b>	<b>(16)%</b>

N/A — not applicable

For the six month period ended June 30, 2014, operating activities from continuing operations generated cash of \$28.7 million compared to \$53.9 million in the prior year period. The \$25.2 million decrease is primarily due to the \$37.8 million payment relating to the significant tenant allowance in respect of the lease extension to 2024 at Granite's largest facility, Thondorf, in Austria. Excluding that tenant allowance, cash provided by operating activities from continuing operations would have been \$66.5 million. The \$12.6 million increase over the prior year period is primarily related to a \$14.0 million increase in rental revenue, partially offset by a \$2.2 million increase in cash used by changes in working capital balances.

The change in working capital balances for the six month period ended June 30, 2014 used cash of \$6.5 million primarily due to a \$4.4 million decrease in accounts payable and other accruals, which includes payments of acquisition expenses and incentive compensation pay and a \$1.8 million decrease in deferred revenue due to the timing of rental receipts.

For the six month period ended June 30, 2013, the change in working capital balances used cash of \$4.3 million primarily due to a \$4.8 million decrease in accounts payable and other accruals, consisting principally of the payment of advisory fee accruals related to the REIT conversion and lower incentive pay accruals due to timing of the payment of incentive compensation and a \$1.3 million decrease in deferred revenue related to the timing of rental receipts. These working capital decreases were partially offset by a \$1.0 million reduction in accounts receivable, a \$0.5 million decrease in restricted cash and a \$0.4 million reduction in prepaid expenses.

Cash provided by operating activities from discontinued operations for the six month period ended June 30, 2014 of \$20.0 million primarily consists of \$14.4 million of value-added tax payable related to the disposition of the Mexican properties and \$7.0 million of operating income. Cash provided by operating activities from discontinued operations for the six month period ended June 30, 2013 of \$4.4 million was primarily related to \$6.3 million of operating income partially offset by a \$0.3 million change in working capital balances and \$1.6 million of income tax payments.

### **Investing Activities**

Investing activities for the three month period ended June 30, 2014 provided cash of \$101.9 million, which was primarily a result of net proceeds before income taxes of \$108.6 million received on the disposal of the Mexican portfolio, partially offset by investment property additions of \$7.6 million. Cash used in investing activities for the second quarter of 2013 of \$21.1 million was primarily due to cash payments of \$22.8 million for acquisitions and investment property additions of \$10.8 million, partially offset by net proceeds from the

disposal of an income-producing property of \$10.3 million and proceeds from the Meadows holdback of \$2.1 million.

Investing activities for the six month period ended June 30, 2014 provided cash of \$114.9 million which, in addition to the net proceeds from the disposition of the Mexican properties, included \$20.8 million of net proceeds received on the disposal of two income-producing properties in the first quarter of 2014, partially offset by \$14.9 million of investment property additions and \$0.3 million of fixed asset additions. For the six month period ended June 30, 2013, investing activities used cash of \$40.5 million, which was primarily the result of \$37.3 million of cash payments related to acquisitions, investment property additions of \$16.8 million and fixed asset additions of \$0.3 million, partially offset by net proceeds from the disposal of an income-producing property of \$10.3 million and proceeds from the Meadows holdback of \$3.7 million.

### **Financing Activities**

Cash used in financing activities for the three month period ended June 30, 2014 of \$22.1 million was primarily related to distribution payments of \$25.8 million and payments of \$0.2 million for financing costs related to a construction loan (see “*Bank and Debenture Financing*”), partially offset by U.S. dollar secured long-term debt borrowings of \$4.0 million. Cash used in financing activities for the three month period ended June 30, 2013 of \$6.9 million was primarily related to distribution payments of \$24.6 million, partially offset by net U.S. dollar denominated borrowings from bank indebtedness of \$15.1 million, \$1.5 million in contributions from non-controlling interests and \$1.3 million received upon the exercise of unit options.

For the six month period ended June 30, 2014, financing activities used cash of \$52.5 million which was primarily related to distribution payments of \$51.6 million and the repayment of U.S. dollar denominated bank indebtedness of \$11.3 million, partially offset by U.S. dollar secured long-term debt borrowings of \$8.9 million and \$1.8 million received upon the exercise of unit options. Cash used in financing activities for the six month period ended June 30, 2013 of \$7.2 million was primarily related to distribution payments of \$41.0 million and \$0.7 million of financing costs paid with respect to the credit facility, partially offset by U.S. dollar denominated borrowings from bank indebtedness of \$30.0 million, \$3.1 million received upon the exercise of unit options and \$1.5 million in contributions from non-controlling interests.

### **Bank and Debenture Financing**

Effective on February 1, 2013, the Trust entered into an unsecured senior revolving credit facility in the amount of \$175.0 million that is available by way of Cdn. dollar, U.S. dollar or euro denominated loans or letters of credit (the “Granite Credit Facility”) and matures on February 1, 2015. However, the Trust has the option to extend the maturity date by one year to February 1, 2016, subject to the agreement of lenders in respect of a minimum of 66 $\frac{2}{3}$ % of the aggregate amount committed under the Granite Credit Facility. The Granite Credit Facility provides Granite with the ability to increase the amount of the commitment by an additional aggregate principal amount of up to \$75.0 million with the consent of the participating lenders. Interest on drawn amounts will be calculated based on an applicable margin determined by the Trust’s external credit rating. Based on Granite’s current credit rating, the Trust would be subject to interest rate margins of up to 1.50% depending on the currency and form of advance. At June 30, 2014, the Trust had \$42.7 million (U.S. \$40.0 million) drawn under the Granite Credit Facility and \$1.3 million in letters of credit issued against the Granite Credit Facility.

In December 2004, Granite issued \$265.0 million of unsecured debentures, which were due December 22, 2016, at a price of \$995.70 per \$1,000.00 of principal amount and were guaranteed by Granite REIT, Granite GP and certain of their subsidiaries. The 2016 Debentures ranked equally with all of Granite’s existing unsecured indebtedness. The total outstanding at June 30, 2014 was \$264.1 million, however, the 2016 Debentures were fully redeemed on August 5, 2014, for an aggregate redemption price of \$294.7 million, which included a redemption premium of \$27.7 million and accrued and unpaid interest to the Redemption Date of \$2.0 million.

In October 2013, Granite issued at par \$200.0 million of Series 1 senior debentures (the “2018 Debentures”) which are due October 2, 2018. The 2018 Debentures rank equally with all of the Trust’s existing and future unsubordinated and unsecured indebtedness and are guaranteed by Granite REIT and Granite GP. The total

outstanding at June 30, 2014 was \$198.3 million. At June 30, 2014, all of the 2018 Debentures remained outstanding.

Also in October 2013, in connection with funding the acquisition of eight European income-producing properties in the fourth quarter of 2013, the Trust entered into a cross currency interest rate swap (the “Cross Currency Interest Rate Swap”) to exchange the \$200.0 million proceeds and related 4.613% interest payments from the 2018 Debentures to euro 142.3 million and euro denominated interest payments at a 3.56% interest rate. Under the terms of the swap, on October 2, 2018, the Trust will repay the principal proceeds received of euro 142.3 million for \$200.0 million. As at June 30, 2014, the fair value of the Cross Currency Interest Rate Swap was a net financial liability of \$11.8 million which resulted primarily from the strengthening of the euro against the Cdn. dollar.

In connection with the acquisitions of income-producing properties that were completed in February and May 2013, the Trust has two mortgages outstanding totaling \$38.7 million (U.S. \$36.2 million). The mortgages mature on June 10, 2017 and May 10, 2018, respectively, and both bear interest at LIBOR plus 2.50%. Interest rate caps were entered into for 100% of the mortgage amounts and for the duration of the mortgages thereby limiting the interest rate exposure to a maximum of 4.0%. The mortgages are recourse only to the three investment properties acquired which are pledged as collateral.

In July 2013, the Trust entered into the 2016 Construction Loan for U.S. \$17.0 million relating to the development land purchased in the United States (see “*INVESTMENT PROPERTIES — Properties and Land Under Development*”). The 2016 Construction Loan bears interest at LIBOR plus 2.25% and matures on July 25, 2016. Proceeds from the 2016 Construction Loan may only be used to pay for the cost of improvements on the property and other related costs, and loan advances will be made based on the value of the work completed. The maximum amount available under the 2016 Construction Loan may be increased to U.S. \$19.0 million, subject to certain terms and conditions being met. The Trust has the option to extend the maturity date for two successive periods to July 25, 2017 and 2018, subject to certain terms and conditions. The 2016 Construction Loan is secured by a first mortgage lien on the property. At June 30, 2014, \$11.9 million (U.S. \$11.2 million) had been drawn under the 2016 Construction Loan.

On June 20, 2014, Granite entered into the 2017 Construction Loan for U.S. \$26.2 million relating to land that was previously held for development (see “*INVESTMENT PROPERTIES — Properties and Land Under Development*”). The 2017 Construction Loan bears interest at LIBOR plus 2.25% and matures on June 20, 2017. Proceeds from the 2017 Construction Loan may only be used to pay for the construction cost of improvements on the property and other related costs, and loan advances will be made based on the value of the work completed. Granite also has the option to extend the maturity date for two successive periods to June 20, 2018 and 2019, subject to certain terms and conditions. The 2017 Construction Loan is secured by a first mortgage lien on the property. At June 30, 2014, no amount had been drawn under the 2017 Construction Loan.

On July 3, 2014, Granite LP issued \$250.0 million of the Series 2 senior debentures due July 5, 2021. Interest on the 2021 Debentures is payable semi-annually in arrears on January 5 and July 5 of each year, commencing on January 5, 2015. The 2021 Debentures rank equally with all of the Trust’s existing and future unsubordinated and unsecured indebtedness and are guaranteed by Granite REIT and Granite GP.

Also on July 3, 2014, the Trust entered into a cross currency interest rate swap to exchange the Cdn. dollar 3.788% interest payments from the 2021 Debentures to euro denominated payments at 2.68%. In addition, under the terms of the swap, the Trust will pay principal proceeds of euro 171.9 million for \$250.0 million on July 5, 2021.

At June 30, 2014, the Trust’s leverage ratio (defined as total debt divided by the total fair value of its investment properties) was 25%. Management believes that the Trust’s cash resources, cash flow from operations and available third-party borrowings will be sufficient to finance its operations and capital expenditures program over the next year as well as pay distributions. Additional acquisition and development activity will depend on the availability of suitable investment opportunities and related financing.

At June 30, 2014, the Trust was in compliance with its debt agreements and related covenants.

## Credit Ratings

On June 16, 2014, Moody's upgraded its credit rating of the Trust to Baa2 from Baa3 with a stable outlook and on June 30, 2014, Moody's confirmed the rating. On July 23, 2014, DBRS confirmed the BBB rating on the 2018 Debentures and 2021 Debentures with a stable trend. Credit ratings are intended to provide investors with an independent measure of credit quality of an issue of securities. A rating accorded to any security is not a recommendation to buy, sell or hold such securities and may be subject to revision or withdrawal at any time by the rating organization which granted such ratings.

## Distributions

As required by National Policy 41-201, *Income Trusts and Other Indirect Offerings*, the following table outlines the differences between cash flow from operating activities and cash distributions as well as the differences between net income and cash distributions, in accordance with the guidelines.

<i>(in thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income . . . . .	<u>\$ 30,785</u>	<u>\$ 43,394</u>	<u>\$ 45,348</u>	<u>\$137,788</u>
Cash flows provided by operating activities . . . . .	<u>54,637</u>	<u>25,025</u>	<u>48,705</u>	<u>58,320</u>
Distributions paid and payable . . . . .	<u>(25,811)</u>	<u>(24,643)</u>	<u>(51,596)</u>	<u>(49,257)</u>
<b>Cash flows from operating activities over (under) distributions paid and payable . . . . .</b>	<u><b>\$ 28,826</b></u>	<u><b>\$ 382</b></u>	<u><b>\$ (2,891)</b></u>	<u><b>\$ 9,063</b></u>

Distributions declared to stapled unitholders in the three month periods ended June 30, 2014 and 2013 were \$25.8 million or 54.9 cents per stapled unit and \$24.6 million or 52.5 cents per stapled unit, respectively. Total distributions declared to stapled unitholders in the six month periods ended June 30, 2014 and 2013 were \$51.6 million or \$1.10 per stapled unit and \$49.3 million or \$1.05 per stapled unit, respectively. Excluding the tenant allowance related to the Thondorf lease extension that was funded from cash on hand, cash provided by operating activities from continuing operations for the six month period ended June 30, 2014 would have been \$66.5 million, being a more representative amount and more comparable to the prior year period. The Trust expects distributions to be funded from cash flows from operating activities.

Net income prepared in accordance with IFRS recognizes revenue and expenses at time intervals that do not necessarily match the receipt or payment of cash. Therefore, when establishing cash distributions to unitholders, consideration is given to factors such as cash generated from and required for operating activities and forward-looking cash flow information, including forecasts and budgets. Management does not expect current or potential commitments to replace and maintain its investment properties to adversely affect distributions.

## CONTROLS AND PROCEDURES

During the second quarter of 2014, there were no changes in the internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## COMMITMENTS, CONTRACTUAL OBLIGATIONS, CONTINGENCIES AND OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business activities, the Trust may become subject to litigation and other claims brought by, among others, tenants, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to accurately estimate the extent of potential costs and losses, if any, management believes, but can provide no assurance,

that the ultimate resolution of such claims would not have a material adverse effect on the financial position of the Trust.

Off-balance sheet arrangements consist of letters of credit, construction and development project commitments and certain operating agreements. At June 30, 2014, the Trust had contractual commitments related to construction and development projects amounting to approximately \$17.8 million and commitments on non-cancellable operating leases requiring future minimum annual rental payments as follows:

Not later than 1 year . . . . .	\$ 432
Later than 1 year and not later than 5 years . . . . .	1,036
Later than 5 years . . . . .	<u>337</u>
	<u>\$1,805</u>

In addition, the Trust is committed to making annual payments under two ground leases for the land upon which two income-producing properties are situated of \$0.1 million and \$0.5 million to the years 2049 and 2096, respectively and to making future payments of interest and principal on long-term debt.

For further discussion of commitments, contractual obligations, contingencies and off-balance sheet arrangements, refer to notes 5, 6, 8, 16 and 18 to the unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014 and “*LIQUIDITY AND CAPITAL RESOURCES*”.

## **OUTSTANDING STAPLED UNITS**

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As at the date of this MD&A, the Trust had 47,013,716 stapled units issued and outstanding.

## **DISTRIBUTIONS**

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Granite REIT’s monthly distribution to unitholders is currently 18.3 cents per stapled unit, representing, on an annualized basis, \$2.20 per stapled unit. Total distributions declared in the three and six month periods ended June 30, 2014 were \$25.8 million and \$51.6 million, respectively. On July 17, 2014, Granite REIT declared a distribution of 18.3 cents per stapled unit, or \$8.6 million, which will be paid on August 15, 2014.

## **CRITICAL ACCOUNTING ESTIMATES**

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The preparation of financial statements in conformity with IFRS requires management to apply judgment and make estimates that affect the amounts reported and disclosed in the combined financial statements. Management bases estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the values of assets and liabilities. On an ongoing basis, management evaluates its estimates. However, actual results could differ from those estimates.

The Trust’s significant accounting policies that involve the most judgment and estimate are as follows:

### ***Judgments***

#### ***Leases***

The Trust’s policy for revenue recognition is described in note 2(j) of the audited combined financial statements for the year ended December 31, 2013. The Trust makes judgments in determining whether certain leases are operating or finance leases, in particular tenant leases with long contractual terms or leases where the property is a large square-footage and/or architecturally unique and ground leases where the Trust is the lessee.

### *Investment properties*

The Trust's policy relating to investment properties is described in note 2(d) of the audited combined financial statements for the year ended December 31, 2013. In applying this policy, judgment is applied in determining whether certain costs incurred for tenant improvements are additions to the carrying amount of the property or represent incentives, identifying the point at which practical completion of properties under development occurs and determining borrowing costs to be capitalized to the carrying value of properties under development. Judgment is also applied in determining the extent and frequency of independent appraisals.

### *Income taxes*

The Trust applies judgment in determining whether it will continue to qualify as a REIT for both Canadian and U.S. tax purposes for the foreseeable future. However, should it, at some point no longer qualify, it would be subject to income tax and would be required to recognize current and deferred income taxes.

## **Estimates and Assumptions**

### *Valuation of investment properties*

The fair value of investment properties is determined by management using primarily the discounted cash flow method in which the income and expenses are projected over the anticipated term of the investment plus a terminal value discounted using an appropriate discount rate. The Trust obtains, from time to time, appraisals from independent qualified real estate valuation experts. However, the Trust does not measure its investment properties based on these valuations, but uses such appraisals as data points, together with other external market information accumulated by management, in arriving at its own conclusions on values. The Trust's critical assumptions relating to the estimates of fair values of investment properties include the receipt of contractual rents, contractual renewal terms, expected future market rental rates, discount rates that reflect current market uncertainties, capitalization rates and recent property investment prices. If there is any change in these assumptions or regional, national or international economic conditions, the fair value of investment properties may change materially. Refer to note 3 of the unaudited condensed combined financial statements for the three and six month periods ended June 30, 2014 for further information on the estimates and assumptions made by management in connection with the fair values of investment properties.

### *Fair value of financial instruments*

Where the fair value of financial assets or liabilities recorded on the balance sheet or disclosed in the notes cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as credit risk and volatility. Changes in assumptions about these factors could materially affect the reported fair value of financial instruments.

### *Income taxes*

The Trust operates in a number of countries and is subject to the income tax laws in its operating jurisdictions. These laws can be subject to different interpretations by relevant taxation authorities. Significant judgment is required in the estimation of Granite's income tax expense, interpretation and application of the relevant tax laws and provision for any exposure that may arise from tax positions that are under audit by relevant taxation authorities.

The recognition and measurement of deferred tax assets or liabilities is dependent on management's estimate of future taxable profits and income tax rates that are expected to be in effect in the period the asset is realized or the liability is settled. Any changes in management's estimates can result in changes in deferred tax assets or liabilities as reported in the condensed combined balance sheets and also the deferred income tax expense in the condensed combined statements of income.

## **NEW ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS**

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The accounting policies adopted in the preparation of the condensed combined financial statements are consistent with those followed in the preparation of the Trust's annual combined financial statements for the year ended December 31, 2013, except for the adoption of new standards and interpretations effective January 1, 2014. The Trust applies for the first time certain standards and amendments that require restatement of previous financial statements. As required by International Accounting Standard 34 Interim Financial Reporting, the nature and effect of these changes are disclosed below.

There are a number of amendments to IAS 32 Financial Instruments: Presentation ("IAS 32"), relating to offsetting certain assets and liabilities. These amendments relate to the application of the guidance set out in IAS 32 and clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. The amendments are effective January 1, 2014. The adoption of these amendments did not have an impact on the Trust's condensed combined financial statements.

In May 2013, IFRIC Interpretation 21 — Levies ("IFRIC 21") was issued which is an interpretation of IAS 37 — Provisions, Contingent Liabilities and Contingent Assets. IFRIC 21 clarifies what the obligating event is that gives rise to a levy and when a liability should be recognized. IFRIC 21 is effective for years beginning on or after January 1, 2014 and must be applied retrospectively. For the purposes of IFRIC 21, realty taxes payable by the Trust are considered levies. The adoption of this standard did not have an impact on the Trust's condensed combined financial statements.

## **RISKS AND UNCERTAINTIES**

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Investing in our stapled units involves a high degree of risk. There are a number of risk factors that could have a material adverse effect on our business, financial condition, operating results and prospects. These risks and uncertainties are discussed in our AIF filed with securities regulators in Canada and available online at [www.sedar.com](http://www.sedar.com) and Annual Report on Form 40-F filed with the SEC and available online on EDGAR at [www.sec.gov](http://www.sec.gov), each in respect of the year ended December 31, 2013, and remain substantially unchanged in respect of the three and six month periods ended June 30, 2014.



## SUPPLEMENTARY QUARTERLY FINANCIAL DATA (UNAUDITED)

Refer to note 2 of the audited combined financial statements for the year ended December 31, 2013 for a description of the accounting policies used in the determination of the financial data.

(in thousands, except per unit/share information)	Q2'14	Q1'14	Q4'13	Q3'13	Q2'13	Q1'13	Q4'12 <sup>(1)</sup>	Q3'12 <sup>(1)</sup>
<b>Rental Revenue and tenant recoveries</b> . . . .	\$52,160	\$52,933	\$51,238	\$47,565	\$46,151	\$44,946	\$42,276	\$41,628
<b>Net income:</b>								
Continuing operations . . . . .	26,416	12,175	(3,857)	19,324	38,919	89,058	11,099	62,324
Discontinued operations . . . . .	4,369	2,388	1,466	(9,455)	4,475	5,336	3,389	3,513
<b>Net income (loss)<sup>(2)(3)</sup></b> . . . . .	<u>\$30,785</u>	<u>\$14,563</u>	<u>\$(2,391)</u>	<u>\$9,869</u>	<u>\$43,394</u>	<u>\$94,394</u>	<u>\$14,488</u>	<u>\$65,837</u>
<b>Net income (loss) attributable to stapled unitholders or common shareholders</b> . . . .	\$30,668	\$14,455	\$(2,599)	\$9,791	\$43,548	\$94,291	\$14,466	\$65,824
<b>Add (deduct):</b>								
<b>Fair value losses (gains) on investment properties</b> . . . . .	5,570	23,553	29,898	9,436	(8,122)	(15,030)	40,704	(48,103)
<b>Fair value losses (gains) on financial instruments</b> . . . . .	(377)	38	(216)	(4)	643	(495)	585	(225)
<b>Gain on Meadows holdback</b> . . . . .	—	—	—	—	—	(5,143)	—	—
<b>Acquisition transaction costs</b> . . . . .	—	—	7,751	5,702	382	411	—	—
<b>Loss on sale of investment properties</b> . . . .	—	182	450	—	328	—	—	21
<b>Current income tax expense associated with sale of an investment property</b> . . . . .	—	1,099	—	—	—	—	—	—
<b>Deferred income taxes</b> . . . . .	5,541	(1,051)	(341)	(569)	(3,624)	(37,322)	(32,552)	12,606
<b>Non-controlling interests relating to the above</b> . . . . .	34	10	107	(6)	(260)	54	—	(12)
<b>Discontinued operations FFO adjustments</b> . .	(1,566)	718	1,420	12,201	(1,637)	(2,760)	(1,132)	(982)
<b>FFO</b> . . . . .	<u>\$39,870</u>	<u>\$39,004</u>	<u>\$36,470</u>	<u>\$36,551</u>	<u>\$31,258</u>	<u>\$34,006</u>	<u>\$22,071</u>	<u>\$29,129</u>
<b>Comparable FFO<sup>(4)</sup></b> . . . . .	<u>\$39,870</u>	<u>\$39,004</u>	<u>\$36,470</u>	<u>\$36,551</u>	<u>\$35,478</u>	<u>\$34,006</u>	<u>\$22,071</u>	<u>\$29,129</u>
<b>Diluted FFO per stapled unit or share</b> . . . .	<u>\$0.85</u>	<u>\$0.83</u>	<u>\$0.78</u>	<u>\$0.78</u>	<u>\$0.67</u>	<u>\$0.73</u>	<u>\$0.47</u>	<u>\$0.62</u>
<b>Diluted comparable FFO per stapled unit or share<sup>(4)</sup></b> . . . . .	<u>\$0.85</u>	<u>\$0.83</u>	<u>\$0.78</u>	<u>\$0.78</u>	<u>\$0.76</u>	<u>\$0.73</u>	<u>\$0.47</u>	<u>\$0.62</u>
<b>Cash distributions or dividends declared</b> . .	<u>\$0.55</u>	<u>\$0.55</u>	<u>\$0.53</u>	<u>\$0.53</u>	<u>\$0.53</u>	<u>\$0.52</u>	<u>\$0.50</u>	<u>\$0.50</u>
<b>Basic stapled units or shares outstanding</b> . .	<u>47,014</u>	<u>46,962</u>	<u>46,942</u>	<u>46,942</u>	<u>46,932</u>	<u>46,882</u>	<u>46,833</u>	<u>46,824</u>
<b>Diluted stapled units or shares outstanding</b> .	<u>47,070</u>	<u>46,973</u>	<u>46,957</u>	<u>46,948</u>	<u>46,948</u>	<u>46,910</u>	<u>46,866</u>	<u>46,846</u>

(1) The amounts reflected for 2012 have been restated for IFRS.

(2) The results for 2014 include \$23.6 million and \$5.5 million (\$22.8 million and \$5.0 million net of income taxes) in the first and second quarters of net fair value losses on investment properties.

(3) The results for 2013 include (i) \$1.4 million, \$0.6 million, \$0.3 million and \$0.2 million (\$1.4 million, \$0.6 million, \$0.3 million and \$0.1 million net of income taxes) in the first, second, third and fourth quarters of advisory costs related to the REIT conversion and related corporate reorganizations, (ii) \$0.4 million, \$0.4 million, \$5.7 million and \$7.8 million (\$0.4 million, \$0.4 million, \$4.7 million and \$5.9 million net of income taxes) in the first, second, third and fourth quarters of acquisition transaction costs, (iii) \$5.1 million (\$5.1 million net of income taxes) in the first quarter relating to a gain on the Meadows holdback, (iv) \$18.7 million and \$10.9 million (\$17.4 million and \$9.0 million net of income taxes) in the first and second quarters of fair value gains and \$25.1 million and \$29.8 million (\$22.8 million and \$25.0 million net of income taxes) of fair value losses in the third and fourth quarters on investment properties, (v) \$4.2 million in the second quarter of current tax expense relating to net withholding tax on the repatriation of prior years' earnings from foreign jurisdictions and (vi) a \$41.9 million deferred income tax recovery related to the REIT conversion in the first quarter.

The results for 2012 include (i) \$0.3 million and \$0.3 million (\$0.2 million and \$0.2 million net of income taxes) in the third and fourth quarters respectively, of appraisal, environmental assessment and valuation costs related to income-producing properties, (ii) \$1.6 million (\$1.2 million net of income taxes) in the fourth quarter of land transfer taxes and associated costs related to the REIT conversion and related corporate reorganizations and (iii) \$2.6 million and \$3.8 million (\$2.5 million and \$2.8 million net of income taxes) in the third and fourth quarters respectively, of advisory costs related to the REIT conversion and related corporate reorganizations.

(4) Comparable FFO in the second quarter of 2013 excludes the \$4.2 million of withholding taxes paid with respect to the repatriation of prior years' earnings from foreign jurisdictions primarily associated with certain planned internal reorganizations undertaken post REIT conversion.

## FORWARD-LOOKING STATEMENTS

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This MD&A may contain statements that, to the extent they are not recitations of historical fact, constitute “forward-looking statements” or “forward-looking information” within the meaning of applicable securities legislation, including the United States Securities Act of 1933, as amended, and the United States Securities Exchange Act of 1934, as amended, and applicable Canadian securities legislation. Forward-looking statements and forward-looking information may include, among others, statements regarding the Trust’s future plans, goals, strategies, intentions, beliefs, estimates, costs, objectives, capital structure, cost of capital, tenant base, tax consequences, economic performance or expectations, or the assumptions underlying any of the foregoing. Words such as “may”, “would”, “could”, “will”, “likely”, “expect”, “anticipate”, “believe”, “intend”, “plan”, “forecast”, “project”, “estimate”, “seek” and similar expressions are used to identify forward-looking statements and forward-looking information. Forward-looking statements and forward-looking information should not be read as guarantees of future events, performance or results and will not necessarily be accurate indications of whether or the times at or by which such future performance will be achieved. Undue reliance should not be placed on such statements. There can be no assurance that the intended developments in Granite’s relationships with its tenants, the expansion and diversification of Granite’s real estate portfolio, the expected cost of development and re-development projects and the expected sources of funding and increases in leverage can be achieved in a timely manner, with the expected impact or at all. Forward-looking statements and forward-looking information are based on information available at the time and/or management’s good faith assumptions and analyses made in light of our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances, and are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond the Trust’s control, that could cause actual events or results to differ materially from such forward-looking statements and forward-looking information. Important factors that could cause such differences include, but are not limited to, the risk of changes to tax or other laws that may adversely affect Granite Real Estate Investment Trust’s mutual fund trust status under the *Income Tax Act* (Canada) or the effective tax rate in other jurisdictions in which Granite operates; economic, market and competitive conditions and other risks that may adversely affect Granite’s ability to achieve desired developments in its relationships with its tenants, expand and diversify its real estate portfolio and increase its leverage; and the risks set forth in the “Risk Factors” section in Granite’s AIF for 2013, filed on SEDAR at [www.sedar.com](http://www.sedar.com) and attached as Exhibit 1 to the Trust’s Annual Report on Form 40-F for the year ended December 31, 2013 filed with the SEC and available online on EDGAR at [www.sec.gov](http://www.sec.gov), all of which investors are strongly advised to review. The “Risk Factors” section also contains information about the material factors or assumptions underlying such forward-looking statements and forward-looking information. Forward-looking statements and forward-looking information speak only as of the date the statements were made and unless otherwise required by applicable securities laws, the Trust expressly disclaims any intention and undertakes no obligation to update or revise any forward-looking statements and forward-looking information contained in this MD&A to reflect subsequent information, events or circumstances or otherwise.

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Condensed Combined Financial Statements  
of Granite Real Estate Investment Trust  
and Granite REIT Inc.

For the three and six months ended June 30, 2014 and 2013

## Condensed Combined Balance Sheets

(Canadian dollars in thousands)

(Unaudited)

<u>As at</u>	<u>Note</u>	<u>June 30, 2014</u>	<u>December 31, 2013</u>
<b>ASSETS</b>			
<b>Non-current assets:</b>			
Investment properties . . . . .	3	\$2,246,600	\$2,351,897
Deferred tax assets . . . . .		7,658	8,173
Fixed assets, net . . . . .		1,964	1,938
Other assets . . . . .	4	2,099	1,958
		<u>2,258,321</u>	<u>2,363,966</u>
<b>Current assets:</b>			
Accounts receivable . . . . .		2,809	2,491
Income taxes receivable . . . . .		2,337	930
Prepaid expenses and other . . . . .		1,912	1,366
Restricted cash . . . . .		4,954	4,360
Cash and cash equivalents . . . . .		205,748	95,520
<b>Total assets</b> . . . . .		<u>\$2,476,081</u>	<u>\$2,468,633</u>
<b>LIABILITIES AND STAPLED UNITHOLDERS' EQUITY</b>			
<b>Non-current liabilities:</b>			
Unsecured debentures, net . . . . .	5	\$ 462,439	\$ 462,070
Cross currency interest rate swap . . . . .	5	11,757	11,003
Secured long-term debt . . . . .	6	50,159	41,856
Deferred tax liabilities . . . . .		156,824	166,622
Other non-current liabilities . . . . .	7	10,392	3,777
		<u>691,571</u>	<u>685,328</u>
<b>Current liabilities:</b>			
Deferred revenue . . . . .		3,418	5,194
Bank indebtedness . . . . .	8	42,704	53,180
Current portion of secured long-term debt . . . . .	6	468	—
Accounts payable and accrued liabilities . . . . .	9	44,347	33,178
Distributions payable . . . . .	10	8,604	8,591
Income taxes payable . . . . .		19,507	6,652
<b>Total liabilities</b> . . . . .		<u>810,619</u>	<u>792,123</u>
<b>Equity:</b>			
Stapled unitholders' equity . . . . .		1,659,976	1,671,227
Non-controlling interests . . . . .		5,486	5,283
<b>Total equity</b> . . . . .		<u>1,665,462</u>	<u>1,676,510</u>
<b>Total liabilities and stapled unitholders' equity</b> . . . . .		<u>\$2,476,081</u>	<u>\$2,468,633</u>

Commitments and contingencies (note 18)

See accompanying notes

## Condensed Combined Statements of Income

(Canadian dollars in thousands)

(Unaudited)

	Note	Three months ended June 30,		Six months ended June 30,	
		2014	2013	2014	2013
<b>Revenues</b>					
Rental revenue and tenant recoveries . . . . .		\$52,160	\$46,151	\$105,093	\$ 91,097
<b>Operating costs and expenses (income)</b>					
Property operating costs					
Non-recoverable from tenants . . . . .	12(a)	1,454	1,003	2,623	1,958
Recoverable from tenants . . . . .	12(a)	692	314	1,255	422
General and administrative . . . . .	12(b)	6,419	5,987	13,685	13,071
Depreciation and amortization . . . . .		151	56	272	222
Interest expense and other financing costs, net . . . . .	12(c)	6,915	4,669	13,784	9,188
Foreign exchange losses (gains), net . . . . .		309	(298)	77	(651)
<b>Income before fair value changes, acquisition transaction costs, gain on Meadows holdback, loss on sale of investment properties and income taxes . . . . .</b>		<b>36,220</b>	<b>34,420</b>	<b>73,397</b>	<b>66,887</b>
Fair value gains (losses) on investment properties, net . . . . .	3	(5,570)	8,122	(29,123)	23,152
Fair value gains (losses) on financial instruments . . . . .	12(d)	377	(643)	339	(148)
Acquisition transaction costs . . . . .		—	(382)	—	(793)
Gain on Meadows holdback . . . . .		—	—	—	5,143
Loss on sale of investment properties . . . . .	3	—	(328)	(182)	(328)
<b>Income before income taxes . . . . .</b>		<b>31,027</b>	<b>41,189</b>	<b>44,431</b>	<b>93,913</b>
Income tax expense (recovery) . . . . .	13	4,611	2,270	5,840	(34,064)
Net income from continuing operations . . . . .		26,416	38,919	38,591	127,977
Net income from discontinued operations . . . . .	14	4,369	4,475	6,757	9,811
<b>Net income . . . . .</b>		<b>\$30,785</b>	<b>\$43,394</b>	<b>\$ 45,348</b>	<b>\$137,788</b>
<b>Net income attributable to:</b>					
Stapled unitholders					
Continuing operations . . . . .		\$26,299	\$39,073	\$ 38,366	\$128,028
Discontinued operations . . . . .		4,369	4,475	6,757	9,811
		<u>30,668</u>	<u>43,548</u>	<u>45,123</u>	<u>137,839</u>
Non-controlling interests					
Continuing operations . . . . .		117	(154)	225	(51)
Discontinued operations . . . . .		—	—	—	—
		<u>117</u>	<u>(154)</u>	<u>225</u>	<u>(51)</u>
		<u>\$30,785</u>	<u>\$43,394</u>	<u>\$ 45,348</u>	<u>\$137,788</u>

See accompanying notes

## Condensed Combined Statements of Comprehensive Income (Loss)

(Canadian dollars in thousands)

(Unaudited)

	Note	Three months ended June 30,		Six months ended June 30,	
		2014	2013	2014	2013
<b>Net income</b> .....		<b>\$ 30,785</b>	\$43,394	<b>\$45,348</b>	\$137,788
<b>Other comprehensive income (loss):</b>					
Foreign currency translation adjustment <sup>(1)</sup> .....		<b>(58,974)</b>	54,483	<b>(132)</b>	56,686
Unrealized gain (loss) on cross currency interest rate swap <sup>(1)</sup> .....	5(b)	<b>7,444</b>	—	<b>(801)</b>	—
Net foreign exchange gain (loss) on net investment hedge, includes income taxes of nil <sup>(1)</sup> .....		<b>1,508</b>	(4,923)	<b>(775)</b>	(4,923)
Reclassification adjustment relating to foreign operation disposed of in year .....	14	<b>(5,722)</b>	—	<b>(5,722)</b>	—
<b>Total other comprehensive income (loss)</b> .....		<b>(55,744)</b>	49,560	<b>(7,430)</b>	51,763
<b>Comprehensive income (loss)</b> .....		<b><u>\$(24,959)</u></b>	<u>\$92,954</u>	<b><u>\$37,918</u></b>	<u>\$189,551</u>

(1) Items that may be reclassified subsequently to net income

### Comprehensive income (loss) attributable to:

<b>Stapled unitholders</b>					
Continuing operations .....		<b>\$(20,049)</b>	\$84,631	<b>\$36,024</b>	\$173,556
Discontinued operations .....		<b>(4,831)</b>	8,323	<b>1,666</b>	15,914
		<b><u>(24,880)</u></b>	<u>92,954</u>	<b><u>37,690</u></b>	<u>189,470</u>
<b>Non-controlling interests</b>					
Continuing operations .....		<b>(79)</b>	—	<b>228</b>	81
Discontinued operations .....		<b>—</b>	—	<b>—</b>	—
		<b><u>(79)</u></b>	<u>—</u>	<b><u>228</u></b>	<u>81</u>
<b>Comprehensive income (loss)</b> .....		<b><u>\$(24,959)</u></b>	<u>\$92,954</u>	<b><u>\$37,918</u></b>	<u>\$189,551</u>

See accompanying notes

**Condensed Combined Statements of Unitholders' Equity**  
*(Canadian dollars in thousands)*  
*(Unaudited)*

**Six Months Ended June 30, 2014**

	Number of Units	Stapled Units	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Total	Non- controlling interests	Total
<b>Equity at January 1, 2014</b>	<b>46,945</b>	<b>\$2,121,412</b>	<b>\$61,425</b>	<b>\$(608,671)</b>	<b>\$97,061</b>	<b>\$1,671,227</b>	<b>\$5,283</b>	<b>\$1,676,510</b>
Net income	—	—	—	45,123	—	45,123	225	45,348
Other comprehensive income (loss)	—	—	—	—	(7,433)	(7,433)	3	(7,430)
Distributions	—	—	—	(51,596)	—	(51,596)	(113)	(51,709)
Contributions from non-controlling interests	—	—	—	—	—	—	88	88
Units issued on exercise of stapled unit options	50	1,916	—	—	—	1,916	—	1,916
Units issued on settlement of deferred stapled units	19	739	—	—	—	739	—	739
<b>Equity at June 30, 2014</b>	<b>47,014</b>	<b>\$2,124,067</b>	<b>\$61,425</b>	<b>\$(615,144)</b>	<b>\$89,628</b>	<b>\$1,659,976</b>	<b>\$5,486</b>	<b>\$1,665,462</b>

**Six Months Ended June 30, 2013**

	Number of Units	Stapled Units	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Total	Non- controlling interests	Total
<b>Equity at January 1, 2013</b>	<b>46,833</b>	<b>\$2,117,256</b>	<b>\$63,168</b>	<b>\$(654,828)</b>	<b>\$(10,784)</b>	<b>\$1,514,812</b>	<b>\$1,041</b>	<b>\$1,515,853</b>
Net income (loss)	—	—	—	137,839	—	137,839	(51)	137,788
Other comprehensive income	—	—	—	—	51,631	51,631	132	51,763
Distributions	—	—	—	(49,257)	—	(49,257)	(68)	(49,325)
Contributions from non-controlling interests	—	—	—	—	—	—	3,588	3,588
Units issued on exercise of stapled unit options	105	3,892	—	—	—	3,892	—	3,892
Units issued on settlement of deferred stapled units	4	171	—	—	—	171	—	171
Reclassification of unit-based awards	—	—	(1,743)	48	—	(1,695)	—	(1,695)
<b>Equity at June 30, 2013</b>	<b>46,942</b>	<b>\$2,121,319</b>	<b>\$61,425</b>	<b>\$(566,198)</b>	<b>\$ 40,847</b>	<b>\$1,657,393</b>	<b>\$4,642</b>	<b>\$1,662,035</b>

See accompanying notes



**Condensed Combined Statements of Cash Flows**  
*(Canadian dollars in thousands)*  
*(Unaudited)*

		Three months ended June 30,		Six months ended June 30,	
	Note	2014	2013	2014	2013
<b>OPERATING ACTIVITIES</b>					
<b>Net income from continuing operations</b> . . . . .		\$ 26,416	\$ 38,919	\$ 38,591	\$127,977
Items not involving current cash flows . . . . .	15(a)	12,991	(9,283)	37,121	(64,855)
Tenant allowance . . . . .		—	—	(37,769)	—
Current income tax expense (recovery) . . . . .		(930)	5,835	1,350	5,972
Income taxes paid . . . . .		(2,026)	(9,046)	(3,601)	(10,891)
Interest expense . . . . .		6,404	4,585	13,114	8,811
Interest paid . . . . .		(13,072)	(8,631)	(13,660)	(8,813)
Changes in working capital balances from continuing operations . . . . .	15(b)	7,731	408	(6,466)	(4,291)
<b>Cash provided by operating activities from continuing operations</b> . . . . .		<b>37,514</b>	22,787	<b>28,680</b>	53,910
Cash provided by operating activities from discontinued operations . . . . .		17,123	2,238	20,025	4,410
<b>Cash provided by operating activities</b> . . . . .		<b>54,637</b>	25,025	<b>48,705</b>	58,320
<b>INVESTING ACTIVITIES</b>					
Investment properties:					
Proceeds on disposal, net . . . . .	3	—	10,272	20,782	10,272
Capital expenditures . . . . .		(7,575)	(10,765)	(14,933)	(16,781)
Business acquisitions (net of cash acquired of \$375) . . . . .		—	(8,566)	—	(23,095)
Acquisition of development lands . . . . .		—	(14,203)	—	(14,203)
Fixed asset additions . . . . .		(131)	(53)	(317)	(321)
Proceeds from notes receivable . . . . .		—	2,069	—	3,717
Decrease (increase) in other assets . . . . .		33	162	(51)	(83)
Cash provided by investing activities from discontinued operations . . . . .	3	109,538	—	109,446	—
<b>Cash provided by (used in) investing activities</b> . . . . .		<b>101,865</b>	(21,084)	<b>114,927</b>	(40,494)
<b>FINANCING ACTIVITIES</b>					
Distributions paid . . . . .		(25,811)	(24,633)	(51,583)	(41,042)
Proceeds from units issued . . . . .		—	1,277	1,781	3,116
Proceeds from secured long-term debt . . . . .		3,958	—	8,867	—
Repayment of secured long-term debt . . . . .		(55)	—	(55)	—
Proceeds from bank indebtedness . . . . .		—	83,959	—	98,949
Repayments of bank indebtedness . . . . .		—	(68,903)	(11,251)	(68,903)
Financing costs paid . . . . .		(231)	—	(231)	(730)
Contributions from non-controlling interests . . . . .		88	1,486	88	1,486
Distributions to non-controlling interests . . . . .		(62)	(68)	(113)	(68)
<b>Cash used in financing activities</b> . . . . .		<b>(22,113)</b>	(6,882)	<b>(52,497)</b>	(7,192)
Effect of exchange rate changes on cash and cash equivalents . . . . .		(4,300)	2,476	(907)	1,467
Net increase (decrease) in cash and cash equivalents during the period . . . . .		130,089	(465)	110,228	12,101
Cash and cash equivalents, beginning of period . . . . .		75,659	63,639	95,520	51,073
<b>Cash and cash equivalents, end of period</b> . . . . .		<b>\$205,748</b>	\$ 63,174	<b>\$205,748</b>	\$ 63,174

See accompanying notes

## Notes to Condensed Combined Financial Statements

*(All amounts in Canadian dollars and all tabular amounts in thousands unless otherwise noted)*

*(All amounts as at June 30, 2014 and December 31, 2013 and for the three and six month periods ended June 30, 2014 and 2013 are unaudited)*

### 1. NATURE AND DESCRIPTION OF THE TRUST

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Effective January 3, 2013, Granite Real Estate Inc. (“Granite Co.”) completed its conversion from a corporate structure to a stapled unit real estate investment trust (“REIT”) structure. The conversion to a REIT was implemented pursuant to a court approved plan of arrangement (the “Arrangement”) under the *Business Corporations Act* (Quebec). Through a series of steps and reorganizations Granite Real Estate Investment Trust (“Granite REIT”) and Granite REIT Inc. (“Granite GP”), in addition to other entities, were formed. Granite REIT is an unincorporated, open ended, limited purpose trust established under and governed by the laws of the province of Ontario and created pursuant to a Declaration of Trust dated September 28, 2012 and amended on January 3, 2013. Granite GP was incorporated on September 28, 2012 under the *Business Corporations Act* (British Columbia).

Under the Arrangement, all of the common shares of Granite Co. were exchanged, on a one-for-one basis, for stapled units, each of which consists of one unit of Granite REIT and one common share of Granite GP. Granite REIT, Granite GP and their subsidiaries (together “Granite” or the “Trust”) are carrying on the business previously conducted by Granite Co. The assets, liabilities and operations of the new combined stapled unit structure comprise all the assets, liabilities and operations of Granite Co. The stapled units trade on the Toronto Stock Exchange and on the New York Stock Exchange. The principal office of Granite REIT is 77 King Street West, Suite 4010, P.O. Box 159, Toronto-Dominion Centre, Toronto, Ontario, M5K 1H1, Canada. The registered office of Granite GP is Suite 2600, Three Bentall Centre, 595 Burrard Street P.O. Box 49314, Vancouver, British Columbia, V7X 1L3, Canada.

The Trust is a Canadian-based REIT engaged in the ownership and management of predominantly industrial, warehouse and logistics properties in North America and Europe. The Trust owns approximately 30.0 million square feet in over 100 rental income properties. The Trust’s tenant base currently includes Magna International Inc. and its operating subsidiaries (together “Magna”) as its largest tenants, together with tenants from other industries.

These condensed combined financial statements were approved by the Board of Trustees of Granite REIT and Board of Directors of Granite GP on August 6, 2014.

### 2. SIGNIFICANT ACCOUNTING POLICIES

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#### (a) Basis of Presentation and Statement of Compliance

The condensed combined financial statements for the three and six month periods ended June 30, 2014 have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting (“IAS 34”) as issued by the International Accounting Standards Board. These interim condensed combined financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Trust’s annual financial statements as at and for the year ended December 31, 2013.

#### (b) Combined Financial Statements and Basis of Consolidation

As a result of the REIT conversion and the steps and reorganizations described in note 1, the Trust does not have a single parent; however, each unit of Granite REIT and each share of Granite GP trade as a single stapled unit and accordingly, Granite REIT and Granite GP have identical ownership. Therefore, these financial statements have been prepared on a combined basis whereby the assets, liabilities and results of Granite GP and Granite REIT have been combined. The combined financial statements include the subsidiaries of Granite GP and Granite REIT. Subsidiaries are fully consolidated by Granite GP or Granite REIT from the date of acquisition, being the date on which control is obtained. The subsidiaries

continue to be consolidated until the date that such control ceases. Control exists when Granite GP or Granite REIT have power, exposure, or rights to variable returns and the ability to use their power over the entity to affect the amount of returns it generates.

All intercompany balances, income and expenses and unrealized gains and losses resulting from intercompany transactions are eliminated.

(c) New Standards, Interpretations and Amendments Adopted by the Trust

The accounting policies adopted in the preparation of the condensed combined financial statements are consistent with those followed in the preparation of the Trust's annual combined financial statements for the year ended December 31, 2013, except for the adoption of new standards and interpretations effective January 1, 2014. The Trust applies for the first time certain standards and amendments that require restatement of previous financial statements. As required by IAS 34, the nature and effect of these changes are disclosed below.

There are a number of amendments to IAS 32 Financial Instruments: Presentation ("IAS 32"), relating to offsetting certain assets and liabilities. These amendments relate to the application of the guidance set out in IAS 32 and clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. The amendments are effective January 1, 2014. The adoption of these amendments did not have an impact on the Trust's condensed combined financial statements.

In May 2013, IFRIC Interpretation 21 — Levies ("IFRIC 21") was issued which is an interpretation of IAS 37 — Provisions, Contingent Liabilities and Contingent Assets. IFRIC 21 clarifies what the obligating event is that gives rise to a levy and when a liability should be recognized. IFRIC 21 is effective for years beginning on or after January 1, 2014 and must be applied retrospectively. For the purposes of IFRIC 21, realty taxes payable by the Trust are considered levies. The adoption of this standard did not have an impact on the Trust's condensed combined financial statements.

### 3. INVESTMENT PROPERTIES

<u>As at</u>	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Income-Producing Properties . . . . .	<b>\$2,237,566</b>	\$2,325,583
Properties and Land Under Development . . . . .	<b>9,034</b>	18,108
Land Held For Development . . . . .	<b>—</b>	8,206
	<b><u>\$2,246,600</u></b>	<b><u>\$2,351,897</u></b>

Changes in investment properties are shown in the following table:

<u>As at</u>	<u>June 30, 2014</u>			<u>December 31, 2013</u>		
	<u>Income Producing Properties</u>	<u>Properties and Land Under Development</u>	<u>Land Held For Development</u>	<u>Income Producing Properties</u>	<u>Properties and Land Under Development</u>	<u>Land Held For Development</u>
Balance, beginning of period . . . . .	<b>\$2,325,583</b>	<b>\$ 18,108</b>	<b>\$ 8,206</b>	\$1,941,936	\$ 1,761	\$ —
Additions						
— Capital expenditures . . . . .	7,638	6,789	816	13,152	14,584	278
— Acquisitions . . . . .	—	—	—	269,154	7,461	9,508
— Land under development . . . . .	—	9,034	(9,034)	—	—	—
— Completed projects . . . . .	24,762	(24,762)	—	6,364	(6,364)	—
— Tenant allowances . . . . .	44,492	—	—	—	—	—
Fair value losses, net . . . . .	(29,127)	—	—	(23,297)	—	(1,927)
Foreign currency translation, net . . . . .	384	(135)	12	135,428	666	347
Disposals . . . . .	(134,663)	—	—	(17,447)	—	—
Other changes . . . . .	(1,503)	—	—	293	—	—
<b>Balance, end of period . . . . .</b>	<b><u>\$2,237,566</u></b>	<b><u>\$ 9,034</u></b>	<b><u>\$ —</u></b>	<b><u>\$2,325,583</u></b>	<b><u>\$18,108</u></b>	<b><u>\$ 8,206</u></b>

On June 26, 2014, Granite completed the disposition of its portfolio of Mexican properties to a subsidiary of Magna for gross proceeds of \$113.7 million (U.S. \$105.0 million) and incurred a \$5.1 million loss on disposal due to certain closing adjustments and associated selling costs. The Trust has presented the results of the Mexican portfolio as discontinued operations in the condensed combined financial statements (note 14). In addition, during the six months ended June 30, 2014, the Trust disposed of two income-producing properties located in the United States and Germany, for aggregate gross proceeds of \$21.0 million and incurred a \$0.2 million loss on disposal due to the associated selling costs. The fair value loss during the six months ended June 30, 2014, excluding the two properties sold in the period, was \$29.8 million.

The Trust determines the fair value of each income-producing property based upon, among other things, rental income from current leases and assumptions about rental income from future leases reflecting market conditions and lease renewal at the applicable balance sheet dates, less future cash outflows in respect of such leases. Fair values are primarily determined by discounting the expected future cash flows, generally over a term of 10 years including a terminal value based on the application of a capitalization rate to estimated year 11 cash flows. The fair values of properties and land under development are measured using a discounted cash flow model, net of costs to complete, as of the balance sheet date unless fair value cannot be determined, in which case, they are valued at cost. The Trust measures its investment properties using valuations prepared by management. The Trust does not measure its investment properties based on valuations prepared by external appraisers but uses such appraisals as data points, together with other external market information accumulated by management, in arriving at its own conclusions on values.

Valuations are most sensitive to changes in discount rates and terminal capitalization rates. The key valuation metrics for investment properties are set out below:

<u>As at</u>	<u>June 30, 2014</u>			<u>December 31, 2013</u>		
	<u>Maximum</u>	<u>Minimum</u>	<u>Weighted average</u>	<u>Maximum</u>	<u>Minimum</u>	<u>Weighted average</u>
<b>Canada</b>						
Discount rate . . . . .	8.50%	6.50%	7.77%	8.50%	6.50%	7.76%
Terminal cap rate . . . . .	8.50%	5.75%	7.26%	8.50%	5.75%	7.26%
<b>United States</b>						
Discount rate . . . . .	14.00%	7.25%	9.33%	14.00%	7.30%	9.35%
Terminal cap rate . . . . .	13.00%	6.75%	9.12%	13.00%	7.25%	9.24%
<b>Mexico</b>						
Discount rate . . . . .	—	—	—	13.25%	11.75%	12.91%
Terminal cap rate . . . . .	—	—	—	13.75%	11.25%	12.95%
<b>Germany</b>						
Discount rate . . . . .	9.50%	6.20%	8.29%	9.25%	6.20%	8.15%
Terminal cap rate . . . . .	9.50%	7.50%	8.49%	9.25%	7.50%	8.37%
<b>Austria</b>						
Discount rate . . . . .	9.00%	8.25%	8.47%	8.75%	8.25%	8.38%
Terminal cap rate . . . . .	9.50%	8.75%	8.97%	9.25%	8.75%	8.87%
<b>Netherlands</b>						
Discount rate . . . . .	9.21%	6.84%	8.39%	9.21%	6.84%	8.39%
Terminal cap rate . . . . .	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
<b>Other</b>						
Discount rate . . . . .	10.75%	8.50%	9.73%	11.00%	9.25%	9.97%
Terminal cap rate . . . . .	10.50%	8.50%	10.01%	10.50%	8.50%	10.19%

Included in investment properties is \$11.4 million (December 31, 2013 — \$11.2 million) of net straight-line rent receivable arising from the recognition of rental revenue on a straight-line basis over the lease term.

Details about contractual obligations to purchase, construct and develop properties can be found in the commitments and contingencies note (note 18).

Minimum rental commitments on non-cancellable tenant operating leases are as follows:

Not later than 1 year . . . . .	\$ 200,256
Later than 1 year and not later than 5 years . . . . .	657,911
Later than 5 years . . . . .	343,455
	<u>\$1,201,622</u>

#### 4. OTHER ASSETS

Other assets consist of:

<u>As at</u>	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Deferred financing costs . . . . .	\$ 774	\$ 433
Long-term receivables . . . . .	510	525
Interest rate caps (note 6) . . . . .	412	678
Deposits . . . . .	403	322
	<u>\$2,099</u>	<u>\$1,958</u>

During the second quarter of 2014, the Trust incurred deferred financing costs of \$0.3 million with respect to senior debentures issued on July 3, 2014 (note 19). These costs will be netted against the debt and amortized to interest expense over the term to maturity.

During the second quarter of 2014, the Trust also incurred deferred financing costs of \$0.2 million with respect to the 2017 Construction Loan (note 6(b)). These costs will also be netted against the debt and amortized to interest expense over the term to maturity.

#### 5. UNSECURED DEBENTURES, NET

(a) Unsecured debentures, net, consist of:

<u>As at</u>	<u>Maturity Date</u>	<u>June 30, 2014</u>		<u>December 31, 2013</u>	
		<u>Amortized Cost</u>	<u>Principal issued and outstanding</u>	<u>Amortized Cost</u>	<u>Principal issued and outstanding</u>
6.05% Debentures . . . . .	December 22, 2016 (note 19)	\$264,118	\$265,000	\$263,941	\$265,000
4.613% Debentures . . . . .	October 2, 2018	198,321	200,000	198,129	200,000
		<u>\$462,439</u>	<u>\$465,000</u>	<u>\$462,070</u>	<u>\$465,000</u>

(b) Cross currency interest rate swap

On October 7, 2013, the Trust entered into a cross currency interest rate swap (the “Cross Currency Interest Rate Swap”) to exchange the \$200.0 million proceeds and related 4.613% interest payments from the debentures that mature in 2018 for euro 142.3 million and euro denominated interest payments at a 3.56% interest rate. Under the terms of the swap, on October 2, 2018, the Trust will repay the principal proceeds received of euro 142.3 million.

As at June 30, 2014, the fair value of the Cross Currency Interest Rate Swap was a net financial liability of \$11.8 million, which includes a \$12.3 million cumulative loss related to the strengthening of the euro against the Canadian dollar. The Cross Currency Interest Rate Swap is designated as a net investment hedge of the Trust’s investment in foreign operations. The effectiveness of the hedge is assessed quarterly. For the three and six month periods ended June 30, 2014, the Trust has assessed that the

hedge continued to be effective. As an effective hedge, the unrealized gains or losses on the Cross Currency Interest Rate Swap that are related to foreign currency movements are recognized in other comprehensive income. The Trust has elected to record the differences resulting from the lower interest rate associated with the Cross Currency Interest Rate Swap in the statement of income.

## 6. SECURED LONG-TERM DEBT

(a) Secured long-term debt consists of:

As at	Maturity Date	Interest Rate	June 30, 2014		December 31, 2013	
			U.S. \$ Outstanding <sup>(2)</sup>	Cdn \$ Outstanding <sup>(2)</sup>	U.S. \$ Outstanding <sup>(2)</sup>	Cdn \$ Outstanding <sup>(2)</sup>
Mortgage payable . .	June 10, 2017	LIBOR + 2.50% <sup>(1)</sup>	\$23,733	\$25,337	\$23,713	\$25,221
Mortgage payable . .	May 10, 2018	LIBOR + 2.50% <sup>(1)</sup>	12,497	13,341	12,541	13,338
2016 Construction Loan . . . . .	July 25, 2016	LIBOR + 2.25%	11,192	11,949	3,099	3,297
			<u>\$47,422</u>	<u>\$50,627</u>	<u>\$39,353</u>	<u>\$41,856</u>
Less: due within one year . . . . .			438	468	—	—
			<u>\$46,984</u>	<u>\$50,159</u>	<u>\$39,353</u>	<u>\$41,856</u>

(1) Interest rate caps were purchased for 100% of the mortgage amounts and for the duration of the mortgage thereby limiting the interest rate exposure to a maximum of 4%.

(2) The amounts outstanding are net of transaction costs.

The mortgages are recourse only to the properties acquired. Those properties have a fair value of \$67.0 million at June 30, 2014 and are pledged as collateral. The 2016 Construction Loan is also secured by a first mortgage lien on the property having a fair value of \$24.8 million.

(b) 2017 Construction Loan

On June 20, 2014, Granite entered into a construction loan (the “2017 Construction Loan”) for U.S. \$26.2 million relating to land that was previously held for development. The 2017 Construction Loan bears interest at LIBOR plus 2.25% and matures on June 20, 2017. Proceeds from the 2017 Construction Loan may only be used to pay for the construction cost of improvements on the property and other related costs, and loan advances will be made based on the value of the work completed. Granite also has the option to extend the maturity date for two successive periods to June 20, 2018 and 2019, subject to certain terms and conditions. The 2017 Construction Loan is secured by a first mortgage lien on the property. At June 30, 2014, no amount had been drawn under the 2017 Construction Loan.

## 7. OTHER NON-CURRENT LIABILITIES

Other non-current liabilities consist of:

As at	June 30, 2014	December 31, 2013
Contingent consideration . . . . .	\$ 3,861	\$3,777
Tenant allowance payable . . . . .	6,531	—
	<u>\$10,392</u>	<u>\$3,777</u>

Contingent consideration was recognized in connection with acquisitions completed in 2013 and is expected to be settled during 2018. The amount is dependent upon a number of assumptions which are subject to change over the period to the date of payment.

The tenant allowance payable of euro 6.0 million is due in January 2018 and relates to a lease extension at the Eurostar facility in Graz, Austria. The future payable of euro 6.0 million has been discounted and is being accreted to its face value through a charge to interest expense.

## 8. BANK INDEBTEDNESS

Effective February 1, 2013, the Trust entered into an unsecured senior revolving credit facility in the amount of \$175.0 million that is available by way of Canadian dollar, U.S. dollar or euro denominated loans or letters of credit (the "Credit Facility") and matures on February 1, 2015 with the option to extend the maturity date by one year to February 1, 2016, subject to the agreement of lenders in respect of a minimum of 66⅔% of the aggregate amount committed under the Credit Facility. At June 30, 2014, the Trust had \$42.7 million (U.S. \$40.0 million) drawn under the Credit Facility and \$1.3 million in letters of credit issued against the Credit Facility.

## 9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of:

<u>As at</u>	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Accounts payable . . . . .	\$ 5,834	\$ 5,828
Accrued salaries and wages . . . . .	2,688	4,771
Accrued interest payable . . . . .	2,840	2,708
Accrued construction payable . . . . .	7,471	7,141
Accrued acquisition costs . . . . .	—	1,733
Accrued stapled unit options . . . . .	225	356
Accrued deferred stapled units . . . . .	1,749	1,395
Accrued trustee/director unit-based compensation . . . . .	3,836	3,291
VAT payable on Mexico asset sale . . . . .	14,182	—
Other accrued liabilities . . . . .	5,522	5,955
	<u>\$44,347</u>	<u>\$33,178</u>

## 10. DISTRIBUTIONS TO STAPLED UNITHOLDERS

Total distributions declared to stapled unitholders in the three month period ended June 30, 2014 were \$25.8 million (2013 — \$24.6 million) or 54.9 cents per stapled unit (2013 — 52.5 cents per stapled unit). Total distributions declared to stapled unitholders in the six month period ended June 30, 2014 were \$51.6 million (2013 — \$49.3 million) or \$1.10 per stapled unit (2013 — \$1.05 per stapled unit). Distributions payable at June 30, 2014 of \$8.6 million, representing the June 2014 distribution, were paid on July 15, 2014. On July 17, 2014 distributions of 18.3 cents per stapled unit were declared and will be paid on August 15, 2014.

## 11. STAPLED UNITHOLDERS' EQUITY

### (a) Unit-based Compensation

#### Incentive Stock Option Plan

The Incentive Stock Option Plan (the "Option Plan") allows for the grant of stock options or stock appreciation rights to directors, officers, employees and consultants. A reconciliation of the changes in the options outstanding is presented below:

	2014		2013	
	Number (000s)	Weighted Average Exercise Price	Number (000s)	Weighted Average Exercise Price
Options outstanding, January 1 . . .	100	\$33.92	205	\$32.01
Exercised . . . . .	(50)	35.62	(50)	31.85
Options outstanding and exercisable, March 31 . . . . .	50	32.21	155	32.07
Exercised . . . . .	—	—	(55)	28.70
<b>Options outstanding and exercisable, June 30 . . . . .</b>	<b>50</b>	<b>\$32.21</b>	<b>100</b>	<b>\$33.92</b>

#### Director/Trustee Deferred Share Unit Plan

The Trust has two Non-Employee Director Share-Based Compensation Plans (the "DSPs"), which provide for a deferral of up to 100% of each outside director's total annual remuneration, at specified levels elected by each director, until such director ceases to be a director. A reconciliation of the changes in the notional deferred share units ("DSUs") outstanding is presented below:

	2014		2013	
	Number (000s)	Weighted Average Grant Date Fair Value	Number (000s)	Weighted Average Grant Date Fair Value
DSUs outstanding, January 1 . . . .	87	\$32.92	61	\$30.95
Granted . . . . .	6	39.46	6	38.74
DSUs outstanding, March 31 . . . . .	93	33.34	67	31.68
Granted . . . . .	6	39.85	7	37.34
<b>DSUs outstanding, June 30 . . . . .</b>	<b>99</b>	<b>\$33.72</b>	<b>74</b>	<b>\$32.21</b>



### Executive Deferred Stapled Unit Plan

The Trust has an Executive Share Unit Plan (the “Stapled Unit Plan”) which is designed to provide equity-based compensation in the form of stapled units to executives and other employees. A reconciliation of the changes in stapled units outstanding is presented below:

	2014		2013	
	Number (000s)	Weighted Average Grant Date Fair Value	Number (000s)	Weighted Average Grant Date Fair Value
Stapled units outstanding, January 1 . . . . .	62	\$37.42	38	\$35.63
Granted . . . . .	53	39.01	28	39.23
Settled . . . . .	(19)	38.74	(4)	35.47
Stapled units outstanding, March 31 . . . . .	96	38.04	62	37.37
Granted . . . . .	1	40.02	1	38.50
<b>Stapled units outstanding, June 30 . . . . .</b>	<b>97</b>	<b>\$38.07</b>	<b>63</b>	<b>\$37.38</b>

During the three month period ended June 30, 2014, the Trust recognized unit-based compensation expense of \$0.6 million (2013 — \$0.2 million), which includes a \$0.1 million expense (2013 — \$0.1 million) pertaining to the DSP plans, a \$0.5 million expense (2013 — \$0.2 million) pertaining to the Stapled Unit Plan and a net expense of nil (2013 — recovery of \$0.1 million) related to the re-measurement of the Option Plan liability in the period.

During the six month period ended June 30, 2014, the Trust recognized unit-based compensation expense of \$1.6 million (2013 — \$0.7 million), which includes a \$0.5 million expense (2013 — \$0.4 million) pertaining to the DSP plans, a \$1.0 million expense (2013 — \$0.4 million) pertaining to the Stapled Unit Plan and a net expense of \$0.1 million (2013 — recovery of \$0.1 million) related to the re-measurement of the Option Plan liability in the period.

(b) Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following:

<b>As at June 30,</b>	<b>2014</b>	<b>2013</b>
Foreign currency translation gains (losses) on investments in subsidiaries, net of related hedging activities and non-controlling interests . . . . .	\$101,919	\$40,847
Losses on derivatives designated as net investment hedges . . . . .	(12,291)	—
	<b>\$ 89,628</b>	<b>\$40,847</b>

## 12. OPERATING COSTS AND EXPENSES (INCOME)

(a) Property operating costs consist of:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Non-recoverable from tenants				
Property taxes and utilities . . . . .	\$ 362	\$ 325	\$ 745	\$ 558
Legal . . . . .	484	287	761	521
Environmental and appraisals . . . . .	165	221	321	474
Repairs and maintenance . . . . .	174	100	233	222
Other . . . . .	269	70	563	183
	<u>\$1,454</u>	<u>\$1,003</u>	<u>\$2,623</u>	<u>\$1,958</u>
Recoverable from tenants				
Property taxes and utilities . . . . .	\$231	\$152	\$ 479	\$214
Repairs and maintenance . . . . .	135	56	171	68
Other . . . . .	326	106	605	140
	<u>\$692</u>	<u>\$314</u>	<u>\$1,255</u>	<u>\$422</u>

(b) General and administrative expenses consist of:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Salaries and benefits . . . . .	\$3,712	\$2,973	\$ 7,824	\$ 6,074
Audit, legal and consulting . . . . .	964	827	2,499	1,815
REIT conversion and reorganization related costs . . . . .	—	560	—	1,997
Trustee/director fees and related expenses . . . . .	412	270	1,026	801
Other . . . . .	1,331	1,357	2,336	2,384
	<u>\$6,419</u>	<u>\$5,987</u>	<u>\$13,685</u>	<u>\$13,071</u>

(c) Interest expense and other financing costs, net consist of:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Interest, accretion and costs on debentures . . . . .	\$6,088	\$4,097	\$12,215	\$8,193
Interest on mortgages payable . . . . .	351	208	670	338
Amortization of deferred financing costs . . . . .	106	91	185	374
Other interest and accretion charges . . . . .	475	363	866	495
	<u>7,020</u>	<u>4,759</u>	<u>13,936</u>	<u>9,400</u>
Capitalized interest . . . . .	(28)	(19)	(28)	(62)
Interest income . . . . .	(77)	(71)	(124)	(150)
	<u>\$6,915</u>	<u>\$4,669</u>	<u>\$13,784</u>	<u>\$9,188</u>

(d) Fair value gains (losses) on financial instruments consist of:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Foreign exchange forward contracts, net . . . . .	\$ 574	\$(842)	\$ 613	\$(307)
Interest rate caps . . . . .	(197)	199	(274)	159
	<u>\$ 377</u>	<u>\$(643)</u>	<u>\$ 339</u>	<u>\$(148)</u>

### 13. INCOME TAXES

(a) The major components of the income tax expense (recovery) are:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Current income tax expense (recovery) . . . . .	\$ (930)	\$ 5,835	\$1,350	\$ 5,972
Deferred income tax (recovery) . . . . .	5,541	(3,565)	4,490	(40,036)
<b>Income tax expense (recovery)</b> . . . . .	<u>\$4,611</u>	<u>\$ 2,270</u>	<u>\$5,840</u>	<u>\$(34,064)</u>

Included in current income tax expense for the six month period ended June 30, 2014 is \$1.1 million arising from the disposition of a property in Germany.

(b) The effective income tax rate reported in the combined statements of income varies from the Canadian statutory rate for the following reasons:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Income before income taxes . . . . .	\$31,027	\$ 41,189	\$44,431	\$ 93,913
Expected income taxes at the Canadian statutory tax rate of 26.5% (2013 — 26.5%) . . . . .	\$ 8,222	\$ 10,915	\$11,774	\$ 24,887
Income distributed and taxable to unitholders . . . . .	(2,252)	(9,188)	(5,125)	(17,883)
Reversal of deferred tax liability upon REIT conversion and related reorganizations . . . . .	—	—	—	(41,905)
Net foreign rate differentials . . . . .	631	(684)	637	276
Net change in provisions for uncertain tax positions . . .	(2,216)	(19)	(1,892)	(940)
Net permanent differences . . . . .	194	291	320	(107)
Withholding taxes and other items . . . . .	32	955	126	1,608
<b>Income tax expense (recovery)</b> . . . . .	<u>\$ 4,611</u>	<u>\$ 2,270</u>	<u>\$ 5,840</u>	<u>\$(34,064)</u>

### 14. DISCONTINUED OPERATIONS

During the three month period ended June 30, 2014, Granite disposed of its portfolio of Mexican properties. As the Mexican properties represented a significant geographical area of operations, the Trust has retroactively presented the Mexican portfolio as discontinued operations in the condensed combined financial statements.

Granite's results of operations from discontinued operations for the three and six month periods ended June 30, 2014 and 2013, respectively, are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
<b>Rental revenue</b> . . . . .	<b>\$ 3,431</b>	\$ 3,325	<b>\$ 7,079</b>	\$ 6,503
Operating costs and expenses . . . . .	<b>82</b>	425	<b>90</b>	194
Fair value (gains) losses on investment properties, net . . . . .	<b>—</b>	(2,805)	<b>4</b>	(6,509)
Income before income taxes . . . . .	<b>3,349</b>	5,705	<b>6,985</b>	12,818
Income tax expense . . . . .	<b>(546)</b>	(1,230)	<b>(1,702)</b>	(3,007)
<b>Income from discontinued operations before gain on sale of disposed properties</b> . . . . .	<b>2,803</b>	4,475	<b>5,283</b>	9,811
Loss on sale of investment properties . . . . .	<b>(4,979)</b>	—	<b>(5,071)</b>	—
Reclassification adjustment relating to foreign operation disposed of in the period . . . . .	<b>5,722</b>	—	<b>5,722</b>	—
Income tax recovery . . . . .	<b>823</b>	—	<b>823</b>	—
<b>Net gain on sale of disposed properties</b> . . . . .	<b>1,566</b>	—	<b>1,474</b>	—
<b>Net income from discontinued operations</b> . . . . .	<b>\$ 4,369</b>	\$ 4,475	<b>\$ 6,757</b>	\$ 9,811

#### 15. DETAILS OF CASH FROM OPERATING ACTIVITIES FROM CONTINUING OPERATIONS

(a) Items not involving current cash flows are shown in the following table:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Straight-line rent adjustment . . . . .	<b>\$ 1,353</b>	\$ 498	<b>\$ 1,928</b>	\$ 797
Unit-based compensation expense . . . . .	<b>617</b>	191	<b>1,644</b>	663
Fair value losses (gains) on investment properties . . . . .	<b>5,570</b>	(8,122)	<b>29,123</b>	(23,152)
Depreciation and amortization . . . . .	<b>151</b>	56	<b>272</b>	222
Fair value losses (gains) on financial instruments . . . . .	<b>(377)</b>	643	<b>(339)</b>	148
Gain on settlement of Meadows note . . . . .	<b>—</b>	—	<b>—</b>	(5,143)
Loss on sale of investment properties . . . . .	<b>—</b>	328	<b>182</b>	328
Amortization of issuance costs and accretion of discount of debentures . . . . .	<b>205</b>	100	<b>405</b>	194
Amortization of deferred financing costs . . . . .	<b>106</b>	91	<b>185</b>	374
Foreign exchange on note receivable . . . . .	<b>—</b>	(424)	<b>—</b>	(167)
Deferred income taxes . . . . .	<b>5,541</b>	(3,565)	<b>4,490</b>	(40,036)
Other . . . . .	<b>(175)</b>	921	<b>(769)</b>	917
	<b>\$12,991</b>	\$ (9,283)	<b>\$37,121</b>	\$ (64,855)

(b) Changes in working capital balances are shown in the following table:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Accounts receivable . . . . .	\$ 6,858	\$(467)	\$ (357)	\$ 952
Prepaid expenses and other . . . . .	246	448	29	396
Accounts payable and accrued liabilities . . . . .	1,873	(673)	(4,357)	(4,764)
Deferred revenue . . . . .	(1,246)	691	(1,781)	(1,338)
Restricted cash . . . . .	—	409	—	463
	<u>\$ 7,731</u>	<u>\$ 408</u>	<u>\$(6,466)</u>	<u>\$(4,291)</u>

(c) Non-cash financing activities

During the six month period ended June 30, 2014, 19 thousand stapled units (2013 — 4 thousand stapled units) with a value of \$0.7 million (2013 — \$0.2 million) were issued under the Stapled Unit Plan.

## 16. FAIR VALUE

(a) Fair Value of Financial Instruments

The following table provides the classification and measurement of financial assets and liabilities as at June 30, 2014:

Measurement basis	Fair value through profit or loss	Loans and receivables/ other financial liabilities		Total	Total
	(Fair value)	(Amortized cost)	(Fair value)	(Carrying Value)	(Fair Value)
<b>Financial assets</b>					
Other assets . . . . .	\$ 412 <sup>(1)</sup>	\$ 510 <sup>(2)</sup>	\$ 510	\$ 922	\$ 922
Accounts receivable . . . . .	—	2,809	2,809	2,809	2,809
Prepaid expenses and other . . . . .	613 <sup>(3)</sup>	—	—	613	613
Restricted cash . . . . .	—	4,954	4,954	4,954	4,954
Cash and cash equivalents . . . . .	—	205,748	205,748	205,748	205,748
	<u>\$ 1,025</u>	<u>\$214,021</u>	<u>\$214,021</u>	<u>\$215,046</u>	<u>\$215,046</u>
<b>Financial liabilities</b>					
Unsecured debentures, net . . . . .	\$ —	\$462,439	\$494,841	\$462,439	\$494,841
Cross Currency Interest					
Rate Swap . . . . .	11,757	—	—	11,757	11,757
Secured long-term debt . . . . .	—	50,627	50,627	50,627	50,627
Other non-current liabilities . . . . .	—	10,392	10,392	10,392	10,392
Bank indebtedness . . . . .	—	42,704	42,704	42,704	42,704
Accounts payable and accrued liabilities . . . . .	—	44,347	44,347	44,347	44,347
Distributions payable . . . . .	—	8,604	8,604	8,604	8,604
	<u>\$11,757</u>	<u>\$619,113</u>	<u>\$651,515</u>	<u>\$630,870</u>	<u>\$663,272</u>

(1) Interest rate caps included in other assets.

(2) Long-term receivables included in other assets.

(3) Foreign exchange forward contracts included in prepaid expenses and other.

The following table provides the classification and measurement of financial assets and liabilities as at December 31, 2013:

Measurement basis	Fair value through profit or loss	Loans and receivables/ other financial liabilities		Total	Total
	(Fair value)	(Amortized cost)	(Fair value)	(Carrying Value)	(Fair Value)
<b>Financial assets</b>					
Other assets . . . . .	\$ 678 <sup>(4)</sup>	\$ 525 <sup>(5)</sup>	\$ 525	\$ 1,203	\$ 1,203
Accounts receivable . . . . .	—	2,491	2,491	2,491	2,491
Restricted cash . . . . .	—	4,360	4,360	4,360	4,360
Cash and cash equivalents . . . . .	—	95,520	95,520	95,520	95,520
	<u>\$ 678</u>	<u>\$102,896</u>	<u>\$102,896</u>	<u>\$103,574</u>	<u>\$103,574</u>
<b>Financial liabilities</b>					
Unsecured debentures, net . . . . .	\$ —	\$462,070	\$485,558	\$462,070	\$485,558
Cross Currency Interest					
Rate Swap . . . . .	11,003	—	—	11,003	11,003
Secured long-term debt . . . . .	—	41,856	41,856	41,856	41,856
Other non-current liabilities . . . . .	—	3,777	3,777	3,777	3,777
Bank indebtedness . . . . .	—	53,180	53,180	53,180	53,180
Accounts payable and accrued liabilities . . . . .	—	33,178	33,178	33,178	33,178
Distributions payable . . . . .	—	8,591	8,591	8,591	8,591
	<u>\$11,003</u>	<u>\$602,652</u>	<u>\$626,140</u>	<u>\$613,655</u>	<u>\$637,143</u>

(4) Interest rate caps included in other assets.

(5) Long-term receivables included in other assets.

The fair value of the Trust's accounts receivable, cash and cash equivalents, restricted cash, bank indebtedness, accounts payable and accrued liabilities and distributions payable approximate their carrying amounts due to the relatively short periods to maturity of these financial instruments. The fair value of other non-current liabilities approximates the carrying value as it is revalued at each reporting date. The fair value of the unsecured debentures is determined using quoted market prices. The fair value of the Cross Currency Interest Rate Swap is determined using market inputs quoted by its counterparties. The fair value of the secured long-term debt approximates its carrying amount as the mortgages and construction loan payable were drawn recently and bear interest at rates comparable to current market rates that would be used to calculate fair value.

The Trust periodically purchases foreign exchange forward contracts to hedge specific anticipated foreign currency transactions and mitigate its foreign exchange exposure on its net cash flows. At June 30, 2014, the Trust held four foreign exchange forward contracts (December 31, 2013 — no contracts outstanding). The foreign exchange contracts are comprised of three contracts to purchase \$10.7 million and sell euro 7.0 million and one contract to purchase \$3.4 million and sell U.S. \$3.0 million. For the three and six month periods ended June 30, 2014, the Trust recorded a net fair value gain of \$0.6 million (2013 — fair value loss of \$0.8 million) and \$0.6 million (2013 — fair value loss of \$0.3 million), respectively.

As disclosed in note 6, the Trust entered into two interest rate caps to hedge the interest rate risk associated with the mortgages payable. The interest rate caps have not been designated and the Trust is not employing hedge accounting for these instruments. The fair value of the interest rate caps at June 30, 2014 was \$0.4 million.

(b) Fair Value Hierarchy

Fair value measurements are based on inputs of observable and unobservable market data that a market participant would use in pricing an asset or liability. IFRS establishes a fair value hierarchy which is summarized below:

Level 1: Fair value determined based on quoted prices in active markets for identical assets or liabilities.

Level 2: Fair value determined using significant observable inputs, generally either quoted prices in active markets for similar assets or liabilities or quoted prices in markets that are not active.

Level 3: Fair value determined using significant unobservable inputs, such as pricing models, discounted cash flows or similar techniques.

The following tables represent information related to the Trust's financial assets and liabilities measured or disclosed at fair value on a recurring and non-recurring basis and the level within the fair value hierarchy in which the fair value measurements fall.

<u>As at June 30, 2014</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>ASSETS AND LIABILITIES MEASURED OR DISCLOSED AT FAIR VALUE</b>			
<b>Assets measured at fair value</b>			
Interest rate caps included in other assets . . . . .	\$ —	\$ 412	\$ —
Foreign exchange forward contracts included in prepaid expenses and other . . . . .	—	613	—
<b>Liabilities measured or disclosed at fair value</b>			
Unsecured debentures, net . . . . .	494,841	—	—
Cross Currency Interest Rate Swap . . . . .	—	11,757	—
Other non-current liabilities . . . . .	—	—	10,392
Secured long-term debt . . . . .	—	50,627	—
Bank indebtedness . . . . .	—	42,704	—
<b>Net Assets (Liabilities) measured at fair value . . . . .</b>	<b><u>\$(494,841)</u></b>	<b><u>\$(104,063)</u></b>	<b><u>\$(10,392)</u></b>

<u>As at December 31, 2013</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>ASSETS AND LIABILITIES MEASURED OR DISCLOSED AT FAIR VALUE</b>			
<b>Assets measured at fair value</b>			
Interest rate caps included in other assets . . . . .	\$ —	\$ 678	\$ —
<b>Liabilities measured or disclosed at fair value</b>			
Unsecured debentures, net . . . . .	485,558	—	—
Cross Currency Interest Rate Swap . . . . .	—	11,003	—
Other non-current liabilities . . . . .	—	—	3,777
Secured long-term debt . . . . .	—	41,856	—
Bank indebtedness . . . . .	—	53,180	—
<b>Net Assets (Liabilities) measured at fair value . . . . .</b>	<b><u>\$(485,558)</u></b>	<b><u>\$(105,361)</u></b>	<b><u>\$(3,777)</u></b>

For assets and liabilities that are measured at fair value on a recurring basis, the Trust determines whether transfers between the levels of the fair value hierarchy have occurred by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. For the three and six month periods ended June 30, 2014 and the year ended December 31, 2013, there were no transfers between the levels.

## 17. COMBINED FINANCIAL INFORMATION

The condensed combined financial statements include the financial position and results of operations and cash flows of each of Granite REIT and Granite GP. Below is a summary of the financial information for each entity along with the elimination entries and other adjustments that aggregate to the combined financial statements:

### Balance Sheet

As at June 30, 2014

	Granite REIT	Granite GP	Eliminations/ Adjustments	Granite REIT and Granite GP Combined
<b>ASSETS</b>				
<b>Non-current assets:</b>				
Investment properties . . . . .	\$2,246,600			\$2,246,600
Deferred tax assets . . . . .	7,658			7,658
Investment in Granite LP . . . . .	—	4	(4)	—
Other non-current assets . . . . .	4,063			4,063
	<u>2,258,321</u>	<u>4</u>	<u>(4)</u>	<u>2,258,321</u>
<b>Current assets:</b>				
Other current assets . . . . .	11,996	16		12,012
Intercompany receivable . . . . .	—	1,319	(1,319)	—
Cash and cash equivalents . . . . .	204,419	1,329		205,748
<b>Total assets</b> . . . . .	<u>\$2,474,736</u>	<u>2,668</u>	<u>(1,323)</u>	<u>\$2,476,081</u>
<b>LIABILITIES AND STAPLED UNITHOLDERS' EQUITY</b>				
<b>Non-current liabilities:</b>				
Unsecured debentures, net . . . . .	\$ 462,439			\$ 462,439
Cross Currency Interest Rate Swap . .	11,757			11,757
Deferred tax liabilities . . . . .	156,824			156,824
Other non-current liabilities . . . . .	60,551			60,551
	<u>691,571</u>			<u>691,571</u>
<b>Current liabilities:</b>				
Bank indebtedness . . . . .	42,704			42,704
Intercompany payable . . . . .	1,319		(1,319)	—
Other current liabilities . . . . .	73,680	2,664		76,344
<b>Total liabilities</b> . . . . .	<u>809,274</u>	<u>2,664</u>	<u>(1,319)</u>	<u>810,619</u>
<b>Equity:</b>				
Stapled unitholders' equity . . . . .	1,659,972	4		1,659,976
Non-controlling interests . . . . .	5,490		(4)	5,486
<b>Total liabilities and stapled unitholders' equity</b> . . . . .	<u>\$2,474,736</u>	<u>2,668</u>	<u>(1,323)</u>	<u>\$2,476,081</u>



**Balance Sheet**
**As at December 31, 2013**

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>ASSETS</b>				
<b>Non-current assets:</b>				
Investment properties . . . . .	\$2,351,897			\$2,351,897
Deferred tax assets . . . . .	8,173			8,173
Investment in Granite LP . . . . .	—	2	(2)	—
Other non-current assets . . . . .	3,896			3,896
	<u>2,363,966</u>	<u>2</u>	<u>(2)</u>	<u>2,363,966</u>
<b>Current assets:</b>				
Other current assets . . . . .	9,147			9,147
Intercompany receivable . . . . .	—	850	(850)	—
Cash and cash equivalents . . . . .	95,520			95,520
<b>Total assets</b> . . . . .	<u>\$2,468,633</u>	<u>852</u>	<u>(852)</u>	<u>\$2,468,633</u>
<b>LIABILITIES AND STAPLED UNITHOLDERS' EQUITY</b>				
<b>Non-current liabilities:</b>				
Unsecured debentures, net . . . . .	\$ 462,070			\$ 462,070
Cross Currency Interest Rate Swap . . . . .	11,003			11,003
Deferred tax liabilities . . . . .	166,622			166,622
Other non-current liabilities . . . . .	45,633			45,633
	<u>685,328</u>			<u>685,328</u>
<b>Current liabilities:</b>				
Bank indebtedness . . . . .	53,180			53,180
Intercompany payable . . . . .	850		(850)	—
Other current liabilities . . . . .	52,765	850		53,615
<b>Total liabilities</b> . . . . .	<u>792,123</u>	<u>850</u>	<u>(850)</u>	<u>792,123</u>
<b>Equity:</b>				
Stapled unitholders' equity . . . . .	1,671,225	2		1,671,227
Non-controlling interests . . . . .	5,285		(2)	5,283
<b>Total liabilities and stapled unitholders' equity</b> . . . . .	<u>\$2,468,633</u>	<u>852</u>	<u>(852)</u>	<u>\$2,468,633</u>

**Income Statement**

Three months ended June 30, 2014

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>Revenues</b> . . . . .	\$52,160			\$52,160
<b>Operating costs and expenses (income)</b>				
General and administrative . . . . .	6,419			6,419
Interest expense and other financing costs, net . . . . .	6,915			6,915
Other costs and expenses . . . . .	2,606			2,606
Share of (income) loss of Granite LP . . . . .	—	(1)	1	—
<b>Income before fair value changes and income taxes</b> . . . . .	36,220	1	(1)	36,220
Fair value losses on investment properties, net . . . . .	(5,570)			(5,570)
Fair value gains on financial instruments . . . . .	377			377
<b>Income before income taxes</b> . . . . .	31,027	1	(1)	31,027
Income tax expense . . . . .	4,611	—	—	4,611
<b>Net Income from continuing operations</b> . . . . .	26,416	1	(1)	26,416
Net income from discontinued operations . . . . .	4,369	—	—	4,369
<b>Net income</b> . . . . .	30,785	1	(1)	30,785
Less net income attributable to non-controlling interests . . . . .	118	—	(1)	117
<b>Net income attributable to stapled unitholders</b> . . . . .	<u>\$30,667</u>	<u>1</u>	<u>—</u>	<u>\$30,668</u>

**Income Statement**

Three months ended June 30, 2013

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>Revenues</b> . . . . .	\$46,151			\$46,151
<b>Operating costs and expenses (income)</b>				
General and administrative . . . . .	5,987			5,987
Interest expense and other financing costs, net . . . . .	4,669			4,669
Other costs and expenses . . . . .	1,075			1,075
Share of (income) loss of Granite LP . . . . .	<u>—</u>	<u>(1)</u>	<u>1</u>	<u>—</u>
<b>Income before fair value changes, loss on sale of investment property, acquisition transaction costs and income taxes</b> . . . . .	34,420	1	(1)	34,420
Fair value gains on investment properties, net . . . . .	8,122			8,122
Fair value losses on financial instruments . . . . .	(643)			(643)
Loss on sale of investment property . . . . .	(328)			(328)
Acquisition transaction costs . . . . .	<u>(382)</u>	<u>—</u>	<u>—</u>	<u>(382)</u>
<b>Income before income taxes</b> . . . . .	41,189	1	(1)	41,189
Income tax expense . . . . .	<u>2,270</u>	<u>—</u>	<u>—</u>	<u>2,270</u>
<b>Net Income from continuing operations</b> . . . . .	38,919	1	(1)	38,919
Net income from discontinued operations . . . . .	<u>4,475</u>	<u>—</u>	<u>—</u>	<u>4,475</u>
<b>Net income</b> . . . . .	43,394	1	(1)	43,394
Add net loss attributable to non-controlling interests . . . . .	<u>153</u>	<u>—</u>	<u>1</u>	<u>154</u>
<b>Net income attributable to stapled unitholders</b> . . . . .	<u>\$43,547</u>	<u>1</u>	<u>—</u>	<u>\$43,548</u>

**Income Statement**

Six months ended June 30, 2014

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>Revenues</b> . . . . .	\$105,093			\$105,093
<b>Operating costs and expenses (income)</b>				
General and administrative . . . . .	13,685			13,685
Interest expense and other financing costs, net . . . . .	13,784			13,784
Other costs and expenses . . . . .	4,227			4,227
Share of (income) loss of Granite LP . . . . .	<u>—</u>	<u>(2)</u>	<u>2</u>	<u>—</u>
<b>Income before fair value changes, loss on sale of investment properties and income taxes</b> . . . . .	73,397	2	(2)	73,397
Fair value losses on investment properties, net . . . . .	(29,123)			(29,123)
Fair value gains on financial instruments . . . . .	339			339
Loss on sale of investment properties . . . . .	<u>(182)</u>	<u>—</u>	<u>—</u>	<u>(182)</u>
<b>Income before income taxes</b> . . .	44,431	2	(2)	44,431
Income tax expense . . . . .	<u>5,840</u>	<u>—</u>	<u>—</u>	<u>5,840</u>
<b>Net Income from continuing operations</b> . . . . .	38,591	2	(2)	38,591
Net income from discontinued operations . . . . .	<u>6,757</u>	<u>—</u>	<u>—</u>	<u>6,757</u>
<b>Net income</b> . . . . .	45,348	2	(2)	45,348
Less net income attributable to non-controlling interests . . . . .	<u>227</u>	<u>—</u>	<u>(2)</u>	<u>225</u>
<b>Net income attributable to stapled unitholders</b> . . . . .	<u>\$ 45,121</u>	<u>2</u>	<u>—</u>	<u>\$ 45,123</u>

**Income Statement**

Six months ended June 30, 2013

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>Revenues</b> . . . . .	\$ 91,097			\$ 91,097
<b>Operating costs and expenses (income)</b>				
General and administrative . . . . .	13,071			13,071
Interest expense and other financing costs, net . . . . .	9,188			9,188
Other costs and expenses . . . . .	1,951			1,951
Share of (income) loss of Granite LP . . . . .	<u>—</u>	<u>(2)</u>	<u>2</u>	<u>—</u>
<b>Income before fair value changes, loss on sale of investment property, acquisition transaction costs, gain on Meadows holdback and income taxes</b> . . . . .	66,887	2	(2)	66,887
Fair value gains on investment properties, net . . . . .	23,152			23,152
Fair value losses on financial instruments . . . . .	(148)			(148)
Loss on sale of investment property . . . . .	(328)			(328)
Acquisition transaction costs . . . . .	(793)			(793)
Gain on Meadows holdback . . . . .	5,143			5,143
<b>Income before income taxes</b> . . . . .	93,913	2	(2)	93,913
Income tax recovery . . . . .	<u>(34,064)</u>			<u>(34,064)</u>
<b>Net Income from continuing operations</b> . . . . .	127,977	2	(2)	127,977
Net income from discontinued operations . . . . .	9,811			9,811
<b>Net income</b> . . . . .	137,788	2	(2)	137,788
Add net loss attributable to non-controlling interests . . . . .	<u>49</u>		<u>2</u>	<u>51</u>
<b>Net income attributable to stapled unitholders</b> . . . . .	<u>\$137,837</u>	<u>2</u>	<u>—</u>	<u>\$137,839</u>

**Statement of Cash Flows**

Three months ended June 30, 2014

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>OPERATING ACTIVITIES</b>				
Net income from continuing operations . . . . .	\$ 26,416	1	(1)	\$ 26,416
Items not involving current cash flows	12,991	(1)	1	12,991
Current income tax recovery . . . . .	(930)			(930)
Income taxes paid . . . . .	(2,026)			(2,026)
Interest expense . . . . .	6,404			6,404
Interest paid . . . . .	(13,072)			(13,072)
Changes in working capital balances from continuing operations . . . . .	<u>6,562</u>	<u>1,169</u>	—	<u>7,731</u>
<b>Cash provided by operating activities from continuing operations . . . . .</b>	<b>36,345</b>	<b>1,169</b>	<b>—</b>	<b>37,514</b>
Cash provided by operating activities from discontinued operations . . . . .	<u>17,123</u>	—	—	<u>17,123</u>
<b>Cash provided by operating activities . . . . .</b>	<b>53,468</b>	<b>1,169</b>	<b>—</b>	<b>54,637</b>
<b>INVESTING ACTIVITIES</b>				
Investment property capital additions . . . . .	(7,575)			(7,575)
Other investing activities . . . . .	(98)			(98)
Cash provided by investing activities from discontinued operations . . . . .	<u>109,538</u>	—	—	<u>109,538</u>
<b>Cash provided by investing activities . . . . .</b>	<b>101,865</b>	<b>—</b>	<b>—</b>	<b>101,865</b>
<b>FINANCING ACTIVITIES</b>				
Distributions paid . . . . .	(25,811)			(25,811)
Other financing activities . . . . .	3,698			3,698
<b>Cash used in financing activities . . . . .</b>	<b>(22,113)</b>	<b>—</b>	<b>—</b>	<b>(22,113)</b>
<b>Effect of exchange rate changes . . . . .</b>	<b>(4,300)</b>	<b>—</b>	<b>—</b>	<b>(4,300)</b>
<b>Net increase in cash and cash equivalents during the period . . . . .</b>	<b>\$128,920</b>	<b>1,169</b>	<b>—</b>	<b>\$130,089</b>

**Statement of Cash Flows**

Three months ended June 30, 2013

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>OPERATING ACTIVITIES</b>				
Net income from continuing operations . . . . .	\$ 38,919	1	(1)	\$ 38,919
Items not involving current cash flows	(9,283)	(1)	1	(9,283)
Current income tax expense . . . . .	5,835			5,835
Income taxes paid . . . . .	(9,046)			(9,046)
Interest expense . . . . .	4,585			4,585
Interest paid . . . . .	(8,631)			(8,631)
Changes in working capital balances from continuing operations . . . . .	<u>542</u>	<u>(134)</u>	—	<u>408</u>
<b>Cash provided by (used in) operating activities from continuing operations . . . . .</b>	<b>22,921</b>	<b>(134)</b>	<b>—</b>	<b>22,787</b>
Cash provided by operating activities from discontinued operations . . . . .	<u>2,238</u>	—	—	<u>2,238</u>
<b>Cash provided by (used in) operating activities . . . . .</b>	<b><u>25,159</u></b>	<b><u>(134)</u></b>	<b>—</b>	<b><u>25,025</u></b>
<b>INVESTING ACTIVITIES</b>				
Business acquisitions (net of cash acquired of \$375) . . . . .	(8,566)			(8,566)
Investment property capital additions . . . . .	(24,968)			(24,968)
Other investing activities . . . . .	<u>12,450</u>	—	—	<u>12,450</u>
<b>Cash used in investing activities . . . . .</b>	<b><u>(21,084)</u></b>	<b>—</b>	<b>—</b>	<b><u>(21,084)</u></b>
<b>FINANCING ACTIVITIES</b>				
Distributions paid . . . . .	(24,633)			(24,633)
Other financing activities . . . . .	<u>17,751</u>	—	—	<u>17,751</u>
<b>Cash used in financing activities . . . . .</b>	<b><u>(6,882)</u></b>	<b>—</b>	<b>—</b>	<b><u>(6,882)</u></b>
<b>Effect of exchange rate changes . . . . .</b>	<b><u>2,476</u></b>	<b>—</b>	<b>—</b>	<b><u>2,476</u></b>
<b>Net decrease in cash and cash equivalents during the period . . . . .</b>	<b><u>\$ (331)</u></b>	<b><u>(134)</u></b>	<b>—</b>	<b><u>\$ (465)</u></b>

## Statement of Cash Flows

Six months ended June 30, 2014

	Granite REIT	Granite GP	Eliminations/ Adjustments	Granite REIT and Granite GP Combined
<b>OPERATING ACTIVITIES</b>				
Net income from continuing operations . . . . .	\$ 38,591	2	(2)	\$ 38,591
Items not involving current cash flows . . . . .	37,121	(2)	2	37,121
Tenant allowance . . . . .	(37,769)			(37,769)
Current income tax expense . . . . .	1,350			1,350
Income taxes paid . . . . .	(3,601)			(3,601)
Interest expense . . . . .	13,114			13,114
Interest paid . . . . .	(13,660)			(13,660)
Changes in working capital balances from continuing operations . . . . .	(7,795)	1,329		(6,466)
<b>Cash provided by operating activities from continuing operations . . . . .</b>	<b>27,351</b>	<b>1,329</b>	<b>—</b>	<b>28,680</b>
Cash provided by operating activities from discontinued operations . . . . .	20,025			20,025
<b>Cash provided by operating activities . . . . .</b>	<b>47,376</b>	<b>1,329</b>	<b>—</b>	<b>48,705</b>
<b>INVESTING ACTIVITIES</b>				
Investment property capital additions . . . . .	(14,933)			(14,933)
Other investing activities . . . . .	20,414			20,414
Cash provided by investing activities from discontinued operations . . . . .	109,446			109,446
<b>Cash provided by investing activities . . . . .</b>	<b>114,927</b>	<b>—</b>	<b>—</b>	<b>114,927</b>
<b>FINANCING ACTIVITIES</b>				
Distributions paid . . . . .	(51,583)			(51,583)
Other financing activities . . . . .	(914)			(914)
<b>Cash used in financing activities . . . . .</b>	<b>(52,497)</b>	<b>—</b>	<b>—</b>	<b>(52,497)</b>
Effect of exchange rate changes . . . . .	(907)			(907)
<b>Net increase in cash and cash equivalents during the period</b>	<b>\$108,899</b>	<b>1,329</b>	<b>—</b>	<b>\$110,228</b>



**Statement of Cash Flows**

Six months ended June 30, 2013

	<u>Granite REIT</u>	<u>Granite GP</u>	<u>Eliminations/ Adjustments</u>	<u>Granite REIT and Granite GP Combined</u>
<b>OPERATING ACTIVITIES</b>				
Net income from continuing operations . . . . .	\$127,977	2	(2)	\$127,977
Items not involving current cash flows . . . . .	(64,855)	(2)	2	(64,855)
Current income tax expense . . . . .	5,972			5,972
Income taxes paid . . . . .	(10,891)			(10,891)
Interest expense . . . . .	8,811			8,811
Interest paid . . . . .	(8,813)			(8,813)
Changes in working capital balances from continuing operations . . . . .	(4,296)	5	—	(4,291)
<b>Cash provided by operating activities from continuing operations . . . . .</b>	<b>53,905</b>	<b>5</b>	<b>—</b>	<b>53,910</b>
Cash provided by operating activities from discontinued operations . . . . .	4,410	—	—	4,410
<b>Cash provided by operating activities . . . . .</b>	<b>58,315</b>	<b>5</b>	<b>—</b>	<b>58,320</b>
<b>INVESTING ACTIVITIES</b>				
Business acquisitions (net of cash acquired of \$375) . . . . .	(23,095)			(23,095)
Investment property capital additions . . . . .	(30,984)			(30,984)
Other investing activities . . . . .	13,585	—	—	13,585
<b>Cash used in investing activities . . . . .</b>	<b>(40,494)</b>	<b>—</b>	<b>—</b>	<b>(40,494)</b>
<b>FINANCING ACTIVITIES</b>				
Distributions paid . . . . .	(41,042)			(41,042)
Other financing activities . . . . .	33,850	—	—	33,850
<b>Cash used in financing activities . . . . .</b>	<b>(7,192)</b>	<b>—</b>	<b>—</b>	<b>(7,192)</b>
<b>Effect of exchange rate changes . . . . .</b>	<b>1,467</b>	<b>—</b>	<b>—</b>	<b>1,467</b>
<b>Net increase in cash and cash equivalents during the period</b>	<b>\$ 12,096</b>	<b>5</b>	<b>—</b>	<b>\$ 12,101</b>

**18. COMMITMENTS AND CONTINGENCIES**

- (a) In the ordinary course of business activities, the Trust may become subject to litigation and other claims brought by, among others, tenants, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to accurately estimate the extent of potential costs and losses, if any, management believes, but can provide

no assurance, that the ultimate resolution of such claims would not have a material adverse effect on the financial position of the Trust.

- (b) At June 30, 2014, the Trust’s contractual commitments related to construction and development projects amounted to approximately \$17.8 million.
- (c) At June 30, 2014, the Trust had commitments on non-cancellable operating leases requiring future minimum annual rental payments as follows:

Not later than 1 year . . . . .	\$ 432
Later than 1 year and not later than 5 years . . . . .	1,036
Later than 5 years . . . . .	<u>337</u>
	<u>\$1,805</u>

In addition, the Trust is committed to making annual payments under two ground leases for the land upon which two income-producing properties are situated of \$0.1 million and \$0.5 million to the years 2049 and 2096, respectively.

## 19. SUBSEQUENT EVENTS

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On July 3, 2014, Granite REIT Holdings Limited Partnership (“Granite LP”), a wholly owned subsidiary of the Trust, issued at par \$250.0 million of 3.788% Series 2 senior debentures due July 5, 2021 (the “2021 Debentures”). Interest on the 2021 Debentures is payable semi-annually in arrears on January 5 and July 5 of each year, commencing on January 5, 2015. The 2021 Debentures rank equally with all of the Trust’s existing and future unsubordinated and unsecured indebtedness and are guaranteed by Granite REIT and Granite GP.

On July 3, 2014, the Trust entered into a cross currency interest rate swap to exchange the 3.788% Canadian dollar interest payments from the 2021 Debentures to euro denominated payments at 2.68%. In addition, under the terms of the swap, the Trust will pay principal proceeds of euro 171.9 million for \$250.0 million on July 5, 2021.

On July 3, 2014, Granite LP issued a notice of redemption to the registered holders of the 2016 Debentures for redemption of all of the outstanding 2016 Debentures on August 5, 2014 (the “Redemption Date”). The 2016 Debentures have been redeemed for an aggregate redemption price of \$294.7 million, being the higher of the principal amount, and the Canada Yield Price calculated in accordance with the trust indenture governing the 2016 Debentures, together in each case with accrued and unpaid interest to the Redemption Date of \$2.0 million. The redemption price also included a redemption premium of \$27.7 million. The proceeds from the 2021 Debentures, together with other available funds, were used to redeem the 2016 Debentures.



## REIT Information

### Board of Trustees

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**G. Wesley Voorheis**  
*Chairman*

**Peter Dey**  
*Vice-Chairman*

**Michael Brody**  
*Trustee*

**Barry Gilbertson**  
*Trustee*

**Thomas Heslip**  
*Trustee*

**Gerald Miller**  
*Trustee*

**Scott Oran**  
*Trustee*

### Officers

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**Thomas Heslip**  
*Chief Executive Officer*

**Michael Forsayeth**  
*Chief Financial Officer*

**Jennifer Tindale**  
*Executive Vice President,  
General Counsel and Secretary*

**John De Aragon**  
*Executive Vice President,  
Real Estate Investment*

**Lorne Kumer**  
*Executive Vice President, Real Estate  
Portfolio and Asset Management*

**Stefan Wierzbinski**  
*Executive Vice President Europe*

### Office Location

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77 King Street West  
Suite 4010, P.O. Box 159  
Toronto-Dominion Centre  
Toronto, ON M5K 1H1  
Phone: (647) 925-7500  
Fax: (416) 861-1240

### Investor Relations Queries

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**Thomas Heslip**  
*Chief Executive Officer*  
(647) 925-7539

**Michael Forsayeth**  
*Chief Financial Officer*  
(647) 925-7600

### Transfer Agents and Registrars

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*Canada*  
Computershare Investor Services Inc.  
100 University Avenue, 8<sup>th</sup> Floor, North Tower  
Toronto, Ontario, Canada M5J 2Y1  
Phone: 1 (800) 564-6253  
www.computershare.com

*United States*  
Computershare Trust Company N.A.  
250 Royall Street  
Canton, Massachusetts, USA 02021

### Exchange Listings

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Stapled Units – Toronto Stock Exchange (GRT.UN) and New York Stock Exchange (GRPU)

Please refer to our website ([www.granitereit.com](http://www.granitereit.com)) for information on Granite's compliance with the corporate governance standards of the New York Stock Exchange and applicable Canadian standards and guidelines.

### Publicly Available Documents

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Copies of the financial statements for the year ended December 31, 2013 are available through the Internet on the Electronic Data Gathering Analysis and Retrieval System (EDGAR), which can be accessed at [www.sec.gov](http://www.sec.gov), and on the System for Electronic Document Analysis and Retrieval (SEDAR), which can be accessed at [www.sedar.com](http://www.sedar.com). Other required securities filings can also be found on EDGAR and SEDAR.

**GRANITE**  
**REIT**



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