

H&R Real Estate Investment Trust

Current Report: May 12, 2005
 Press Released: May 12, 2005
 Previous Report: May 20, 2004

RATING

<u>Current</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
STA-3 (high)p	STA-3 (high)p	STA-3 (high)p	NR

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Note: DBRS ratings are not a recommendation to buy, sell, or hold Fund units. (All figures in Canadian currency, unless otherwise noted.)
 p – This rating is based on public information.

STABILITY RATING SUMMARY

Legend:

Superior
 Moderate
 Weak

Operating Characteristics	Asset Quality	Financial Profile	Diversification	Size & Market Position	Sponsorship & Governance	Growth

STABILITY RATING RATIONALE

H&R Real Estate Investment Trust's ("H&R" or the "Trust") rating is supported by solid underlying operations that are producing stable cash flows from its existing portfolio. Acquisitions have contributed to rapid growth in recent years, which has improved diversification while also managing to extend average lease terms, both enhancing cash flow stability. The rating confirmation reflects the following factors: (1) stability of cash flow is supported by minimal lease maturities which range from 1% to just over 5% over the next five years with long average lease terms of 12.5 years, higher than most other real estate investment trusts (REITs). (2) H&R maintained consistently high occupancy across its portfolio of 99% over the past five years despite weakness in the Canadian office market. The combination of high occupancy and minimal lease maturities should provide for continued stability in cash flow and limit risks from potential downward pressure in market net rents over the medium term. (3) H&R benefits from its focus on single tenant properties having quality tenants under long-term triple net leases. This ensures recovery of most maintenance capital costs and improves stability of cash flow. H&R has maintained a sustainable payout ratio in the range of 87% to 92% over the past three years which is expected to continue in 2005. The higher cash flows from acquisitions have resulted in steady increases in distributions and should support the recent 5% increase to \$1.30 per unit. H&R added 40 properties in 2004 (25 in Canada and 15 in the U.S.) as well as acquiring most of the 30% of its initial portfolio it does not

already own. The increased U.S. exposure (25% of leaseable area) enhances H&R's geographic diversification, but also brings added risk of managing operations in a foreign market and exposes it to currency risk. To date, the currency impact from a weakened U.S. dollar has been minimized through hedging contracts. Recent growth has been largely funded with higher leverage, which DBRS now estimates at 65% of debt to total capital on a pro forma basis (61% of gross book value), reflecting the recent equity issue and further acquisitions early in 2005. While this has caused coverage ratios to fall to the lower end of its peer group, DBRS views the EBITDA coverage ratio at just over 2.0 times as manageable given the underlying size and stability of the portfolio. The main challenges include the following: (1) Concentration among the top three tenants (Bell Canada, Bell Mobility Cellular Inc., and TransCanada PipeLines Limited) account for 27% of gross rents. One mitigating factor has been the use of non-recourse financing for a significant portion of these properties. (2) The Trust has a geographic focus in Ontario and Alberta (60% of leaseable area) exposing it to regional factors such as oversupply in a given market. Looking forward, DBRS expects continued growth in cash flows from acquisitions, but the pace should slow in 2005 as valuations for attractive properties have risen. H&R's internal growth is limited by low vacancy rates and minimal lease maturities, however, these factors contribute to cash flow stability.

Strengths:

- Long-term leases with average term of 12.5 years
- Diversified portfolio with high quality tenants
- High portfolio occupancy at over 99%

Challenges:

- Internal growth opportunities are limited
- Portfolio concentration by tenant
- Portfolio concentration in Ontario and Alberta

FINANCIAL INFORMATION

	For the year ended December 31				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Declared distributions per unit (\$)	1.24	1.22	1.20	1.16	1.11
Cash available for distribution per unit (\$)	1.43	1.36	1.28	1.18	1.22
Net income before extras. per unit (\$)	1.02	1.15	1.18	1.17	1.16
Total debt/total capital	66.1%	63.3%	61.8%	49.7%	52.4%
Cash flow/total debt	0.06	0.06	0.08	0.11	0.11
EBITDA interest coverage	2.10	2.07	2.27	2.48	2.53
Cash flow return on average equity	13.9%	12.5%	13.2%	12.6%	12.4%
Declared distributions/cash avail. for distribution	88.2%	91.0%	93.9%	98.6%	91.0%
Market capitalization (\$)(millions)	1,786	1,370	947	963	582

THE FUND

H&R Real Estate Investment Trust holds interests in 199 properties diversified across office (32), industrial (103), and retail (64) segments in Canada and the U.S. totalling over 30 million square feet of leaseable area. The Trust is also involved in development activities with four projects currently under development.

Income Fund

DOMINION BOND RATING SERVICE

OPERATING CHARACTERISTICS Superior

Strengths:

- (1) H&R has long average lease terms of 12.5 years and lease maturities are minimal at just under 16% over the next five years in aggregate. The average lease terms are among the highest of any REIT rated by DBRS and are a key factor in H&R's stability of cash flow.
- (2) Most of the portfolio comprises single-tenant properties under long-term, triple net leases, which provide stable cash flows and assures cost recovery of almost all property expenses including maintenance capital. Also, the average age of the Trust's properties is only 12 years, which means that non-recoverable capital costs are minimal.
- (3) Portfolio occupancy has been consistently high at 99% for the past five years. Only the office portfolio was below 100% occupancy in 2004 at 98%, which is still well above the Canadian average for office properties. Despite difficulties in the Canadian office market, H&R has managed to maintain a high office occupancy rate at 95% or greater since its properties have quality tenants under long-term leases.
- (4) H&R's portfolio is diversified by asset with office [55% of net operating income (NOI)], industrial (29%), and retail (16%). The industrial and retail segments have increased in importance in recent years contributing a combined 45% of NOI (from 40% in 2002) which is positive as these tend to provide more stable cash flows over the long term.
- (5) H&R is one of the largest REITs in Canada, having a market capitalization of \$1.9 billion which provides access to capital to continue to grow. H&R's acquisitions in recent years have translated into steadily growing cash distributions.

Challenges:

- (1) Internal growth is limited to contractual rent increases in existing leases, which could be offset by lower net rents achieved on re-leasing office space. H&R has some multi-tenant office properties that have experienced weakness and require capital investment to reposition to improve performance.
- (2) There is also tenant concentration as Bell Canada, Bell Mobility Cellular Inc., and TransCanada PipeLines Limited account for 27% of gross rents, although the credit quality of these tenants is solid at A (low) or higher as rated by DBRS. The strong negotiating position of larger tenants may limit the ability to increase net rents, especially in the case of single tenant properties. Most of these long-term leases have built-in rent steps.
- (3) The portfolio has concentration in Ontario and Alberta representing 61% of the total leaseable area. In particular, the office market in Ontario, at 18% of total space, has been difficult in recent years and could continue to place downward pressure on NOI growth.
- (4) The expansion into the U.S. has been substantial over the past two years (the U.S. now represents 24% of leaseable area) which brings risks in terms of understanding the local markets and tenants. H&R mitigates these risks through long-term leases with quality tenants. This has also brought currency risk which could impact cash flows should the U.S. dollar further depreciate. H&R has hedged 80% of its cash flow exposure for 2005.
- (5) Acquisitions have increased debt levels to 65% on a pro forma basis, causing EBITDA interest coverage to decline to just over 2.0 times which is now in the lower range of H&R's peer group.

ASSET QUALITY Superior

- The Superior score in the asset quality category reflects the Trust's asset base, composed of commercial real estate properties, which have relatively long operating lives and require minimal maintenance, given a low average age of 12 years for the property portfolio.
- The Trust has a majority of tenants under triple net leases, which allows it to recover most of the property expenses including maintenance capital expenditures.
- With a minimal annual maintenance capital requirement, the Trust is able to distribute a high proportion of cash available.

FINANCIAL PROFILE



Moderate

(\$ thousands)	For the year ended December 31				
	2004	2003	2002	2001	2000
Net income (before extras.)	67,486	84,603	81,032	66,314	52,211
Depreciation and amortization	66,012	23,799	19,457	13,693	8,494
Other non-cash	1,618	0	0	0	0
Cash Flow From Operations	135,116	108,402	100,489	80,007	60,705
Leasing costs (1)	(7,355)	(6,756)	(10,681)	(11,293)	(3,960)
Cash Available For Distribution	127,761	101,646	89,808	68,714	56,745
Gross cash distributions	(112,698)	(92,499)	(84,318)	(67,770)	(51,647)
Cash Available After Distributions	15,063	9,147	5,490	944	5,098
Change in working capital	4,277	(5)	(1,548)	7,393	938
Free Cash Flow	19,340	9,142	3,942	8,337	6,036
(Acquisitions)/dispositions	(430,952)	(358,189)	(374,368)	(181,933)	(5,773)
Discontinued operations	0	0	0	0	0
Other investments	(24,400)	(35,191)	(7,283)	8,179	20,740
Cash Flow Before Financing	(436,012)	(384,238)	(377,709)	(165,417)	21,003
Equity financing (net)	63,700	214,035	13,043	242,966	(1,114)
Debt financing (net)	359,402	179,536	350,543	(55,711)	(19,576)
Net Change in Cash	(12,910)	9,333	(14,123)	21,838	313

Key Financial Ratios

Total debt/total capital	66.1%	63.3%	61.8%	49.7%	52.4%
Cash flow/total debt	0.06	0.06	0.08	0.11	0.11
EBITDA interest coverage	2.10	2.07	2.27	2.48	2.53
EBIT interest coverage	1.56	1.84	2.02	2.22	2.32

(1) DBRS estimate of leasing costs.

Summary:

- H&R has achieved strong growth in cash flow through acquisitions, although its moderate financial profile reflects its higher leverage, resulting in weaker coverage ratios. Overall, H&R's financial profile is supported by stable operating characteristics including long-term leases with high quality tenants.
- Balance sheet leverage has trended upward to 65% total debt-to-total capital (61.3% of gross book value) on a pro forma basis to reflect the recent equity issue for \$100.3 million. This is high as compared to other REITs.
- However, this level of debt and EBITDA interest coverage of around 2.0 times is acceptable given the underlying stable characteristics of the portfolio.

Outlook:

- Internal growth is limited to contractual rent steps as occupancy is high and lease maturities are minimal, between 1% and just over 5% over the next five years.
- H&R is expected to continue to generate free cash flow after leasing costs and cash distributions by maintaining its payout ratio at approximately 90%.
- DBRS expects the pace of acquisitions to slow somewhat in 2005 as recent high valuations will to some extent limit the availability of quality properties.
- Capital expenditures will be slightly higher in 2005 and 2006 at \$11.2 million and \$6.4 million to improve the competitive positioning of certain office properties.

LONG-TERM DEBT MATURITIES AND BANK LINES

As at December 31, 2004	2005	2006	2007	2008	2009	Thereafter	Total
Maturing debt (\$ thousands)	78.3	84.8	109.9	141.8	97.9	1,526.4	2,039.1
% of maturing debt	3.8%	4.2%	5.4%	7.0%	4.8%	74.9%	100.0%

- Most of H&R's debt (96%) is property-specific, secured debt, of which 53.7% is non-recourse to the Trust, which limits exposure of the remainder of the assets in the portfolio.
- Interest rates are mostly fixed (96% of debt) with an average rate of 6.9%.
- Debt maturities are reasonably well spread out with an average remaining life of 12 years. DBRS views refinancing risk as minimal given the solid underlying characteristics of H&R's portfolio.
- H&R has a one-year revolving bank line of \$180 million of which \$90 million is currently drawn, providing liquidity.

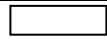
DIVERSIFICATION



Moderate

- The Trust has some concentration in the following ways:
 - Geographically the portfolio is focused on Ontario and Alberta where over 75% of the net operating income is generated.
 - Bell Canada, TransCanada PipeLines Limited, and Bell Mobility Cellular Inc. are the dominant tenants for the Trust and represent 27% of the rental revenue.
- The Trust, however, partially mitigates this exposure to concentration with a portfolio diversified by asset type with 55% of NOI derived from office, 29% from industrial, and 16% from retail.

SIZE & MARKET POSITION



Superior

- The Trust is one of the largest REITs in Canada, with a market capitalization of about \$1.9 billion and a portfolio of 199 properties comprising over 30 million square feet of leaseable area.
- The industrial portfolio has scale with about 17 million square feet.
- The office portfolio is moderate in size, while the retail portfolio is relatively small compared with other Canadian REITs.
- The Trust's large size also results in economies of scale, better diversification, and easier access to capital.

SPONSORSHIP & GOVERNANCE



Moderate

- There are currently nine trustees, five of whom are unrelated to the Trust and provide third-party advice.
- The Trust has an external property management agreement with H&R Property Management Ltd. that provides property services to the Trust for fees averaging 3% of gross revenue, in line with the average for the industry.

GROWTH



Moderate

For the year ended December 31

	2004	2003	2002	2001	2000	1999
Trust units outstanding as at (thousands)	96,306	86,198	70,911	69,771	49,093	45,294
Weighted average trust units (basic) (thousands)	89,591	74,676	70,289	58,242	46,559	41,637
Net income before extras. per unit (\$)	1.02	1.15	1.18	1.17	1.16	1.15
Cash flow from operations per unit (\$)	1.51	1.45	1.43	1.37	1.30	1.25
Cash available for distribution per unit (\$)	1.43	1.36	1.28	1.18	1.22	1.16
Declared distributions per unit (\$)	1.24	1.22	1.20	1.16	1.11	1.10
Declared distributions/cash avail. for distribution	88.2%	91.0%	93.9%	98.6%	91.0%	95.0%
Declared distributions/cash flow from operations	83.4%	85.3%	83.9%	84.7%	85.1%	87.9%

- Cash flow from operations per unit and cash available for distributions have continued to steadily grow mainly from property acquisitions.
- The Trust has been able to sustain its level of distribution with internal cash flow given its manageable payout ratio of 88%-92% of cash available for distribution.
- Other than contractual lease rent steps, the Trust will likely have limited opportunities for internal growth given that the portfolio vacancy rate is very low at 1% and lease maturities are minimal over the next five years at an average of only 3% annually.
- Growth in cash available is still expected to continue from the full year contribution from 2004 acquisitions totalling over \$700 million and potential growth through equity options exercised on current development projects.

THE PORTFOLIO

(As at December 31, 2004)	<u>Office</u>	<u>Industrial</u>	<u>Retail</u>	<u>Total</u>
Leaseable area (thousand sq. ft.)	7,608	17,121	5,378	30,107
% of leaseable area	25.3%	56.9%	17.9%	100.0%
Number of properties	32	101	63	196
Occupancy	98%	100%	100%	99%
Average rent per square foot (\$)	17.42	5.11	11.94	9.44
Average age of buildings (years)	14.1	12.7	6.3	11.9

- H&R now has one of the largest portfolios of any Canadian REIT. It is also diversified by asset type.
- The industrial and retail segments have grown in importance and tend to be more stable through cycles. However, office still represents 55% of NOI (industrial represents 29% of NOI and retail represents 16% of NOI).

PORTFOLIO OCCUPANCY

	As at December 31				
	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
Office	98%	96%	97%	97%	95%
Industrial	100%	99%	100%	100%	100%
Retail	100%	100%	99%	99%	100%
Total portfolio	99%	99%	99%	99%	99%

- H&R has maintained consistently high occupancy levels at 99% despite difficulties in the office segment in Canada.
- H&R benefits from having long-term average leases with mostly single-tenant properties.

LEASE MATURITIES BY ASSET TYPE

(As at December 31, 2004)	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Total</u>
Office	0.7%	0.6%	0.5%	1.4%	1.3%	4.6%
Industrial	0.1%	0.9%	2.3%	3.5%	4.0%	10.7%
Retail	0.0%	0.1%	0.1%	0.2%	0.1%	0.6%
Total	0.8%	1.6%	2.9%	5.1%	5.4%	15.9%

- Lease maturities of 1%-5% per annum are well spread out and an average lease term of 12.5 years is among the highest of any REIT in Canada.
- This limits H&R's exposure to higher occupancy levels and potential for lower net rents on renewals depending on leasing conditions.

TENANT PROFILE

(As at December 31, 2004)	<u>% of rental revenue</u>	<u>Lease term to maturity (years)</u>
Tenants		
Bell Canada	11.6%	16.8
TransCanada PipeLines Limited	8.2%	16.0
Bell Mobility Cellular Inc.	7.2%	19.5
RONA Inc.	4.0%	15.0
Royal Bank of Canada	3.3%	6.5
Lowes Companies Inc.	3.3%	14.3
Nestlé Canada Inc.	2.2%	14.3
TELUS Communications Inc.	2.2%	11.3
Purolator Courier Ltd.	2.2%	16.5
Finning International Inc.	2.1%	17.3
Total	46.3%	

- There is some concentration among the top three tenants, accounting for 27% of rental revenue. A mitigating factor is the high credit quality of these tenants, rated A (low) or higher by DBRS.
- The remaining tenants are well diversified and are nationally recognized with long-term leases. The top ten tenants' average lease term is almost 15 years.

H&R Real Estate Investment Trust
Balance Sheet

(\$ millions)

	As at December 31				As at December 31		
	2004	2003	2002		2004	2003	2002
Assets				Liabilities & Equity			
Cash & s.t. invest.	6.6	19.5	10.2	Mortgage debt	2,053.2	1,615.0	1,239.2
Income properties	3,145.0	2,510.8	1,922.2	Bank debt	89.5	56.3	1.3
Accounts receivable	4.9	5.7	7.1	Other liabilities	61.6	42.3	42.7
Mortgages receivable	54.8	91.7	60.1	Non-controlling interest	119.5	0.0	0.0
Other assets	89.6	54.0	51.3	Unitholders' equity	977.1	968.2	767.6
Total Assets	3,300.9	2,681.8	2,050.9	Total Liab. & Equity	3,300.9	2,681.8	2,050.9

Balance Sheet &
Liquidity Ratios

	For the year ended December 31					
	2004	2003	2002	2001	2000	1999
Total debt/total capital	66.1%	63.3%	61.8%	49.7%	52.4%	49.3%
Net debt/total capital	66.1%	63.0%	61.6%	48.8%	52.3%	49.2%
Total debt/gross book value assets	62.6%	60.9%	59.3%	47.7%	50.3%	47.6%
Secured debt/total debt	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cash flow/total debt	0.06	0.06	0.08	0.11	0.11	0.12

Coverage Ratios

EBITDA interest coverage	2.10	2.07	2.27	2.48	2.53	2.67
EBIT interest coverage	1.56	1.84	2.02	2.22	2.32	2.46

Profitability Ratios

Net rental margin	66.6%	64.5%	61.9%	63.2%	62.1%	58.8%
Return on average equity	6.9%	9.7%	10.6%	10.5%	10.7%	10.6%
Return on average capital	6.5%	8.0%	9.1%	9.4%	9.2%	9.3%
G&A/rental revenue	1.5%	1.5%	1.5%	1.9%	2.6%	2.8%

Operating Statistics

Total portfolio GLA (thousands sq. ft.)	30,107	24,461	17,753	13,534	10,643	9,092
Portfolio occupancy rate	99%	99%	99%	99%	99%	99%

Income Statement

(\$ thousands)

	For the year ended December 31					
	2004	2003	2002	2001	2000	1999
Income from properties	382,307	320,059	286,926	197,620	134,182	114,022
Operating expense	(127,863)	(113,561)	(109,398)	(72,668)	(50,881)	(47,028)
Net rental income	254,444	206,498	177,528	124,952	83,301	66,994
Interest income	8,104	7,864	6,584	13,114	20,590	19,710
General and administrative	(5,796)	(4,843)	(4,372)	(3,835)	(3,494)	(3,143)
EBITDA	256,752	209,519	179,740	134,231	100,397	83,561
Interest expense	(122,178)	(101,117)	(79,251)	(54,224)	(39,692)	(31,333)
Income Before Non-Cash Items	134,574	108,402	100,489	80,007	60,705	52,228
Depreciation & amortization	(66,012)	(23,799)	(19,457)	(13,693)	(8,494)	(6,328)
Straight line rent adjustment	22,406	1,585	1,585	1,585	1,593	1,860
Non-controlling interest	(1,076)	0	0	0	0	0
Net Income Before Extraordinary Items	89,892	86,188	82,617	67,899	53,804	47,760
Discontinued operations	(35)	0	0	0	0	0
Extraordinary items	(1,076)	4,365	1,405	795	654	499
Reported Net Income	88,781	90,553	84,022	68,694	54,458	48,259
Distributions declared	(112,698)	(92,499)	(84,318)	(67,770)	(51,647)	(45,931)
Net Remaining	(23,917)	(1,946)	(296)	924	2,811	2,328

Earnings Per Trust Unit (Basic)

Weighted average trust units (basic) (thousands)	89,591	74,676	70,289	58,242	46,559	41,637
Cash available for distribution per unit (\$)	1.43	1.36	1.28	1.18	1.22	1.16
Net income before extras. per unit (\$)	1.02	1.15	1.18	1.17	1.16	1.15
Reported net income per unit (\$)	1.00	1.21	1.20	1.18	1.17	1.16
Gross cash distributions per unit (\$)	1.26	1.24	1.20	1.16	1.11	1.10
Declared distributions per unit (\$)	1.24	1.22	1.20	1.16	1.11	1.10

Earnings Per Trust Unit (Diluted)

Weighted average Trust units (diluted) (thousands)	90,075	75,232	70,810	58,606	46,652	n/a
Cash available for distribution per unit (\$)	1.42	1.35	1.27	1.17	1.22	
Gross cash distributions per unit (\$)	1.25	1.23	1.19	1.16	1.11	

Payout Ratio

Declared distributions/cash avail. for distribution	88.2%	91.0%	93.9%	98.6%	91.0%	95.0%
Declared distributions/cash flow from operations	83.4%	85.3%	83.9%	84.7%	85.1%	87.9%