2002

ANNUAL REPORT

KILLAM PROPERTIES INC.

CORPORATE **PROFILE**

Killam Properties Inc. is a publicly traded real estate company focused on the acquisition, re-development, and management of multi-family residential properties and manufactured home communities in the Provinces of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland. Killam's long-term strategy is to create and enhance shareholder value by becoming the dominant owner of residential real estate properties and manufactured home communities in Eastern Canada.

TABLE OF **CONTENTS**

The Annual General Meeting of Shareholders of Killam Properties Inc. will be held on Thursday, February 20, 2003, at 11:00 a.m. (Halifax time) at the offices of Stewart McKelvey Stirling Scales, Ste. 900, 1959 Upper Water St., Halifax, Nova Scotia. Shareholders who are unable to attend the Meeting are requested to complete and return the Instrument of Proxy to Computershare Trust Company of Canada, at their earliest convenience.

FINANCIAL **HIGHLIGHTS**

	2002 $	2001 $
Revenue	**1,460,392**	15,718
Net earnings	**83,443**	(46,305)
Funds from operations	**138,021**	(43,129)
Total assets	**20,136,098**	553,935
Long-term debt	**11,299,601**	--
Shareholders equity	**8,529,395**	541,743
Weighted average shares outstanding (000's)	**13,396,825**	4,750,000

Mission **Statement**

To increase shareholder value by becoming the dominant owner of multi-family residential properties. Because we value our employees and residents, and recognize that they are integral to achieving our mission, we endeavour to provide them with the following:

Our Employees

We will provide our employees with a challenging and fulfilling work environment that recognizes, attracts, and fosters motivated, high-performing team members.

Our Residents

We will set a standard of service excellence by providing our residents with a high-quality living environment and promptly addressing their needs with thoughtfulness and concern.

Report to **Shareholders**

On behalf of the Board of Directors, I am pleased to present the 2002 Annual Report, and review the first year in the life of Killam Properties Inc. as a publicly traded company. We have grown from a Capital Pool Company working to complete our Qualifying Transaction with assets of $553,935 to a publicly traded company with assets over $20,000,000 in 12 months.

Looking ahead, our goal is to grow our current portfolio of 311 units by a minimum of 1,000 units per year, with a long term target of more than 5,000 units within five years. To achieve our targets, we will need to strictly adhere to our business strategy and focus. To that end, we will concentrate our efforts on acquiring and managing multi-family residential properties that offer stable cash flow today with upside in the future. When considering potential acquisitions, we will focus on the anticipated cash flow from the asset to be acquired. Location, demographics and current and future competition will all be critical factors in such analysis.

As part of our stated objectives, we also intend to explore opportunities to acquire manufactured home communities in Atlantic Canada. These potential acquisitions will be driven by above average return considerations and opportunities to acquire manufactured home communities at a substantial discount to replacement cost.

We maintain and foster strong ties within the local real estate community, and are broadening our association with real estate agents, lenders, and lawyers to ensure, that when a property becomes available in our target market, Killam is the first party contacted. We are targeting both individual property opportunities, as well as portfolio acquisitions, and are closely examining additional adjacent markets in which to expand.

Killam now owns properties in Halifax, Nova Scotia, Moncton and Saint John, New Brunswick, and we are actively looking in Fredericton, New Brunswick and Charlottetown, Prince Edward Island, as well as our other target markets in Atlantic Canada for more acquisitions. Fundamentals for the multi-family rental sector in Atlantic Canada remain conducive to our strategy of growth through the accretive acquisition of apartment properties. Economic conditions are favourable, rental apartment markets remain tight, and capitalization rates are significantly greater than the cost of mortgage debt.

Report to **Shareholders**

The multi-family residential sector is no different than a lot of businesses. Long-term success is a function of the service you provide your customer. In our case, providing a quality service and environment for our tenants is our business and is a top priorty. We are in the process of developing a number of innovative programs and initiatives designed to enhance our residents' comfort, security and peace of mind. All new tenants of Killam, whether in currently owned properties or those newly acquired, receive a welcome letter that includes our representative's name and telephone number to ensure that any concerns are answered quickly and effectively. We are in the process of developing a web based newsletter that will be available to the public and all of our residents on line. In addition, our website provides tips on fire safety, home security and other residential services. Satisfied tenants will have a greater preference to remain in a Killam building, which will keep apartment refurbishment and tenant inducement costs low.

During the past year, we were successful in completing our qualifying transaction prospectus financing and two private placement financings which in total raised over $7,750,000. The fact that we were able to raise the funds during the infancy of Killam is a testament to our management team and board of directors.

I would like to acknowledge our three new board members this year: Mr. Robert Kay, Mr. George Reti and Mr. Barry Reichmann, and would like to recognize and thank the entire board of directors for the tremendous support and committment each one has shown throughout the year.

In closing, I would like to thank our loyal shareholders for their support of Killam Properties Inc. Killam is a vibrant company that is well positioned to take advantage of the opportunities in the Canadian multi-family market, and we are poised for strong growth in 2003.

Philip Fraser
President and CEO

Corporate **Highlights 2002:**

February 22

- Completed Qualifying Transaction and Prospectus Offering of $1,582,966 at $.30 per share

Acquired:
- Cambridge Court, Moncton, N.B. – 45 units
- Cambridge Place, Moncton, N.B. – 63 units
- 75 Knightsridge, Halifax, N.S. – 41 units

March 8

- Common shares resumed trading on the TSX Venture Exchange

June 28

- Completed Private Placement of $422,000 at $.30 per share

August 15

Acquired:
- Carleton Towers, Saint John, N.B. – 60 units

November 20

- Completed Private Placement of $5,750,000 at $.50 per share

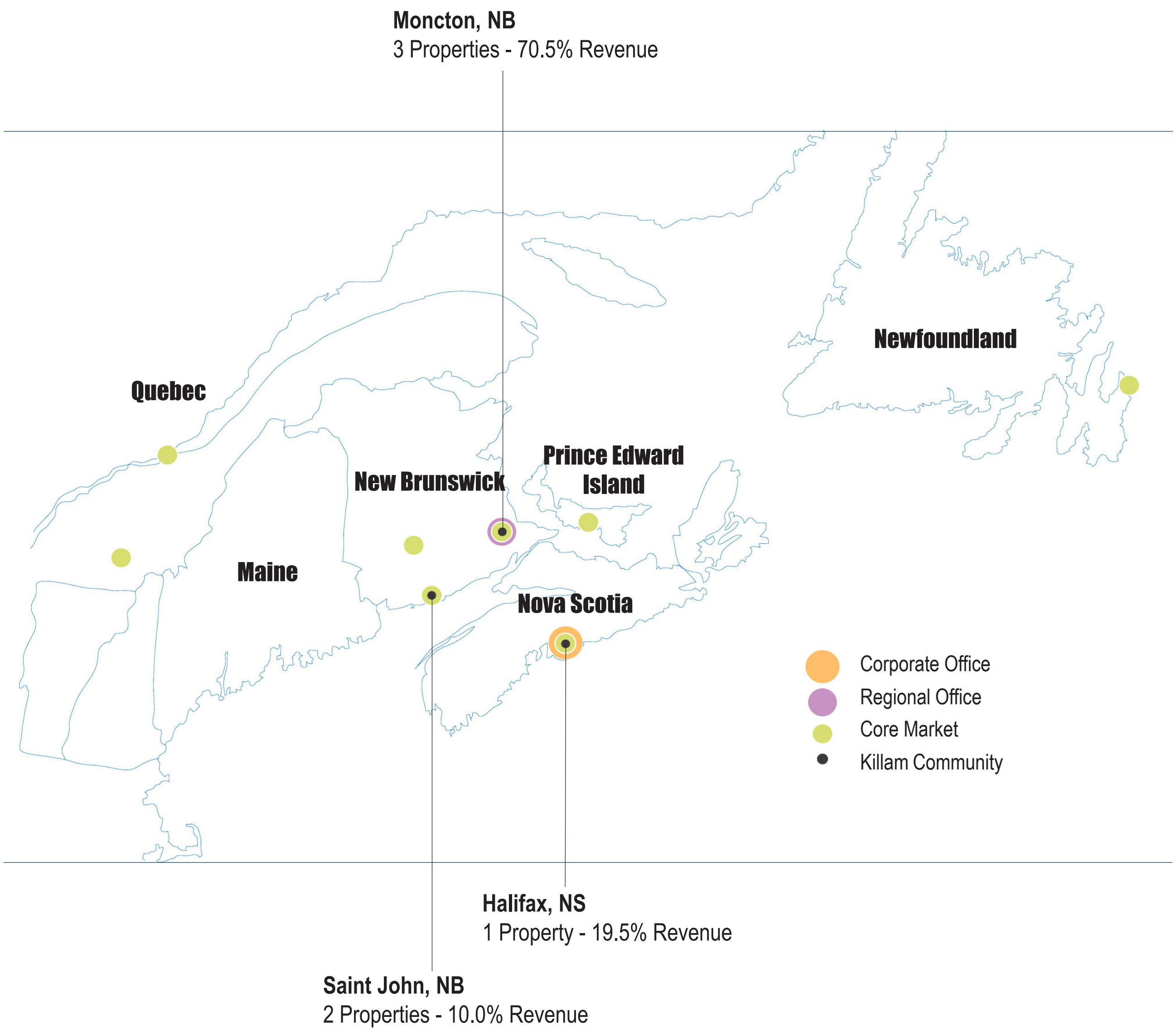
---

December 31

Acquired:
- Lakeview Estates, Moncton, N.B. – 48 units
- Sydney Arms, Saint John, N.B. – 54 units

311 Wholly Owned Apartment Units in **6 Apartment Communities**

% Revenue is the location's contribution to the 2002 Revenue



Killam Community **Portfolio**

Date Purchased 2/22/02
Average Rent $770

A four storey, 45 unit luxury apartment complex located within a residential neighbourhood featuring underground parking

CAMBRIDGE COURT
10 Brookside Drive, Moncton, NB

Date Purchased 2/22/02
Average Rent $944

A four storey, 63 unit luxury apartment complex located within the Central Business District offering underground parking and seven appliances

CAMBRIDGE PLACE
40 Weldon Street, Moncton, NB

Date Purchased 2/22/02
Average Rent $662

A four-level, 41 unit apartment complex located in Halifax's fastest growing residential community within close proximity to universities, shopping, schools and more

75 KNIGHTSRIDGE
75 Knightsridge Drive, Halifax, NS

Killam Community **Portfolio**

Date Purchased 08/15/02
Average Rent $536

A seven-storey, 60-unit concrete constructed apartment complex offering underground parking, waterfront & downtown views, and close proximity to all amenities

CARLETON TOWERS
15 Mecklenburg Street, Saint John, NB

Date Purchased 12/31/02
Average Rent $558

A six-storey, 54-unit concrete constructed apartment complex offering underground parking, waterfront & downtown views, and close proximity to all amenities.

SYDNEY ARMS
111 Sydney Street, Saint John, NB

Date Purchased 12/31/02
Average Rent $540

A 48 unit complex containing three 16 unit buildings. Located within close proximity to the Central Business District and all amenities.

LAKEVIEW ESTATES
1630-36-40 Main Street, Moncton, NB

Managements' Discussion and **Analysis**

Overview

Killam Properties Inc. ("Killam") is a publicly traded real estate company focused on the acquisition, re-development and management of multi-family residential properties and manufactured home communities in Atlantic Canada. Killam's plan is to increase shareholder value by becoming the dominant owner of multi-family residential properties and manufactured home communities, thereby growing earnings. Our employees and tenants are integral to achieving our mission. We endeavour to provide our employees with a challenging and fulfilling work environment that recognizes, attracts, and fosters motivated, high-performing team members. For our tenants, we will provide a high-quality living environment and promptly address their needs with thoughtfulness and concern.

Background and History

Killam was incorporated on May 26, 2000 under the Canada Business Corporations Act. On October 26, 2000, Killam filed a prospectus in the Provinces of Alberta and British Columbia and made an initial public offering. On December 21, 2000, Killam's shares were listed and posted for trading on the TSX Venture Exchange as a Capital Pool Company. On November 21, 2001, Killam's shareholders approved its Qualifying Transaction, which was completed on February 22, 2002. On March 7, 2002, the TSX Venture Exchange issued its Final Exchange Notice, at which time, Killam ceased being a Capital Pool Company and resumed trading on March 8, 2002.

Acquisitions

Between February 22, 2002 and December 31, 2002 Killam acquired six properties totaling 311 units as described below:

Location	**Purchase Date**	**Units**	**Purchace Price**	**Occupancy** (as at Dec31/02)
Moncton, New Brunswick				
Cambridge Court	February 22, 2002	45	$2,500,000	100%
Cambridge Place	February 22, 2002	63	$5,250,000	98.3%
Lakeview Estates	December 31, 2002	48	$1,900,000	100%
Halifax, Nova Scotia				
75 Knightsridge Drive	February 22, 2002	41	$2,150,000	100%
Saint John, New Brunswick				
Carleton Towers	August 15, 2002	60	$2,025,000	92%
Sydney Arms	December 31, 2002	54	$1,775,000	96%

Managements' Discussion and **Analysis**

Cambridge Court and Cambridge Place were purchased by the assumption of existing first mortgages totaling $5,337,712, the creation of two new vendor take-back second mortgages in the aggregate amount of $700,000, $1,012,288 cash, and the issuance of 2,333,333 common shares in the capital of Killam at $0.30 per share.

75 Knightsridge Drive was purchased using cash and proceeds from a new first mortgage financing of approximately $1,612,500.

Carleton Towers was purchased by the assumption of the existing first mortgage of approximately $1,562,000, $333,000 cash, and the issuance of 216,667 common shares in the capital of Killam at $0.60 per share.

Sydney Arms was purchased using cash and the assumption of the existing first mortgage of approximately $683,000. Killam's management intends to re-finance this property in the near future.

Lakeview Estates was purchased using $375,000 in cash, together with proceeds from a new first mortgage financing of $1,425,000 and the creation of a new vendor take-back second mortgage of $100,000.

Operating Results

Revenue

Gross revenues for the year ending December 31, 2002 were $1,460,392 compared to fiscal 2001 of $15,718 and consisted of rental income, interest income and other income. Revenues from rental operations totaled $1,445,926 in fiscal 2002 compared to $nil in fiscal 2001. Interest income was $8,470 in fiscal 2002 compared to $15,718 in fiscal 2001. Other income in fiscal 2002 was $5,996 compared to $nil in fiscal 2001.

None of the properties contributed to revenues for the full year. The number of months that each property did contribute to revenues is noted below.

Property	Number of Months Contributed to Revenues
Cambridge Court	10.2 months
Cambridge Place	10.2 months
75 Knightsridge Drive	10.2 months
Carleton Towers	4.5 months
Sydney Arms	0 months (purchased Dec. 31, 2002)
Lakeview Estates	0 months (purchased Dec. 31, 2002)

Managements' Discussion and **Analysis**

Funds from Operations

Funds from operations were $138,021 in fiscal 2002 compared to $(43,129) in fiscal 2001. The increase in funds from operations is due to the six acquisitions throughout the year.

Operating Expenses

Operating expenses were $574,983 in fiscal 2002 compared to $nil in fiscal 2001. Operating expenses include property taxes, utilities, salaries and benefits for employees at the property level, repairs and maintenance, insurance and advertising. Management will focus on reducing operating expenses through economies of scales in the purchase of materials and services, the installation of energy efficiency devices, and employment of skilled and dedicated people to manage and maintain Killam's properties.

General and Administrative Expenses

General and administrative expenses include all corporate and administrative expenses not allocated to the individual properties. Corporate administrative expense covers reporting costs, management salaries and benefits, and other related expenses. General and administrative expense in fiscal 2002 was $201,145 compared to $46,721 in fiscal 2001. Salaries for head office employees accounted for $120,047 out of the $201,145 of general and administrative expense in 2002. Salaries expense in the fourth quarter was up 28% over the third quarter period due to new employee hiring with the anticipated purchase of additional properties, and an increased workload in connection with the fourth quarter equity private placement.

Financing Cost Expense

Interest expense on the Corporation's debt totaled $445,908 in fiscal 2002 compared to $0 in fiscal 2001. All of the interest expense corresponds directly to the increase in the long-term debt held by Killam as of December 31, 2002.

Amortization Expense

Amortization in fiscal 2002 was $72,578 compared to $3,176 in fiscal 2001. The increase in the amortization expense of buildings and other assets is the result of Killam's six acquisitions.

Professional Fees

Professional fees for fiscal 2002 were $31,606 compared to $12,126 for fiscal 2001. Approximately $23,000 in professional fees were expensed in the fourth quarter, up substantially over the first three quarters of the year.

Managements' Discussion and **Analysis**

Provision for Income Taxes

The Corporation follows section 3465 of the Canadian Institute of Chartered Accountants (CICA) Handbook regarding accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the estimated tax recoverable or payable which would arise if assets and liabilities were recovered and settled at the financial statement carrying amounts. Future tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Changes to these balances are recognized in income in the period in which they occur. Future income tax assets and liabilities have been reflected in this year's financial statements.

Killam has accumulated loss carryforwards for income tax purposes of approximately $7,000 which will expire in 2008. Approximately $47,000 of these losses has been utilized for tax purposes and used to reduce current income taxes payable. Any future benefit will be recorded as a reduction of income expense in the year of utilization.

Selected Quarterly Information

The following is a summary of financial information of Killam for the year ended December 31, 2002 and December 31,2001:

		Quarterly results		
	Dec. 31/02 Audited	Sep. 30/02 Unaudited	Jun. 30/02 Unaudited	Mar. 31/02 Unaudited
Total Revenue	1,460,392	425,757	381,875	159,406
Net Income	83,443	43,343	26,495	36,200
Net Income per Share	.0062	.0038	.0026	.0045
Total Assets	20,136,098	12,396,045	10,748,055	10,406,851
Shareholder's Equity	8,529,395	3,140,767	2,967,423	2,517,612

	Dec. 31/01 Audited	Sep. 30/01 Unaudited	Jun. 30/01 Unaudited	Mar. 31/01 Unaudited
Total Revenue	15,718	3,261	4,924	5,856
Net Income	(46,305)	(8,268)	(4,428)	(8,833)
Net Income per Share	(.0100)	(.0017)	(.0009)	(.0019)
Total Assets	553,935	566,772	580,413	591,153
Shareholder's Equity	541,743	566,518	574,786	579,153

Managements' Discussion and **Analysis**

Investor Relations

Personnel employed directly by Killam handle all investor relations. The duties include news releases, investor communications and general day to day operations.

Legal Proceedings

There are no legal proceedings.

Contingent Liabilities

In the opinion of management of Killam, there are no present contingent liabilities.

Market for Securities

Killam's common shares are listed and posted for trading on the TSX Venture Exchange under the trading symbol "KMP".

Regulatory Approval Requirement for Significant Transactions

All regulatory approvals have been obtained with regards to issuance of common shares during 2002.

Net Income and Funds from Operations Per Share

Net Income and funds from operations per share were calculated based on the weighted average number of common shares outstanding during the reporting period. For the year ended December 31, 2002, the per share amounts were calculated based on a weighted average of 13,396,825 common shares outstanding.

Capital Structure and Liquidity

Killam's plan is to ensure it has sufficient capital consisting of mortgage debt, other debt instruments, and equity in order to allow for continued growth to meet its business plan.

Killam issued common share capital in 2002, as noted below:

Number of Shares Issued	Issue Price	Date	Use of Proceeds
7,609,887	$0.30	February 22, 2002	Completion of Qualifying Transaction
200,000	$0.20	June 3, 2002	General corporate purposes
1,406,666	$0.30	June 28, 2002	General cororate purposes
216,667	$0.60	August 15, 2002	Acquire additional properties
11,500,000	$0.50	November 20, 2002	Acquire additional properties
527,564	$0.30	December 10, 2002	General corporate purposes

Managements' Discussion and **Analysis**

Shareholders' Equity

Shareholders' equity was $8,529,395 at the end of fiscal 2002, compared to $541,743 at the end of fiscal 2001.

Liquidity

The Corporation had $4,101,874 in cash or cash equivalents at the end of fiscal 2002, compared to $238,902 at the end of fiscal 2001. The Corporation believes that outside sources for debt and additional equity capital, if needed, will be available to finance additional properties. The form of any financing will vary depending upon prevailing market and other conditions, and may include short or long term borrowings from financial institutions, or the issuance of additional equity or debt securities. However, there can be no assurances that funds will be available on terms acceptable to the Corporation and its actions with respect to these activities will be guided accordingly.

Dividend Policy

Killam currently intends to retain earnings to finance the expansion of its business and does not anticipate paying dividends in the foreseeable future. Management and Killam's board of directors will review this policy annually, or more frequently, if required.

Risk Management

Typical of real estate companies, Killam is exposed to numerous business risks in the normal course of its business. These risks can impact the company's performance. Major risk categories are:

Credit Risk Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease term commitments. With a diverse base of revenue, the possibility of a tenant default causing severe financial hardship to Killam is minimal. Thorough credit assessments are conducted with respect to all new leasing. Killam also obtains, where possible, a security deposit to assist in potential recovery requirements.

Interest Rate Risk Interest rate risk is minimized through management's periodic review of its mortgage portfolio. If market conditions warrant, Killam will re-negotiate its existing debt to take advantage of lower interest rates. Killam will also structure its debt so as to stagger the debt maturities, thereby, minimizing its exposure to interest rate fluctuations.

Managements' Discussion and **Analysis**

Outlook

Killam achieved significant growth in 2002. Killam will continue to focus on acquiring solid performing assets as a means of realizing its goals for its shareholders. The main elements to achieving Killam's corporate objectives are maximizing the value of its portfolio and investing in properties where value can be unlocked.

Vacancy rates in our markets remain low, rents are rising, and operating economics are being achieved on newly acquired properties. We will continue to make strides to be considered one of the leaders in property operations within our market and will continue to strive towards this goal in 2003.

We stated in our 2002 third quarter report to shareholders that, based solely on Killam's then existing portfolio, we anticipated funds from operations for the fourth quarter to be in the range of \$.0065 to \$.0075 per share or to be a minimum of \$91,898. Funds from operations for the fourth quarter before large corporation tax were \$58,381. An increase in professional fees and general and administrative expense during the fourth quarter contributed to this difference. A large portion of the increase in general and administrative expense was attributable to salaries in connection with the private placement and property acquisitions. The majority of the large corporation tax payable this year is attributable to the substantial increase in Killam's asset base (62% increase in the fourth quarter).

Management is very confident that it will be able to continue to grow Killam's asset base, thereby increasing earnings and shareholder value.

Management's **Report**

To the Shareholders of
Killam Properties Inc.

The accompanying financial statements and all information in the Annual Report are the responsibility of management. The financial statements have been prepared by management in accordance with the accounting policies in the notes to financial statements. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the financial statements.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded, and financial records properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting, which responsibility it carries out principally through its Audit Committee.

The Audit Committee is appointed by the Board and the majority of the members of the Audit Committee are independent directors. The committee meets periodically with management to satisfy itself that it has properly discharged its responsibilities, and to review the financial statements. The committee reports its findings to the Board of Directors for consideration when approving the financial statements for issuance to the shareholders.

Philip Fraser
President and CEO

Robert Richardson, CA
Vice-President and CFO

January 10, 2003

Auditors' **Report**

To the Shareholders of
Killam Properties Inc.

We have audited the balance sheet of **Killam Properties Inc.** as at December 31, 2002 and 2001 and the statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Halifax, Canada
January 6, 2003

Chartered Accountants

Balance Sheet

As at December 31

	2002 $	2001 $
ASSETS		
Capital assets *[notes 4 and 5]*	**15,864,201**	18,285
Cash and cash equivalents *[note 3]*	**4,101,874**	238,902
Accounts receivable	**3,055**	11,964
Prepaid expenses	**15,007**	—
Refundable deposits	**11,000**	—
Future income taxes *[note 8]*	**27,000**	—
Deferred costs	**113,961**	284,784
	20,136,098	553,935
LIABILITIES AND SHAREHOLDERS' EQUITY		
Long-term debt *[note 5]*	**11,057,870**	—
Accounts payable and accrued liabilities	**213,415**	12,192
Income taxes payable	**68,729**	—
Current portion of long-term debt *[note 5]*	**241,731**	—
Security deposits	**15,958**	—
Future income taxes *[note 8]*	**9,000**	—
	11,606,703	12,192
Shareholders' Equity		
Capital stock *[note 6]*	**8,500,390**	596,181
Retained earnings (deficit)	**29,005**	(54,438)
	8,529,395	541,743
	20,136,098	553,935

See accompanying notes

On behalf of the Board

G. W. Watson

G. Wayne Watson
Director

Philip Fraser

Philip D. Fraser
Director

Statement of Income and **Retained Earnings**

For the year ended December 31

	2002 $	2001 $
Revenue		
Rental income	**1,445,926**	—
Interest income	**8,470**	15,718
Other income	**5,996**	—
	1,460,392	15,718
Expenses		
Property operating expenses	**574,983**	—
Financing costs	**445,908**	—
General and administrative expenses	**201,145**	46,721
Amortization	**72,578**	3,176
Professional fees	**31,606**	12,126
	1,326,220	62,023
Income (loss) before income taxes	**134,172**	(46,305)
Provision for income taxes *[note 8]*		
Current	**(68,729)**	—
Future	**18,000**	—
Net income (loss)	**83,443**	(46,305)
Deficit, beginning of year	**(54,438)**	(8,133)
Retained earnings (deficit), end of year	**29,005**	(54,438)
Net Income (loss) per share *[note 9]* - basic	**$0.0062**	($0.01)
- diluted	**$0.0056**	($0.01)

See accompanying notes

Statement of **Cash Flows**

For year ended December 31

	2002 **$**	2001 $
OPERATING ACTIVITIES		
Net income (loss)	**83,443**	(46,305)
Add items not affecting cash		
Amortization	**72,578**	3,176
Future income taxes	**(18,000)**	—
Funds from operations	**138,021**	(43,129)
Net change in non-cash working capital items related to operations	**268,812**	(19,709)
Cash provided by (used in) operating activities	**406,833**	(62,838)
FINANCING ACTIVITIES		
Decrease (increase) in deferred financing costs	**170,823**	(284,784)
Issue of common shares (net of issue costs)	**5,835,176**	—
Repayment of long-term debt	**(127,132)**	—
Issuance of long-term debt	**11,426,733**	—
Cash provided by (used in) financing activities	**17,305,600**	(284,784)
INVESTING ACTIVITIES		
Purchase of capital assets	**(13,849,461)**	(19,610)
Cash used in investing activities	**(13,849,461)**	(19,610)
Net increase (decrease) in cash and cash equivalents	**3,862,972**	(367,232)
Cash and cash equivalents, beginning of year	**238,902**	606,134
Cash and cash equivalents, end of year	**4,101,874**	238,902
Cash interest received	**—**	15,718
Cash interest paid	**399,322**	—

See accompanying notes

Notes to Financial **Statements**
- December 31, 2002 and 2001

1. Incorporation

Killam Properties Inc. (the "Company") is a real estate corporation specializing in the acquisition and rental of multi-residential buildings.

The Company was incorporated on May 26, 2000 under the Canada Business Corporations Act. On October 26, 2000, the Company filed a prospectus and made an initial public offering. The Company's common shares were listed and posted for trading on the TSX Venture Exchange (the "Exchange") on December 21, 2000 where the Company was established and organized as a Capital Pool Company pursuant to Policy 2.4. On November 21, 2001 the shareholders of the Company approved the Qualifying Transaction. On February 22, 2002 the Company closed its share offering and closed the Qualifying Transaction. On March 7, 2002 the Exchange issued its final exchange notice and the Company ceased being a Capital Pool Company.

2. Summary of Significant Accounting Policies

Basis of presentation
These financial statements have been prepared by management in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies and in accordance with Canadian generally accepted accounting principles.

Cash and cash equivalents
Cash and cash equivalents consist of cash, restricted cash, and short-term investments. Short-term investments consist of short-term monetary investments with maturities not exceeding 3 months and are recorded at the lower of cost or fair market value. The effective interest rate on these investments is 0.85%.

Revenue recognition
Revenue from rental properties is recognized when a tenant commences occupancy of a rental suite and rent is due. The Company retains all of the benefits and risks of ownership of its rental properties and therefore accounts for leases with its tenants as operating leases. Rental revenue includes rent, parking and other sundry revenues.

Capital assets
Revenue producing real estate properties held as ongoing investments are stated at cost less accumulated amortization. Cost includes all expenditures incurred in connection with the acquisition of real estate property including all direct costs. All costs associated with upgrading the existing facilities, other than ordinary repairs and maintenance, are capitalized and amortized as improvements.

Notes to Financial **Statements**
- December 31, 2002 and 2001

2. Summary of Significant Accounting Policies (continued)

Amortization
Capital assets are amortized at rates designed to amortize the cost of the properties over their useful lives as follows:

Buildings	5%	sinking fund, 40 years
Parking lots	8%	declining balance
Suite renovations	20%	declining balance
Project improvements	10%	declining balance
Appliances	10%	declining balance
Equipment	20%	declining balance
Computer software	100%	declining balance
Computer hardware	30%	declining balance

The Company utilizes the sinking fund method of amortization for its buildings. The sinking fund method charges amortization to income at an amount which increases annually, consisting of a fixed annual sum together with a factor compounded at the rate of 5% per annum so as to fully amortize the buildings over their estimated useful lives of 40 years.

Deferred costs
Financing fees and other costs incurred in connection with debt financing are amortized on a straight-line basis over the term of such financing.

Income taxes
The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates and laws that are expected to be in effect in the periods in which the future tax assets and liabilities are expected to be realized or settled. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

Use of accounting estimates
The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Financial instruments
The difference between the carrying amounts and the fair market values of the Company's primary financial instruments are not material due to the short-term maturities and or the credit terms of those instruments.

Notes to Financial **Statements**

- December 31, 2002 and 2001

2. Summary of Significant Accounting Policies (continued)

Risk management

The Company is exposed to financial risk that arises from, among other factors, fluctuation in interest rates and the credit quality of its tenants. These risks are managed as follows:

(i) Interest rate risk

Interest rate risk is minimized through management's periodic review of its mortgage portfolio. If market conditions warrant, the Company will renegotiate its existing debt to take advantage of lower interest rates. The Company will also structure its debt so as to stagger the debt maturities, thereby minimizing the Company's exposure to interest rate fluctuations.

(ii) Credit risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease term commitments. The Company mitigates the risk of credit loss through the diversification of its existing portfolio and limiting its exposure to any one tenant. Thorough credit assessments are conducted with respect to all new leasing and the Company also obtains a security deposit to assist in potential recovery requirements.

Stock options

During the year, the Company adopted the new Canadian Institute of Chartered Accountants, Handbook Section 3870, *Stock-Based Compensation and Other Stock-Based Payments.*

The Company has established a stock-based compensation plan, which is a common share option plan granting options at no less than the trading value of the Company's common shares at the date of granting such options to certain employees, directors and officers. As permitted by the new recommendations, no compensation expense is recognized for this plan when stock options are issued. However, as required by the new recommendations, the Company discloses pro-forma net income and pro-forma net income per share amounts using the fair market value method of accounting for stock based compensation awards. This pro-forma information is presented in note 7. Any consideration paid on exercise of stock options is recorded as an increase in share capital. These new requirements caused no impact on earnings.

Net Income per share

During 2001, the Company adopted the new accounting recommendations for reporting net income per share. Diluted net income per share is calculated using the treasury stock method which recognizes the use of proceeds that could be obtained upon exercise of stock options. This method assumes that any proceeds would be used to purchase common shares at the average market price during the period.

Notes to Financial Statements
- December 31, 2002 and 2001

3. Cash and Cash Equivalents

	2002 $	2001 $
Cash	**3,510,025**	238,902
Restricted cash	**183,379**	—
Short-term investments	**408,470**	—
	4,101,874	238,902

Restricted cash includes deposits on real estate properties and property tax reserves.

4. Capital Assets

	2002		
	Cost $	Accumulated Amortization $	Net Book Value $
Land	**1,575,865**	**—**	**1,575,865**
Buildings	**14,206,798**	**44,858**	**14,161,940**
Other capital assets	**157,619**	**31,223**	**126,396**
	15,940,282	**76,081**	**15,864,201**

	2001		
	Cost $	Accumulated Amortization $	Net Book Value $
Other capital assets	21,788	3,503	18,285
	21,788	3,503	18,285

5. Long-Term Debt

Mortgages payable bear interest at fixed rates from 5.924% to 7.50% with maturity dates ranging from May 2004 to January 2008. All mortgages are secured by a first or second charge on the revenue producing real estate properties of the Company.

Principal repayments of mortgages are due as follows:

Year	2003	**$ 241,731**
	2004	**6,036,773**
	2005	**1,592,440**
	2006	**106,073**
	2007	**2,040,986**
	Thereafter	**1,281,598**
		11,299,601
Less: current portion		**241,731**
		$11,057,870

Notes to Financial **Statements**
- December 31, 2002 and 2001

6. Capital Stock

Authorized:
Unlimited number of common shares
Unlimited number of preferred shares, issuable in series

	Number of Shares	Amount
Balance as at December 31, 2001	**4,750,000**	**$ 596,181**
Issued during the year		
For cash:		
June 28, 2002	**1,406,666**	**422,000**
Less share issue costs		**(38,681)**
November 20, 2002	**11,500,000**	**5,750,000**
Less share issue costs		**(495,369)**
On property acquisition:		
February 22, 2002	**7,609,887**	**2,282,966**
Less share issue costs		**(343,297)**
August 15, 2002	**216,667**	**130,000**
Less share issue costs		**(636)**
Shares issued upon exercise of warrants:		
June 3, 2002	**200,000**	**40,000**
December 10, 2002	**527,564**	**158,296**
Less share issue costs		**(1,070)**
Balance as at December 31, 2002	**26,210,784**	**$8,500,390**

As of December 31, 2002, there are a total of 3,831,250 (2001 – 2,750,000) common shares held under escrow agreements dated October 26, 2000, and February 22, 2002. The above escrow agreements cover common shares that are eligible for release over the next 36 months from the completion date of the major transaction, which occurred on February 22, 2002.

During the year, $197,226 was credited to share capital in respect to warrants exercised by investment dealers.

7. Stock Based Compensation

Under the terms of the stock option plan:

(i) the Company designates from time to time eligible participants to whom options will be granted, and the number of shares to be optioned to each;
(ii) eligible participants are persons who are employees, officers, directors and consultants of the Company;

Notes to Financial **Statements**

- December 31, 2002 and 2001

7. Stock Based Compensation (continued)

(iii) shares to be optioned shall not exceed the aggregate number of 2,525,000 and the total number of shares to be optioned to any eligible participant shall not exceed 10% of the issued and outstanding shares of the class as at the date such option is granted;

(iv) the option price for the shares is determined at the time of granting of the option but cannot be less than the fair market value of the shares at the time the option is granted less any applicable discount permitted by the Exchange; and

(v) the term during which any option granted may be exercised is determined by the Company at the time the option is granted but may not exceed the maximum period permitted from time to time by the Exchange

Options granted and exercised are as follows:

	2002		2001	
	Number of Shares	**Exercise Price $**	**Number of Shares**	**Exercise Price $**
Outstanding, beginning of year	**475,000**	**.20**		
Granted			475,000	**.20**
- May 27, 2002	**698,000**	**.30**		
- June 10, 2002	**162,500**	**.30**		
- November 20, 2002	**791,000**	**.50**		
Outstanding, end of year	**2,126,500**		475,000	.20

The following table summarizes the stock options outstanding at December 31, 2002 and 2001:

	2002		2001	
Exercise prices	**Number of Shares**	**Remaining Contractual Life**	**Number of Shares**	**Remaining Contractual Life**
$ .20	**475,000**	**2.95 years**	475,000	3.95 years
$ .30	**698,000**	**4.40 years**		
$ .30	**162,500**	**4.44 years**		
$ .50	**791,000**	**1.91 years**		
	2,126,500		475,000	

Notes to Financial **Statements**
- December 31, 2002 and 2001

7. Stock Based Compensation (continued)

The table below presents pro-forma net income, basic net income per share and diluted net income per share using the fair market value method of accounting for stock-based compensation. The pro-forma adjustments presented below pertain to new awards granted since adoption of the new recommendations of accounting for stock-based compensation on January 1, 2002 as described in note 2.

For the period ended December 31, 2002 (thousands of dollars except per share amounts)		
Pro-forma net income applicable to common shares:		
Reported net income	$	83,443
Pro-forma adjustments		25,255
Pro-forma net income applicable to common shares		58,188
Reported basic net income per share:		0.0062
Average number of common shares outstanding		13,396,825
Pro-forma earnings per share	$	0.004
Reported diluted net income per share:		0.0056
Average number of common shares outstanding		13,396,825
Impact of outstanding stock options		1,602,647
		14,999,472
Pro-forma net income per share	$	0.004

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants:

Expected volatility	0.884 %
Risk-free interest rate	4.30 – 4.9 %
Expected lives	1-5 years
Expected dividend yield	nil

Notes to Financial **Statements**
- December 31, 2002 and 2001

8. Income Taxes

The Company has accumulated non-capital loss carryforwards for income tax purposes of approximately $7,000 which expire in 2008. The benefit of these losses has not been recorded for accounting purposes. Any future benefit will be recorded as a reduction of income tax expense in the year utilization becomes more likely than not.

The income tax provisions differ from that computed using the statutory rates for the following reasons:

	2002 $	%	2001 $
Net income (loss) before taxes	**134,172**		(46,305)
Income taxes, at statutory rates	**54,876**	40.9	
Large Corporations Tax	**68,729**	51.2	
Other permanent differences	**(25,876)**	(19.3)	
Benefit of non-capital losses carried forward	**(47,000)**	(35.0)	
	50,729	37.8	
Consists of:			
Provision for income taxes – current	**68,729**	–	
Provision for income taxes – future	**(18,000)**		
	50,729		

Future income taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future income tax assets and liabilities are as follows:

	2002 $	2001 $
Future income tax assets		
Property, plant and equipment	**27,000**	–
Future income tax liabilities		
Deferred charges	**(9,000)**	–
Net future income tax asset	**18,000**	–

9. Per Share Information

Net income (loss) per share has been calculated based on the weighted average number of shares outstanding of 13,396,825 for 2002 and 4,750,000 for 2001.

10. Comparative Figures

Certain comparative financial information has been reclassified to conform to the presentation adopted for 2002.

Board of **Directors**

Timothy R. Banks, Charlottetown, Prince Edward Island   Mr. Banks is President and owner of the APM Group of Companies, and has extensive experience in the construction, development and management of retail, industrial and residential real estate throughout Atlantic Canada.

Philip D. Fraser, Halifax, Nova Scotia   Mr. Fraser is President and Chief Executive Officer of Killam Properties Inc. Mr. Fraser was formerly the Chief Financial Officer and Vice President of Pacrim Developments Inc., a real estate development company.

Robert G. Kay, Moncton, New Brunswick   Mr. Kay is Chairman of Springwall Group International and of Springwall Sleep Products, Inc., one of Canada's largest mattress manufacturers. Mr. Kay is a past board member of the Canadian Federation of Independent Business.

James C. Lawley, Halifax, Nova Scotia   Mr. Lawley is General Manager of Scotia Fuels Ltd., a residential fuel oil supplier based in Halifax, and also co-owns a number of apartment buildings and operating businesses throughout Atlantic Canada.

Arthur G. Lloyd, Calgary, Alberta   Mr. Lloyd is President and Chief Operating Officer of TGS North American REIT in Calgary, Alberta which is currently listed on the TSX. Mr. Lloyd was formerly a Senior Vice President with TrizecHahn Corporation.

Barry Reichmann, Toronto, Ontario   Mr. Reichmann is President, Co-Chief Executive Officer and a Trustee of Retirement Residences Real Estate Investment Trust, Canada's largest provider of senior care and accommodation and is listed on the TSX. Mr. Reichmann is also a Trustee of IPC US Income Commercial Real Estate Investment Trust and a Trustee of Firm Capital Mortgage Investment Trust, both listed on the TSX.

George J. Reti, Calgary, Alberta   Mr. Reti has more than 29 years of real estate experience, and is a former Executive Vice President and Director of Boardwalk Equities Inc. Currently, he is involved in real estate development projects in Western Canada, and providing independant consulting services in the commercial and residential real estate markets for private and public companies, as well as governmental institutions. Mr. Reti currently serves as a director of several other Canadian private and public companies.

Robert G. Richardson, Halifax, Nova Scotia   Mr. Richardson is Vice President and Chief Financial Officer of Killam Properties Inc. Mr. Richardson is also President of Compass Commercial Realty Limited, a real estate brokerage company. Mr. Richardson was formerly the Director for Oxford Atlantic, a division of Oxford Properties Group.

G. Wayne Watson, Dartmouth, Nova Scotia   Mr. Watson is Vice President of Finance with CanJam Trading Limited and, formerly was the Chief Financial Officer and Vice President, Finance of Fortis Inc., a TSX company with investments in electric utilities, commercial real estate and hotels. Mr. Watson has been a director of Canadian Niagara Power Corp. and Fortis Properties Corp.

Corporate **Information**

HEAD OFFICE
Suite 200, 3700 Kempt Road
Halifax, NS
B3K 4X8
Tel: 902.453.4536
Fax: 902.454.9203

REGIONAL OFFICE - MONCTON
Suite 105, 40 Weldon Street
Moncton, NB
E1C 5V8
Tel: 506.857.0680
Fax: 506.867.0008

INVESTOR INQUIRIES
Philip Fraser
tel: 902.453.4536
fax: 902.454.9203

SHARE LISTING
TSX Venture Exchange
(Trading Symbol: KMP)

OFFICERS
Philip D. Fraser, B.Comm, MURP, MBA
President, Chief Executive Officer

Robert G. Richardson, B.Comm., C.A.
Vice President, Chief Financial Officer

Ronald M. Barron, LLB
Corporate Secretary

BANKER
Bank of Nova Scotia
Halifax, NS

AUDITORS
Ernst & Young, LLP
Halifax, NS

SOLICITORS
Bennett Jones. LLP
Calgary, Alberta

Stewart McKelvey Sterling Scales
Halifax, NS

REGISTRAR AND TRANSFER AGENT
Computershare Trust Company of Canada
1465 Brenton Street
Halifax, NS
B3J 3S9

WEB SITE: www.killamproperties.com

To receive email updates on Killam activities and press releases, visit our web site and complete the email registry form.

Risks and Uncertainties

Certain information provided and statements made in this Annual Report and Management's Discussion and Analysis are forward-looking statements expressing Killam's expectations, hopes, beliefs and intentions on strategies regarding the future. It is important to note that our actual future results could differ materially from those projected in such forward-looking statements because of a number of risks and uncertainties, including those detailed in this Report and detailed from time to time in our Annual Information Form and other filings with regulatory authorities.

KILLAM
PROPERTIES INC.