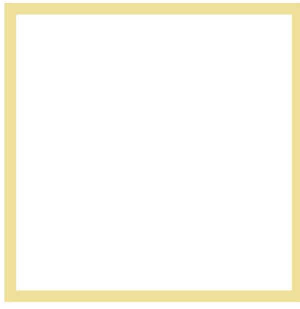

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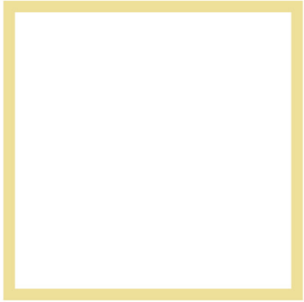
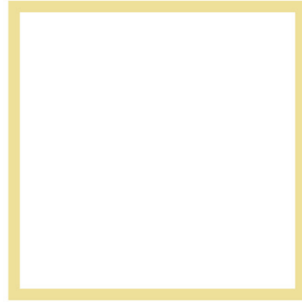
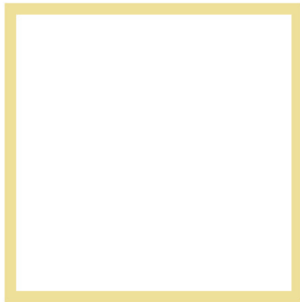
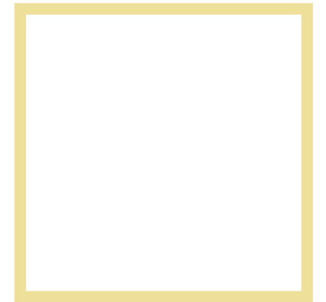
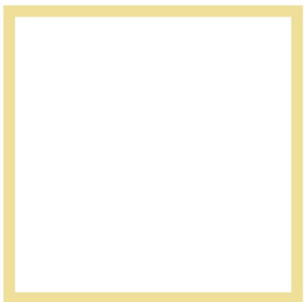
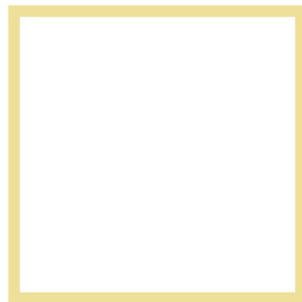








KILLAM PROPERTIES INC

2006 SECOND QUARTER REPORT

Second Quarter 2006 Highlights

Expansion of 34 lots at Cowan Place and 61 lots at Greenhill Estates scheduled to be completed by the end of August and expansion plans progressing on another four communities totaling 170 lots

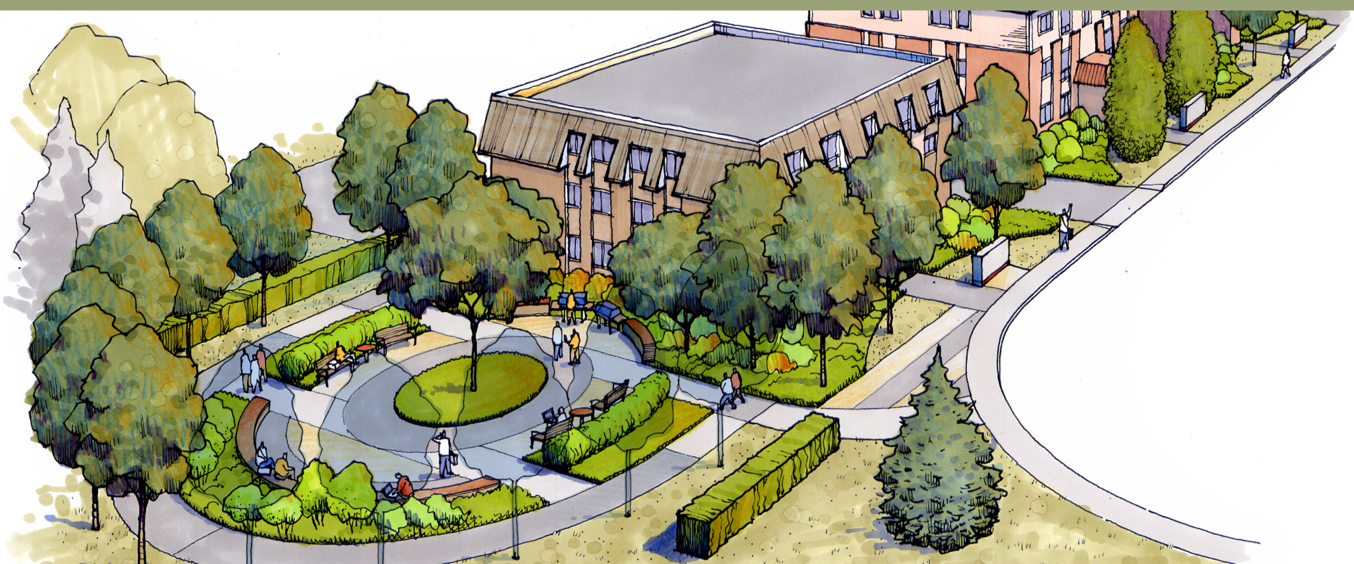
Completed the sale of 1.8 acres of surplus land resulting in a gain of $0.7 million

Received approval for the development of a 60 unit residential building on surplus land at Victoria Gardens in Halifax

Awarded a contract by Atlantic Health and Science Corporation (AHSC), the largest teaching hospital in New Brunswick, to supply 36 apartment units to medical residents in Saint John

MHC Expansion Project at Greenhill in Antigonish, Nova Scotia

Rendering for AHSC Medical Residents in Saint John, New Brunswick



President's Message to Shareholders

On behalf of the Board of Directors, I am pleased to present Killam's second quarter 2006 results and discussion of operations. Killam continues to grow with the acquisition of an additional 852 units in the second quarter, bringing our total units to 13,022 as at June 30, 2006. Throughout the quarter we expanded our apartment portfolio presence in New Brunswick. In addition we continue to grow our manufactured home community (MHC) line of business with the acquisition of an additional 685 units in the second quarter.

Business Initiatives

We had a productive quarter, making progress toward our key objectives for 2006, including:

- Expansion of 34 lots at Cowan Place and 61 lots at Greenhill Estates are scheduled to be completed by the end of August. Expansion plans and permitting are progressing on another four communities totaling 170 lots that are expected to be completed over the next two years.
- Completed the sale of 1.8 acres of surplus land resulting in a gain of $0.7 million and received approval for the development of a 60-unit residential building on surplus land at Victoria Gardens with progress continuing on the proposed development and approval of 11 acres at Kelly Drive.
- Killam continues to decrease its exposure to heating oil with the conversion of 523 units in Halifax at Maplehurst and Parker Street Apartments and 194 units in Fredericton at the newly acquired Elroy Apartments to natural gas. Both projects are expected to be completed by November 1, 2006. Killam has also implemented a natural gas hedge program for 2007.
- Recently awarded a contract by Atlantic Health Science Corporation, the largest teaching hospital in New Brunswick, to supply 36 apartment units to medical residents in Saint John.

Strong Financial Management

Our second quarter 2006 results were on target with our expectations. Our revenues grew by approximately 56% over the first quarter of 2005. More importantly Funds from Operations (FFO) were $3.9 million in the second quarter of 2006, an increase of $1.4 million from the same period in 2005. Our net loss of $0.2 million was negatively affected by $0.7 million of building amortization. We are required by generally accepted accounting principles to amortize our buildings even though they do not decrease in value over time.

Repositioning Assets

We continue to invest capital to reposition certain apartments in our portfolio. Two examples are 3 Veronica Court and Kent Street. Veronica Court was purchased in 2005 as a repositioning opportunity and is ideally located adjacent an existing Killam property and sits at the edge of a new residential development that will contain 400 new single-family dwellings. 3 Veronica Drive will benefit from the surrounding new development and bolsters our earlier investment in this neighborhood. We are already experiencing the positive response to our upgrades as renovated units are leasing up quickly.

The Kent Street asset is being repositioned to respond to changes in the student market in Halifax. The City's south-end had increased student vacancy this past year due principally to a new 500-bed university residence coming on-line. Our Kent Street asset had traditionally catered to students so we repositioned a portion of the property to attract professionals. With its ideal location for downtown living and its close proximity to our Tobin Street building that already had a professional tenant base, Kent Street's finished units are leasing up quickly at increased rents.

Property Operations is a Key Focus

Our growth story is an exciting one; however we understand that the real work begins once the deals are closed. We understand the need to provide our tenants with well maintained properties and superior service delivery to achieve long-term success. We will continue to acquire quality assets that are accretive and effectively integrate the new properties into our portfolio.

Looking Forward

I would like to thank our shareholders for their continued support and I look forward to our next quarterly report to update you on our progress.

Sincerely,

Philip Fraser
President & CEO

Management's Discussion and Analysis:

Overview of the Structure of the MD&A

The following management's discussion and analysis (MD&A) has been prepared by management and focuses on key statistics from the June 30, 2006 consolidated financial statements and pertains to known risks and uncertainties. To ensure that the reader is obtaining the best overall perspective, this MD&A should be read in conjunction with material contained in the Company's 2005 Annual Report and the Company's 2005 Annual Information Form. These documents are available on SEDAR at www.sedar.com. The discussions in this MD&A are based on information available at August 8, 2006.

Forward-looking Statements

Certain statements in this MD&A constitute "forward-looking statements". You can identify forward-looking statements by our use of the words "believe", "expect", "anticipate", "intend", "estimate", "assume", "project", and other similar terms that predict or indicate future events and trends that do not relate to historical matters. Such statements are based on Killam management's assumptions and beliefs in light of the information currently available to them. Readers are cautioned not to place undue reliance on forward-looking statements. A number of important factors could cause actual results to differ materially from those expressed in such forward-looking statements.

Non-GAAP Measures

There are measures included in this MD&A that do not have a standardized meaning under Generally Accepted Accounting Principles (GAAP) and therefore may not be comparable to similarly titled measures presented by other publicly traded companies. The Company includes these measures as a means of measuring financial performance.

- Net operating income is calculated as operating revenue less property operating expenses.
- Funds from operations (FFO) are calculated as net (loss) income plus amortization, stock compensation, non-cash debenture interest and future income taxes.
- Same store results are rental revenues and property operating expenses for stabilized properties the Company has owned for equivalent periods in 2005 and 2006.

Corporate Overview

Killam Properties Inc. ("Killam") is a publicly traded real estate company focused on the acquisition, re-development and management of apartments and manufactured home communities (MHCs). Killam's corporate strategy is based on consolidating and the application of professional property management to apartment buildings in Atlantic Canada and MHCs throughout Canada.

As at the end of Q2, Killam owned and operated over 13,000 rental units, comprised of 7,213 apartment units and 5,809 MHC units.

Killam has been focused on growth through acquisitions for the last four years. Killam continued to consolidate the rental market during the second quarter of 2006 with the acquisition of eight properties representing 852 units to bring the Company's total portfolio to 13,022 units. Our growth in unit numbers over the last ten quarters is highlighted below.

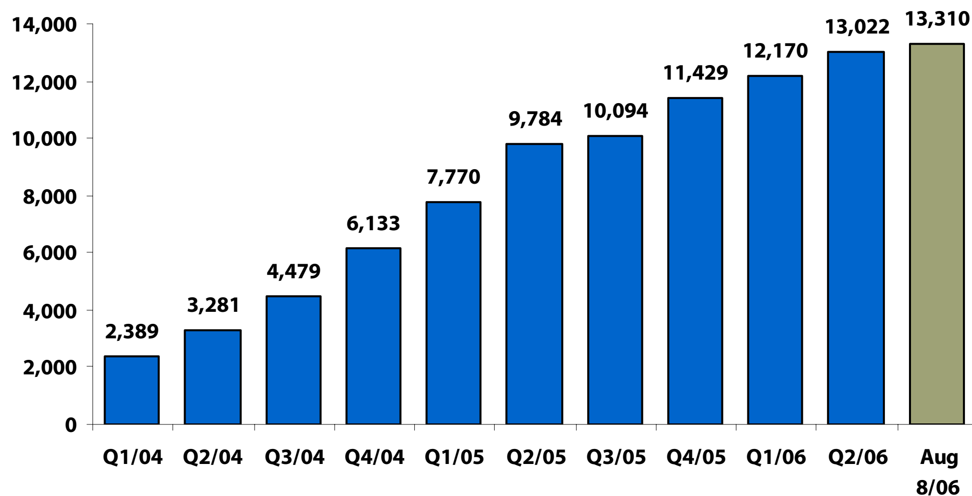
Management's Discussion and Analysis:

Portfolio Summary

By Unit Type and Location

	Apartments	MHCs	Total
Halifax	3,472	466	3,938
Moncton	961	1,160	2,121
Saint John	1,062	100	1,162
Fredericton	295	686	981
St. Johns/Grand Falls	679	86	765
Sydney	156	217	373
PEI	588	-	588
Other NS	-	984	984
Other NB	-	86	86
Ontario	-	1,777	1,777
Saskatchewan	-	247	247
Total	7,213	5,809	13,022
Percentage by unit count	55.4%	44.6%	
Percentage by gross book value	80.5%	19.5%	

Unit Growth



Management's Discussion and Analysis:

Review of Operations

Rental Operations

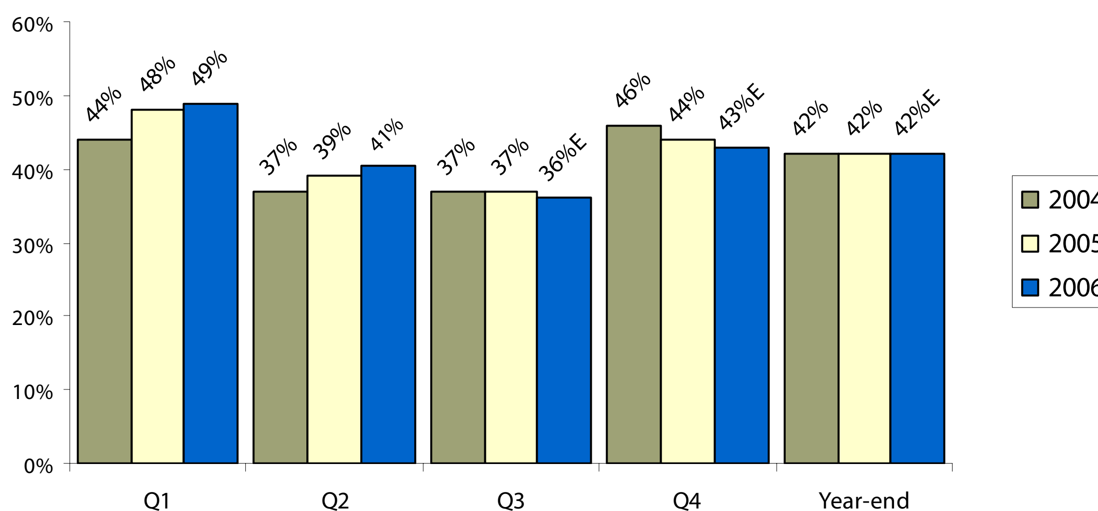
	3 months ended June 30		*6 months ended June 30*	
	2006	2005	**2006**	2005
Rental revenue	**$16,463,132**	$10,580,659	**$32,222,317**	$19,389,577
Other operating revenue [(1)]	**80,673**	47,315	**195,000**	68,967
Total operating revenue	**16,543,805**	10,627,974	**32,417,317**	19,458,544
Property operating expenses				
Operating expenses	**3,126,831**	1,736,851	**6,183,602**	3,341,143
Utilities	**2,193,284**	1,528,591	**5,394,314**	3,322,551
Property taxes	**1,384,234**	890,688	**2,738,289**	1,699,790
Total property operating expenses	**6,704,349**	4,156,130	**14,316,205**	8,363,484
Net operating income	**$9,839,456**	$6,471,844	**$18,101,112**	$11,095,060
Operating expense percentage	**40.5%**	39.1%	**44.2%**	43.0%

(1) 2006 revenue excludes a $656,783 gain on sale of land

Rental revenue increased $5.9 million, or 56%, and $12.8 million, or 66%, compared to the second quarter and first half of 2005, respectively. The increase is due primarily to the completion of acquisitions over the past twelve months. Killam's initiation of rent increases, which started in the first quarter, have also positively impacted earnings.

The annualized rental revenue of the properties the Company owned as at June 30, 2006 is approximately $68.6 million based on current rents and 4% vacancy. Killam, as with all real estate rental operators, is sensitive to vacancy rates. However, Killam believes its portfolio is quite defensive given its diversification in terms of multiple locations and two distinct types of assets. Based on our current rents, a 1% change in vacancy rates would impact the annualized rental revenues by $0.7 million.

Property operating expenses as a percentage of revenue increased to 40.5% from 39.1% due primarily to increased repair and maintenance related costs as Killam focuses on delivering quality living space and service to its tenants.



Management's Discussion and Analysis:

Total utility costs increased in the quarter due to the increased unit count, however as a percentage of rental revenue, decreased to 13.3% from 14.4%. Oil prices increased 33% in Q2-2006 versus Q2-2005 while natural gas prices fell 6% in the same period. Killam has converted 1,543 units to natural gas and have a further 666 units under conversion resulting in approximately 30% of its apartment portfolio being fueled by natural gas for the 2006/07 heating season.

In many of our markets, property taxes and water and sewer rates have increased by 5-15% over the previous quarter, however, as a percentage of revenue, stayed in line with the second quarter of 2006.

The property operating expense percentage is a key performance indicator for Killam as it represents the Company's ability to effectively manage its portfolio. In addition, the Company compares the "same store" results for stabilized properties which we have owned since January 1, 2005. A comparison of these results is presented below.

Gain on Sale of Land

During the second quarter, Killam completed the sale of 1.8 acres of surplus land associated with its Lakefront property. The sale price of $900,000 resulted in a gain of $657,000.

This sale is one example of opportunities that Killam is pursuing to provide additional capital from its current asset base to fund its future growth opportunities. Management has identified another 30.5 acres of land that could be developed or sold following appropriate municipal approvals.

During the second quarter, Killam received development approval on a 1.5 acre lot for a 60 unit residential building. Management is currently evaluating options regarding this opportunity.

Same Store Results

The following table sets out the results of operations for 57 stabilized properties (5,803 units) we have owned for equivalent periods in 2006 and 2005.

	3 months ended June 30		*6 months ended June 30*	
	2006	2005	**2006**	2005
Revenues [1]	**$8,418,244**	$8,152,067	**$16,826,634**	$16,310,329
Property operating expenses	**3,577,314**	3,397,570	**7,772,455**	7,335,088
Net operating income	**$4,840,930**	$4,754,497	**$9,054,179**	$8,975,241
Operating expense percentage	**42.5%**	41.7%	**46.2%**	45.0%

(1) 2006 revenue excludes a $656,783 gain on sale of land

Same store revenue improved $266,000, or 3.3% quarter over quarter. Higher rents, which increased an average of 2.0%, accounted for $177,000 of this improvement. Laundry revenue and contributions from Killam's furnished suites business also contributed positively to operations, with revenues increasing 19% and 17%, respectively.

Operating expenses increased by 80 basis points or $180,000 in the second quarter versus the same quarter of 2005 due primarily to higher repairs and maintenance costs associated with plumbing and ventilation costs and professional fees associated with appealing property tax assessment increases.

Same store property net operating income increased by $86,000 quarter over quarter and $79,000 year-to-date for the six months of 2006.

Excluded in the above analysis is the Company's Kent Street property which has been undergoing major renovations during the winter and spring of 2006.

Management's Discussion and Analysis:

Segment Review

Apartments

	3 months ended June 30		6 months ended June 30	
	2006	2005	**2006**	2005
Rental revenue	**$13,381,114**	$8,553,709	**$26,303,486**	$16,236,929
Other operating revenue *(1)*	**62,606**	30,237	**155,135**	49,730
Total operating revenue	**13,443,720**	8,583,946	**26,458,621**	16,286,659
Property operating expenses				
Operating expenses	**2,527,092**	1,425,433	**5,020,757**	2,840,245
Utilities	**1,919,734**	1,338,960	**4,813,663**	3,008,341
Property taxes	**1,258,224**	813,412	**2,487,387**	1,569,899
Total property operating expenses	**5,705,050**	3,577,805	**12,321,807**	7,418,485
Net operating income	**$7,738,670**	$5,006,141	**$14,136,814**	$8,868,174
Operating expense percentage	**42.4%**	41.7%	**46.6%**	45.5%
Weighted average rent per unit	**$673**	$666		

(1) 2006 revenue excludes a $656,783 gain on sale of land

Killam's apartment business accounted for 78.6% of net operating income in the quarter, compared to 77.4% in the same quarter of 2005. Year-to-date apartments contributed 78.1% of net operating income, a decline from 79.9% in 2005 due to Killam increase in its MHC portfolio over the last year. The MHC unit count grew by 38.5% compared to a 29.0% growth in apartment units.

The portfolio apartment vacancy at the end of June was 2.8% for stable units, compared to 3.0% at June 2005. Vacancy rates for July 2006 have improved and activity for September 2006 move-ins is also up. Killam expects occupancy will be strong for the balance of 2006.

Operating expenses as a percentage of revenues increased by 70 basis points to 42.4%, from 41.7%. This increase relates to those points highlighted earlier in the MD&A.

Management's Discussion and Analysis:

MHCs

	3 months ended June 30		6 months ended June 30	
	2006	2005	**2006**	2005
Rental revenue	**$3,082,018**	$2,026,950	**$5,918,831**	$3,152,648
Other operating revenue	**18,067**	17,078	**39,865**	19,237
Total operating revenue	**3,100,085**	2,044,028	**5,958,696**	3,171,885
Property operating expenses				
Operating expenses	**599,739**	311,418	**1,162,845**	500,898
Utilities	**273,550**	189,631	**580,651**	314,210
Property taxes	**126,010**	77,276	**250,902**	129,891
Total property operating expenses	**999,299**	578,325	**1,994,398**	944,999
Net operating income	**$2,100,786**	$1,465,703	**$3,964,298**	$2,226,886
Operating expense percentage	**32.2%**	28.3%	**33.5%**	29.8%
Weighted average rent per unit	**$199**	$183		

Rental revenue from Killam's MHCs has increased by $1,055,000, or 52%, from the second quarter in 2005 due primarily to the significant increase in properties. As well, of the properties that were acquired, many were in the higher rental markets of Ontario.

Vacancy rates in MHCs remain low, at approximately 0.8%, compared to 0.7% in June 2005.

Killam's MHC operating costs increased to 32.2% of operating revenues, from 28.3%. The most significant increases were seen in repairs and maintenance and general administrative costs associated with compliance with the Ontario Ministry of Environment legislation. As well, two of Killam's newer Ontario communities are seasonal communities and the majority of revenue is earned during the third quarter, although expenses are incurred throughout the year.

Mortgage and Loan Interest

Financing expenses were higher during the first half of 2006 on a gross dollar basis compared to the prior year due to the increase in the mortgage portfolio related to acquisitions. As a percentage of rental income, total interest expense increased to 35.9% from 32.1% in the same quarter of 2005. This increase is due primarily to Killam's use of its acquisition bridge facility during the first half of the year to complete acquisition opportunities. Killam considers this facility to be a temporary financing option for acquisitions. Subsequent to June 30, Killam raised $10 million in debentures and announced a $15 million private placement of capital stock to decrease its reliance on the acquisition bridge facility.

Mortgage and loan interest is expected to continue to increase in 2006 as the Company continues to expand its portfolio. Killam expects to continue to finance properties at favorable rates throughout 2006. Please see further discussion in the Liquidity and Capital Resources section of the MD&A.

Killam is sensitive to interest rate changes. The Company manages this risk by entering into fixed rate mortgages and staggering the maturity dates of the mortgages. An annualized 1% change in the interest rate on Killam's mortgage and vendor debt at June 30, 2006 would affect financing costs by approximately $3.5 million per year. However, as an example, only $67.1 million of Killam's mortgage and vendor debt are due within the next three years and that same interest rate change would only impact Killam by $0.7 million per annum.

Management's Discussion and Analysis:

Depreciation Expense

Depreciation expense increased $1.7 million compared to the second quarter of 2005 and $3.6 million versus the first half of 2005. As a percentage of rental revenue depreciation expense was 23.5% in the quarter, compared to 20.5% in the same quarter in 2005. The increase in depreciation is a result of the portfolio growth as well as Killam's capital improvement plan.

General and Administrative Expenses

	3 months ended June 30		*6 months ended June 30*	
	2006	2005	**2006**	2005
Total	**$797,131**	$565,960	**$1,575,275**	1,119,566
As a percentage of rental revenue	**4.8%**	5.3%	**4.9%**	5.8%

General and administrative expenses include expenses which are not specific to an individual property. These expenses include TSX related costs, management salaries and benefits, office rent, communication costs, office equipment leases, professional fees and other head office expenses. The percentage has decreased from 2005 as there is a relatively fixed component of these expenses which continues to be spread over increased revenue as Killam continues to grow its portfolio.

Provincial Large Corporation Tax (Capital Tax)

The Company is required to pay provincial capital tax in certain provinces based on the total taxable capital invested in those provinces at year-end. Total taxable capital invested includes share capital and mortgages on properties held outside the Company's internal trusts and is not a function of the time the capital is invested. These taxes are deductible for provincial and federal income tax purposes

Income Tax

	3 months ended June 30		*6 months ended June 30*	
	2006	2005	**2006**	2005
Current expense	**$ —**	$45,000	**$22,332**	$64,752
Future expense (recovery)	**(203,000)**	93,502	**(853,000)**	67,719
	$(203,000)	$138,502	**$(830,668)**	$132,471

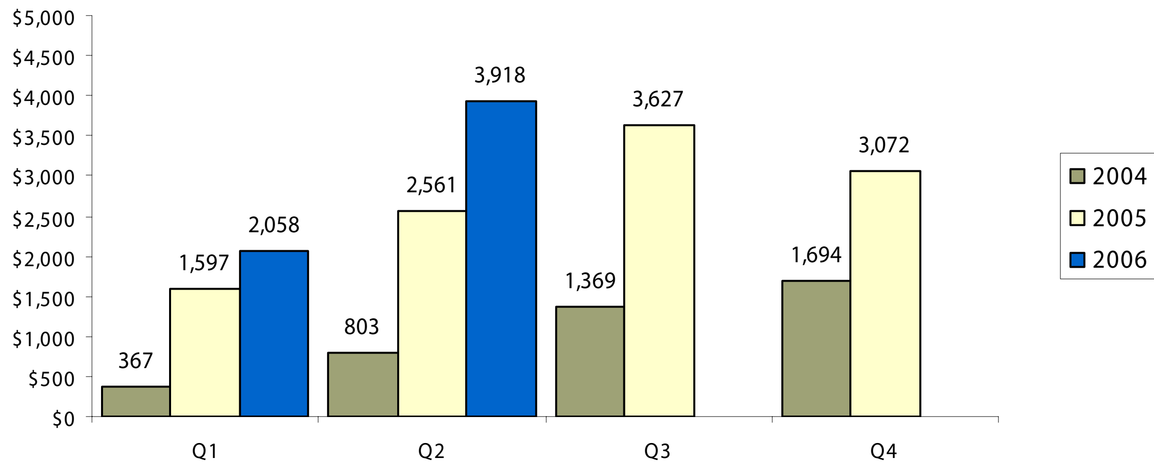
Current income tax expense (recovery) represents federal large corporation's tax. The decrease over the same period of 2005 is largely a result of the elimination of the federal capital tax. In addition, the Company has booked a future income tax recovery for 2006 representing the future tax benefit on Killam's 2006 net loss.

Management's Discussion and Analysis:

Funds from Operations (FFO)

	3 months ended June 30		*6 months ended June 30*	
	2006	2005	**2006**	2005
Net (loss) income	**$(151,375)**	$107,556	**$(1,356,641)**	$45,738
Depreciation and amortization	**4,169,970**	2,270,368	**7,980,754**	3,954,772
Non cash debenture interest	**47,176**	28,731	**94,352**	28,731
Non cash share compensation	**55,010**	61,228	**110,007**	62,675
Future income tax (recovery) expense	**(203,000)**	93,502	**(853,000)**	67,719
Funds from operations	**3,917,781**	2,561,445	**5,975,472**	4,159,635
FFO/share	**$0.05**	$0.03	**$0.07**	$0.05

The Company's funds from operations continued to grow on a total dollar and per share basis during the second quarter of 2006 compared to the same periods in 2005 largely as a result of the expanded portfolio during late 2005 and the first half of 2006.



Management's Discussion and Analysis:

Consolidated Balance Sheet

The following is a discussion of the changes in the Company's balance sheet from the end of the last fiscal year, December 31, 2005 to the end of the second quarter, June 30, 2006.

Real Estate Assets

As at	**June 30 2006**	December 31 2005	% change
Net book value	**$516,847,777**	$452,076,153	14%

Capital assets increased to $516.8 million from $452.1 million, as a result of the acquisition of ten properties totaling 741 units in the first quarter and eight properties totaling 852 units in the second quarter of 2006. Many of Killam's 2006 acquisitions are adjacent to Killam's existing buildings and MHCs which enable the Company to better control the neighbourhood, provide a more consistent level of service and achieve efficiency cost savings.

The following table is a summary of the Company's acquisitions for the three and six months ended June 30, 2006. The acquisition value set out below excludes third party costs such as legal, environmental and other costs paid as part of the acquisition process.

	3 months ended June 30, 2006	**6 months ended June 30, 2006**	**Total Portfolio**
Apartment Acquisitions			
Value of acquisitions	**$10,400,000**	**$42,030,000**	**$385,850,000**
Units acquired	**167**	**745**	**7,213**
Average price per unit	**$62,275**	**$56,419**	**$53,934**
MHC Acquisitions			
Value of acquisitions	**$14,400,000**	**$17,925,000**	**$98,457,000**
Units acquired	**685**	**848**	**5,809**
Average price per unit	**$21,022**	**$21,138**	**$16,949**

Capital Improvements

In addition to property acquisitions, the Company has invested $5.6 million in property improvements in the second quarter of 2006 ($10.6 million on a year-to-date basis) as set out below:

	Q1	**Q2**	**Total YTD**
Development projects	$25,400	$867,800	$893,200
Major repositioning projects	690,500	840,400	1,530,900
Project improvements	2,162,100	1,365,400	3,527,500
Suite improvements	1,509,000	1,864,000	3,373,000
Equipment	396,000	285,800	681,800
Appliances	133,000	232,000	365,000
Furniture & Fixtures	33,000	149,000	182,000
Parking lots	2,000	Nil	2,000
Total	$4,951,000	$5,604,400	$10,555,400

Of the $10.6 million invested in the first half of 2006, approximately $8.0 million relates to revenue enhancing suite and common area upgrades and the balance was invested in elevator, roof, window and heating plant upgrades that enhance revenue or reduce costs over the longer term.

Management's Discussion and Analysis:

Deferred Financing

As at	**June 30 2006**	December 31 2005	% change
Deferred financing costs	**$6,881,462**	$5,872,356	17%
Less: accumulated amortization	**(1,654,708)**	(1,104,360)	(50)%
	$5,226,754	$4,767,996	10%

Deferred financing costs (net of amortization) increased $0.5 million largely as a result of the January and March 2006 subordinated debt issuances with the remainder due to the increase in the portfolio. The costs related to mortgage assumption; application fees and legal costs are amortized over the term of the respective mortgage. CMHC insurance fees are amortized over the amortization period of the mortgage. The costs associated with the convertible and subordinated debentures are amortized over the terms of the debentures.

Other Assets

As at	**June 30 2006**	December 31 2005	% change
Prepaid property taxes	**$2,030,465**	$ 514,368	295%
Prepaid insurance	**654,745**	282,353	132%
Note receivable	**800,000**	—	- %
Other	**389,875**	406,814	(4)%
Deferred charges	**404,963**	354,485	14%
Goodwill	**4,500,000**	4,500,000	- %
	$8,780,048	$6,058,020	45%

The increase in prepaids over the December 31, 2005 balance is due to the increased size of the portfolio as well as the timing of property tax payments in various provinces and the payment of insurance premiums for 2006. The note receivable relates to the land sale in the quarter and is non interest bearing and receivable in quarterly installments with repayment not to exceed 15 months. The note is secured through a charge on the land sold to a third party.

Management's Discussion and Analysis:

Liquidity and Capital Resources

Mortgages and Loans Payable

As at	**June 30 2006**	December 31 2005	% change
Mortgages	**$337,594,557**	$291,760,750	16%
Vendor financing	**9,227,832**	11,060,355	(17)%
Convertible debentures	**40,812,463**	40,765,287	- %
Subordinated debentures	**10,000,000**	—	- %
Credit facility	**30,573,000**	16,943,000	80%
	$428,207,852	$360,529,392	19%
Weighted average years to maturity of mortgage and vendor debt	**5.3**	5.5	
Mortgage and vendor debt as a percentage of GBV	**61.5%**	62.6%	
Total debt as a percentage of GBV	**76.0%**	74.6%	
Weighted average interest rate of mortgage and vendor debt	**5.6%**	5.6%	
Weighted average interest rate of total debt	**6.1%**	5.9%	

The Company's long-term debt consists largely of fixed-rate, long-term mortgage financing. In certain cases the Company will also utilize vendor-take-back mortgages as part of an acquisition. Mortgages are secured by a first or second charge against the individual properties and the vendor financing is secured by a general corporate guarantee. The increase in mortgages payable is due to the continued growth of the Company.

Killam's 2006 weighted average interest rate remained steady at 5.6%. The Company's weighted average years to maturity fell slightly from December 31, 2005 to 5.4 years as a result of the assumption of mortgages during the first quarter of 2006 which have a shorter term to maturity than the Company's usual financing terms.

The Company continually reviews the maturity dates of its mortgages to reduce the overall interest rate risk. The following table sets out the maturity dates and average interest rates of mortgage and vendor debt by the year of maturity:

Year of Maturity	**Balance June 30, 2006 *($000's)***	**Average Int. Rate %**
2006	12,373	6.21
2007	11,958	5.69
2008	42,759	6.15
2009	65,786	5.35
2010	49,692	5.26
2011	21,366	5.70
2012	4,745	6.17
2013	10,694	6.17
2014	37,018	5.84
2015	55,181	5.45
Thereafter	35,250	5.50

Management's Discussion and Analysis:

During the first half of 2006 Killam used its acquisition bridge facility to fund a number of acquisitions. This facility bears interest at variable rates. The average interest rate is currently 480 basis points above our average mortgage rate. Use of this facility in the quarter has resulted in increased interest expenses.

The Company intends to meet its short-term liquidity requirements (defined as monthly mortgage payments of principal and interest and ongoing operating costs) through net cash flow provided by operating activities.

Killam's business plan requires an ample supply of capital resources. Capital resources are defined as mortgage debt, vendor mortgages and share capital equity. As at June 30, 2006 the Company had available $1.0 million of cash. In addition, the Company has credit facilities totaling $40 million of which the Company has drawn $30.6 million as at June 30, 2006. Subsequent to June 30, 2006 the Company raised $10 million of debt financing and expects to close $15 million of equity financing with the majority of the proceeds being used to reduce the credit facility. The cash on hand and credit facilities provide the Company with sufficient capital to continue its acquisitions in the short term. Killam will continue to finance new properties at 75% of their value through new mortgages or placing second mortgages when available. The Company is constantly reviewing existing mortgages to ensure the properties are appropriately leveraged to maximize access to historically low mortgage rates.

Risk Management

Killam, like most real estate companies, is exposed to a variety of risk areas. These are described in detail in the Management's Discussion and Analysis found in Killam's 2005 Annual Report. These factors still exist at the end of this interim period and remain relatively unchanged.

Critical Accounting Estimates

The Company's accounting policies are described in Note 2 of the consolidated financial statements. The preparation of financial statements in conformity with Canadian Generally Accepted Accounting Principles requires management to make estimates and assumptions. The Company's critical accounting estimates remain unchanged from those set out in Killam's 2005 Annual Report

Future Objectives

Killam is well positioned to continue its accretive growth and effectively manage its portfolio.

2006 Goals and Objectives

- Continue to grow our portfolio through accretive acquisitions.
- Increase rental incomes from existing properties at tenant turnover and renewal.
- Lower costs through operational efficiencies.
- Maximize potential in our current portfolio through increases in occupancy rates.
- Grow our MHC business through community expansions utilizing our existing vacant land in the communities.
- Crystallize the value of our apartment surplus land through development agreements or sales.

Consolidated Balance Sheets

As at

	June 30 2006	December 31 2005
ASSETS		
Capital assets *(note 4)*	**516,847,777**	452,076,153
Cash and cash equivalents *(note 3)*	**3,704,380**	4,885,126
Accounts receivable	**682,920**	544,683
Other assets *(note 5)*	**8,780,048**	6,058,020
Deferred financing costs (net)	**5,226,754**	4,767,996
Future income taxes	**2,503,360**	1,184,547
	537,745,239	469,516,525
LIABILITIES AND SHAREHOLDERS' EQUITY		
Mortgages and loans payable *(note 6)*	**346,822,390**	302,821,105
Convertible debentures *(note 7)*	**40,812,463**	40,718,111
Subordinated debentures *(note 8)*	**10,000,000**	-
Credit facility *(note 9)*	**30,573,000**	16,943,000
Accounts payable & accrued liabilities	**8,038,151**	7,057,797
Income tax payable	**339,537**	173,139
Security deposits	**1,499,365**	1,349,199
Future income taxes	**6,069,814**	5,610,506
	444,154,720	374,672,857
Shareholders' Equity		
Capital stock *(note 10)*	**92,894,948**	92,900,223
Contributed surplus *(note 10)*	**514,187**	405,420
Other paid-in capital *(note 7)*	**1,601,693**	1,601,693
Deficit	**(1,420,309)**	(63,668)
	93,590,519	94,843,668
	537,745,239	469,516,525

See accompanying notes

Consolidated Statements of Income and Deficit

	For the 3 months ended June 30		*For the 6 months ended June 30*	
	2006	2005	**2006**	2005
	$	$	**$**	$
Revenue				
Rental income	**16,463,132**	10,580,659	**32,222,317**	19,389,577
Other operating income	**737,456**	47,315	**851,783**	68,967
Corporate income	**132,230**	118,206	**250,920**	134,624
	17,332,818	10,746,180	**33,325,020**	19,593,168
Property expenses				
Property operating expenses	**6,704,349**	4,156,130	**14,316,205**	8,363,484
	10,628,469	6,590,050	**19,008,815**	11,229,684
Mortgage and loan interest	**4,421,826**	2,877,223	**8,671,699**	5,261,183
Convertible debenture interest	**732,926**	449,465	**1,465,852**	449,465
Subordinated debenture interest	**150,305**	-	**232,345**	-
Credit facility interest	**608,206**	72,281	**1,055,913**	87,970
Depreciation	**3,875,787**	2,172,682	**7,435,372**	3,785,600
Amortization of deferred financing	**294,183**	97,686	**545,382**	169,172
General and administrative	**797,131**	565,960	**1,575,275**	1,119,566
Provincial capital taxes	**72,033**	105,000	**144,066**	154,086
Interest and bank charges	**30,447**	3,695	**70,220**	24,433
	10,982,844	6,343,992	**21,196,124**	11,051,475
Income (loss) before income taxes	**(354,375)**	246,058	**(2,187,309)**	178,209
(Provision for) recovery of income taxes				
- current	**-**	(45,000)	**(22,332)**	(64,752)
- future	**203,000**	(93,502)	**853,000**	(67,719)
Net income (loss)	**(151,375)**	107,556	**(1,356,641)**	45,738
Deficit, beginning of period	**(1,268,934)**	(130,333)	**(63,668)**	(68,515)
Deficit, end of period	**(1,420,309)**	(22,777)	**(1,420,309)**	(22,777)
Net income (loss) per share				
- basic	**$ (0.0019)**	$ 0.0014	**$ (0.0017)**	$ 0.0006
- diluted	**$ (0.0019)**	$ 0.0013	**$ (0.0017)**	$ 0.0006

See accompanying notes

Consolidated Statements of Cash Flows

	For the 3 months ended June 30		*For the 6 months ended June 30*	
	2006	2005	**2006**	2005
	$	$	**$**	$
OPERATING ACTIVITIES				
Net income (loss)	**(151,375)**	107,556	**(1,356,641)**	45,738
Add items not affecting cash				
Depreciation and amortization	**4,169,970**	2,270,368	**7,980,754**	3,954,772
Non-cash debenture interest	**47,176**	28,731	**94,352**	28,731
Non-cash compensation expense	**55,010**	61,288	**110,007**	62,675
Future income taxes	**(203,000)**	93,502	**(853,000)**	67,719
Funds from operations	**3,917,781**	2,561,445	**5,975,472**	4,159,635
Gain on land sale	**(656,783)**	-	**(656,783)**	-
Net change in non-cash working capital items related to operations	**(3,781,001)**	(937,389)	**(1,563,347)**	(159,779)
Cash provided by operating activities	**(520,003)**	1,624,056	**3,755,342**	3,999,856
FINANCING ACTIVITIES				
Increase in deferred financing	**(185,912)**	(2,941,689)	**(1,004,140)**	(3,283,225)
Issue of common shares for cash (net of issue costs)	**4,100**	14,474,009	**(12,390)**	14,474,009
Issuance of convertible subordinated debentures	**-**	40,132,504	**10,000,000**	40,132,504
Increase in (repayment of) credit facility	**6,785,000**	(8,400,000)	**13,630,000**	-
Repayment of long term debt	**(7,069,242)**	(1,435,794)	**(9,030,567)**	(3,293,759)
Issuance of long-term debt	**26,669,777**	44,483,650	**43,364,712**	76,008,738
Cash provided by financing activities	**26,203,723**	86,312,680	**56,947,615**	124,038,267
INVESTING ACTIVITIES				
Purchase of capital assets	**(30,182,950)**	(81,457,124)	**(61,883,703)**	(121,177,393)
Cash used in investing activities	**(30,182,950)**	(81,457,124)	**(61,883,703)**	(121,177,393)
Net increase in cash and cash equivalents	**(4,499,230)**	6,479,612	**(1,180,746)**	6,860,730
Cash and cash equivalents, beginning of period	**8,203,610**	4,549,189	**4,885,126**	4,168,071
Cash and cash equivalents, end of period	**3,704,380**	11,028,801	**3,704,380**	11,028,801

Notes to Consolidated Financial Statements

1. Incorporation

Killam Properties Inc. (the "Company") is a real estate corporation specializing in the acquisition and management of multi-residential apartment buildings and manufactured home communities. The Company is incorporated under the Canada Business Corporations Act.

2. Summary of Significant Accounting Policies

Basis of presentation

These financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") without audit or review by the Company's auditors. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The accounting principles used in these interim consolidated financial statements are consistent with those used in the Company's December 31, 2005 annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's 2005 Annual Report.

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.

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 three months and are recorded at cost which approximates fair market value.

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, laundry, parking and other sundry revenues.

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.

Capital assets

Revenue producing real estate properties held as ongoing investments are recorded at cost less accumulated amortization and net of any impairment loss. Cost includes all expenditures incurred in connection with the acquisition of real estate property including all direct costs. All costs associated with capital improvements, other than ordinary repairs and maintenance, are capitalized and amortized over terms appropriate to the expenditure.

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	2% - 2.5%	straight-line, 40 - 50 years
Roads & driveways	4%	declining balance
Water & sewer	6%	declining balance
Suite renovations	20%	declining balance
Project improvements	10%	declining balance
Other assets	5% - 30%	declining balance

Deferred financing 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. Upon refinancing, any financing costs associated with previous mortgages are written off to income. Canadian Mortgage and Housing insurance premiums are amortized over the mortgage amortization period.

Stock-based compensation

The Company expenses the fair value of stock options. The Company determines the fair value of the options at the date of grant using the Black Scholes option pricing model and recognizes the fair value over the vesting period as compensation expense and contributed surplus. When stock options are exercised, the corresponding contributed surplus is transferred to capital stock.

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.

Convertible subordinated debentures

On issuance of subordinated debentures convertible into common shares of the Company, the fair value of the holders' conversion option is reflected as "Other paid-in capital". The Company's obligation to debenture holders for future interest and principal payments is reflected as a liability carried at amortized cost. If the holders exercise their conversion option, common shares issued on conversion will be recorded at an amount equal to the aggregate carrying value of the liability and conversion option extinguished, with no gain or loss recognized.

Derivative instruments

Periodically, the Company enters into futures contracts to hedge its exposure to rising energy prices. Hedge accounting is applied in accordance with CICA Accounting Guideline 13 "Hedging Relationships" and any realized gains or losses resulting from the settlement of these contracts are expensed in the period of settlement.

Seasonality

The Company's results for the three and six months ended June 30, 2006 and 2005 are not necessarily indicative of the results that may be expected for the full year due to seasonal variations in utility, landscaping and snow removal costs. The Company has historically experienced higher utility expenses in the first and fourth quarters as a result of the winter months.

3. Cash and Cash Equivalents

	June 30, 2006	Dec 31, 2005
Cash	**$ 989,851**	$1,211,738
Tenant security deposits	**705,163**	539,589
Restricted cash	**2,009,366**	3,133,799
	$3,704,380	$4,885,126

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

4. Capital Assets

	June 30, 2006		December 31, 2005	
	Cost	**Accumulated Amortization**	Cost	Accumulated Amortization
Land	**$51,664,774**	**$ —**	$ 45,525,506	$ —
Buildings	**362,736,331**	**12,540,812**	319,637,430	8,499,728
Roads and driveways	**45,278,953**	**2,036,412**	36,924,444	1,303,561
Water and sewer	**45,303,310**	**3,028,413**	36,950,269	1,947,734
Suite renovations	**10,517,439**	**1,725,539**	6,819,881	1,003,152
Project improvements	**15,779,606**	**1,268,613**	14,690,865	714,438
Other assets	**6,948,058**	**780,905**	5,473,155	476,784
	$538,228,471	**$21,380,694**	466,021,550	$13,945,397
Less: accumulated amortization	**(21,380,694)**		(13,945,397)	
	$516,847,777		$452,076,153	

During the three and six months ended June 30, 2006, the Company capitalized indirect costs of $0.4 million and $0.8 million (2005- $0.3 million and $0.4 million) as part of its project improvement and suite renovation program. In addition, during the three and six months ended June 30, 2006, $153,000 and $268,000 of interest expense was capitalized as part of the Company's repositioning projects related to properties which were off-line (2005 - $11,000 and $13,000).

5. Other Assets

	June 30, 2006	December 31, 2005
Prepaid	**$3,075,084**	$1,203,535
Deferred charges	**404,964**	354,485
Note receivable	**800,000**	—
Goodwill	**4,500,000**	4,500,000
	$8,780,048	$6,058,020

Goodwill presented above is the tax effect of the Company's acquisition of two properties though share purchase transactions. The offsetting liability is presented in future income taxes.

The note receivable is non interest bearing and receivable in quarterly installments with repayment not to exceed 15 months. The note is secured through a charge on the land sold to a third party.

6. Mortgages and Loans Payable

Mortgages payable bear interest at rates from 3.32% to 8.47% with maturity dates ranging from July 2006 to July 2019. Vendor mortgages and loans payable bear interest at fixed rates from 0.00% to 7.25% with maturity dates ranging from July 2006 to February 2016. Mortgages are secured by a first or second charge on the properties of the Company and vendor mortgages are secured by either a second charge on the property or a general corporate guarantee.

The weighted average mortgage rate at June 30, 2006 was 5.6% (December 31, 2005 – 5.6%).

Principal repayments of mortgages and loans are due as follows:

Year	
2006	$16,271,248
2007	18,898,422
2008	48,304,074
2009	65,411,746
2010	48,838,686
Thereafter	149,098,214
	$346,822,390

7. Convertible Debentures

The Company's $42.2 million convertible subordinated debentures bear interest at a fixed rate of 6.5% payable semi-annually to their maturity at May 2012. The debentures are convertible into common shares of the Company at a share price of $3.10 at any time after May 2007. At the time of issuance, the fair value of the Company's obligation to make principal and interest payments was $40.6 million and the fair value of the holders' conversion option was $1.6 million (which is reflected in "other paid-in capital"). The effective rate of interest on the liability component is calculated at 7.2%.

8. Subordinated Debentures

The Company's unsecured subordinated debentures consist of two $5 million amounts and bear interest at fixed rates of 5.92% and 6.06% respectively, payable semi-annually to their maturity at January 2013. The debentures have attached warrants which are convertible into common shares of the Company at exercise prices of $3.60 and $3.80 per share respectively.

9. Credit Facilities

The Company has negotiated credit facilities set out as follows:

Operating Facility

Consists of a $500,000 revolving demand facility for general business purposes, bearing interest at the lender's prime plus 1%. As at June 30, 2006 the Company had letters of credit totaling $374,900 outstanding against this facility (December 31, 2005 - $Nil). The agreement includes certain restrictive covenants and undertakings of which the Company is in compliance.

9. Credit Facilities (continued)

Acquisition Bridge Facility

This agreement consists of two facilities:

(a) $20,000,000 senior revolving facility to fund asset acquisitions, bearing interest at the greater of prime plus 3.75% or 8.0%.. As at June 30, 2006 the Company had a $20,000,000 balance outstanding (December 31, 2005 - $16,943,000) related to this facility. The agreement includes certain restrictive covenants and undertakings of which the Company is in compliance.

(b) $20,000,000 revolving senior secured facility to fund asset acquisitions bearing interest at the greater of prime plus 5.0% or 9.25% plus a 0.6% fee on undrawn amounts (expensed monthly). As at June 30, 2006, the Company had a $10,573,000 balance outstanding (December 31, 2005 - $Nil) related to this facility. The agreement includes certain restrictive covenants and undertakings of which the Company is in compliance.

10. Capital Stock and Contributed Surplus

Capital Stock

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

Issued:
The following table summarizes the changes in issued common shares of the Company:

	2006		2005	
	Number of Shares	**Value**	Number of Shares	Value
Balance, beginning of year	**81,333,537**	**$92,900,223**	74,856,631	$77,809,075
Issued during 1st quarter				
Warrants issued [(i)]	—	**(17,120)**	—	—
Tax benefit of issuance costs	—	**6,505**	—	—
Balance, end of quarter	**81,333,537**	**$92,889,608**	74,856,631	$77,809,075
Issued during 2nd quarter				
Stock options exercised	**2,000**	**5,340**	—	—
Issued for cash [(ii)]	—	—	6,000,000	14,474,009
Tax benefit of issuance costs	—	—	—	313,877
Balance, end of quarter	**81,335,537**	**$92,894,948**	80,856,631	$92,596,961

(i) Cost of issuing warrants attached to the subordinated debentures
(ii) Net of issuance costs of $Nil (2004 - $825,991)

Contributed Surplus

	2006	2005
Balance, beginning of year	**$405,420**	$233,984
Stock options expensed	**54,997**	1,387
Balance, end of 1st quarter	**$460,417**	$235,371
Stock options expensed	**55,010**	61,288
Stock options exercised	**(1,240)**	—
Balance, end of 2nd quarter	**$514,187**	$296,659

11. Stock Options and Warrants

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;

(iii) shares to be optioned shall not exceed 5,500,000 (December 31, 2005 –5,500,000) 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 Toronto Stock 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 Toronto Stock Exchange.

Options granted and exercised during the three months ended June 30 are as follows:

	2006		2005	
	Number of Shares	**Weighted Average Exercise Price**	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	**3,108,500**	**$1.40**	1,732,000	$0.47
Expired/cancelled	**(4,500)**	**2.05**	—	—
Outstanding, end of 1st quarter	**3,104,000**	**$1.40**	1,732,000	$0.47
Granted	**10,000**	**2.48**	1,779,500	2.05
Exercised	**(2,000)**	**2.05**	—	—
Outstanding, end of 2nd quarter	**3,112,000**	**$1.40**	3,511,500	$1.27

11. Stock Options and Warrants (continued)

The following table summarizes the stock options outstanding at:

	June 30, 2006		December 31, 2005	
Exercise prices	**Number of Options Outstanding**	**Remaining Contractual Life**	Number of Options Outstanding	Remaining Contractual Life
$0.30	**471,000**	**0.90 years**	471,000	1.40 years
$0.30	**10,000**	**0.94 years**	10,000	1.44 years
$0.56	**200,000**	**1.94 years**	200,000	2.44 years
$0.65	**608,500**	**1.94 years**	608,500	2.44 years
$1.30	**10,000**	**2.42 years**	10,000	2.92 years
$1.69	**29,500**	**2.46 years**	29,500	2.96 years
$2.00	**10,000**	**3.42 years**	10,000	3.92 years
$2.05	**1,763,000**	**3.92 years**	1,769,500	4.42 years
$2.48	**10,000**	**5.00 years**	—	—
	3,112,000		3,108,500	

Included in the above figures are 1,361,286 options at an average exercise price of $2.04, that were not exercisable at June 30, 2006, as they had not vested (December 31, 2005 – 1,528,052 options at an average exercise price of $2.04).

Warrants

The Company has issued warrants as part of certain financing and equity arrangements as follows:

	June 30, 2006		December 31, 2005	
Exercise price	**Number of Options Outstanding**	**Remaining Contractual Life**	Number of Options Outstanding	Remaining Contractual Life
$0.95	**500,000**	**2.16 years**	500,000	2.66 years
$3.60	**1,388,889**	**6.51 years**	—	—
$3.80	**1,315,789**	**6.51 years**	—	—
	3,204,678		500,000	

The 500,000 warrants at $0.95 were issued upon obtaining the credit facility and expire August 27, 2008. The warrants priced at $3.60 and $3.80 are the warrants attached to the subordinated debentures issued by the Company in the first quarter of 2006 (see note 8).

Notes to Consolidated Financial Statements

12. Per Share Information

Net income per share has been calculated based on the weighted average number of shares outstanding as follows:

Three months ended June 30,

	2006	2005
Basic	**81,334,196**	75,548,939
Fully diluted	**82,375,196**	81,245,264

Six months ended June 30,

	2006	2005
Basic	**81,333,868**	76,679,835
Fully diluted	**83,232,226**	78,869,490

The diluted share amounts presented above exclude the convertible debentures as the effect would have been anti-dilutive.

13. Segmented Information

The Company operates in two segments of the multi-family residential industry; multi-family apartments and manufactured home communities.

The accounting policies of these segments are the same as those described in the summary of significant accounting policies. The segments are analyzed based on earnings from property operations before amortization. The operating results and capital assets of the segments as at and for the three and six months ended June 30, 2006 and 2005 are set out as follows:

As at and for the three months ended June 30, 2006

	Multi-family Apartments	Manufactured Home Communities	Corporate	Total
Revenue [1]	**$13,443,720**	**$3,100,085**	**$132,230**	**$16,676,035**
Property operating expenses	**5,705,050**	**999,299**	**—**	**6,704,349**
Earnings from property operations	**$7,738,670**	**$2,100,786**	**$132,230**	**$9,971,686**
Capital assets (net)	**$416,340,565**	**$99,430,628**	**$1,076,584**	**$516,847,777**

(1) Apartments revenue includes a $656,783 gain on sale of land

As at and for the three months ended June 30, 2005

	Multi-family Apartments	Manufactured Home Communities	Corporate	Total
Revenue	$8,583,946	$2,044,028	$118,206	$10,746,180
Property operating expenses	3,577,805	578,325	—	4,156,130
Earnings from property operations	$5,006,141	$1,465,703	$118,206	$6,590,050
Capital assets (net)	$308,356,072	$69,879,659	$475,029	$378,710,760

For the six months ended June 30, 2006

	Multi-family Apartments	Manufactured Home Communities	Corporate	Total
Revenue [1]	**$26,458,621**	**$5,958,696**	**$250,920**	**$32,668,237**
Property operating expenses	**12,321,807**	**1,994,398**	—	**14,316,205**
Earnings from property operations	**$14,136,814**	**$3,964,298**	**$250,920**	**$18,352,032**

(1) Apartments revenue includes a $656,783 gain on sale of land

For the six months ended June 30, 2005

	Multi-family Apartments	Manufactured Home Communities	Corporate	Total
Revenue	$16,286,659	$3,171,885	$134,624	$19,593,168
Property operating expenses	7,418,485	944,999	—	8,363,484
Earnings from property operations	$8,868,174	$2,226,886	$134,624	$11,229,684

14. Financial Instruments

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. Credit assessments are conducted with respect to all new leasing and the Company also obtains a security deposit to assist in potential recovery requirements.

Notes to Consolidated Financial Statements

Fair Value

Financial instruments are defined as a contractual right to receive or deliver cash or another financial asset. The fair values of the Company's financial instruments, except for long-term debt, approximate their recorded values at June 30, 2006 and December 31, 2005 due to their short-term nature and or the credit terms of those instruments.

The fair value of the mortgages payable has been determined by discounting the cash flows using current market rates of similar investments. These estimates are subjective in nature and therefore cannot be determined with precision. The fair value of long-term debt as compared to book value has remained relatively consistent with the December 31, 2005 values.

15. Related Party Transactions

During the second quarter the Company paid real estate commissions of $12,530 to a company controlled by a director ($30,228 year-to-date). The commissions were based on market rates and there is no continuing contractual obligation to use the service of the related party.

16. Subsequent Events

During the period of July 1 to August 8, 2006 the Company completed three property acquisitions representing 288 units. The total purchase price of the acquisitions was $18.1 million which was satisfied through mortgages totaling $13.3 million and $4.8 million from the Company's cash and acquisition facilities. In addition, the Company has increased financing on certain properties by $1.5 million.

On July 27, 2006 the Company completed a $10 million private placement of unsecured subordinated debentures and warrants. The debentures and warrants have a term of seven years and the debentures bear a coupon of 6.33%. The warrants are convertible into common shares of the Company at an exercise price of $3.06 per share.

On August 2, 2006 the Company announced it had agreed to issue 6,560,000 common shares at a price of $2.30 per share to generate gross proceeds of $15,088,000 on a private placement basis.

17. Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation adopted for 2006.

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