

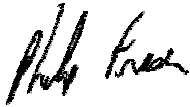
Management's Report

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 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. The Board carries out this responsibility principally through the Audit Committee.

The Audit Committee is appointed by the Board and consists of three independent directors. The committee meets periodically with management and the external auditors to satisfy itself that it has properly discharged its responsibilities, and to review financial statements. The external auditors have full and free access to the Audit Committee at anytime. The committee reports its findings to the Board of Directors for consideration when approving the financial statements for issuance to shareholders.



Philip Fraser
President & CEO



Robert Richardson
Executive V.P. & CFO

February 26, 2010

AUDITORS' REPORT

To the Shareholders of Killam Properties Inc.

We have audited the consolidated balance sheets of Killam Properties Inc. as at December 31, 2009 and 2008, and the consolidated statements of loss, deficit, comprehensive loss and accumulated other comprehensive loss 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

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

Ernst + Young LLP

Halifax, Canada
February 26, 2010

Chartered Accountants

Consolidated Balance Sheets

In thousands

As at December 31,

	2009	2008
ASSETS		
Real estate properties (note 3)	\$709,314	\$718,550
Cash and cash equivalents (note 4)	10,961	4,334
Restricted cash (note 4)	7,020	5,544
Accounts receivable (note 15)	2,676	1,392
Income tax receivable	400	20
Other assets (note 5)	8,278	8,828
Deferred financing costs (net)	84	-
Future income taxes	640	-
	\$739,373	\$738,668
LIABILITIES AND SHAREHOLDERS' EQUITY		
Mortgages and loans payable (note 6)	\$500,080	\$484,092
Convertible debentures (note 7)	40,822	40,293
Subordinated debentures (note 8)	9,552	18,837
Credit facility (note 9)	-	10,441
Accounts payable and accrued liabilities	7,817	7,900
Dividends payable	1,800	1,591
Security deposits	2,100	2,005
Future income taxes	-	316
	562,171	565,475
Shareholders' Equity		
Capital stock (note 10)	243,205	218,057
Contributed surplus (note 10)	1,842	1,332
Other paid-in capital (notes 7 and 8)	2,468	2,468
Accumulated other comprehensive loss	(15)	(550)
Deficit	(70,298)	(48,114)
	177,202	173,193
	\$739,373	\$738,668

See accompanying notes

On behalf of the Board

(signed) "G. Wayne Watson"
G. Wayne Watson

(signed) "Philip D. Fraser"
Philip Fraser

Consolidated Statements of Loss

In thousands (except per share amounts)

For the year ended December 31,

	2009	2008
Property Operations		
Rental revenue	\$103,899	\$97,454
Other operating income	475	474
Property operating expenses	(41,768)	(41,470)
<i>Income from property operations</i>	62,606	56,458
Home Sale Operations		
Home sale revenues	2,669	6,704
Cost of home sales	(2,306)	(5,431)
New home placement fees	70	95
Operating expenses	(199)	(196)
<i>Income from home sales</i>	234	1,172
<i>Income before undernoted items</i>	62,840	57,630
Corporate revenue	(424)	(763)
Gain on debt retirement	(638)	-
Mortgage and loan interest	26,034	25,235
Convertible debenture interest	2,981	2,964
Subordinated debenture interest	1,348	1,360
Credit facility interest	56	213
Depreciation	27,281	27,358
Amortization of deferred financing	1,550	1,354
General and administrative	6,732	6,247
Provincial capital taxes	313	401
Interest and bank charges	280	227
	65,513	64,596
Loss before income taxes	(2,673)	(6,966)
Future tax recovery	830	1,958
Net loss	(\$1,843)	(\$5,008)
Net loss per share		
- basic	(\$0.05)	(\$0.15)
- diluted	(\$0.05)	(\$0.15)

Consolidated Statements of Deficit

In thousands

For the year ended December 31,

	2009	2008
Deficit, beginning of year	(\$48,114)	(\$24,023)
Net loss	(1,843)	(5,008)
Common shares repurchased and cancelled (note 10)	-	(186)
Dividends	(20,341)	(18,897)
Deficit, end of year	(\$70,298)	(\$48,114)

Consolidated Statements of Comprehensive Loss

In thousands

For the year ended December 31,

	2009	2008
Net loss	(\$1,843)	(\$5,008)
Fair value of fuel hedges, net of tax	535	(561)
Comprehensive loss	(\$1,308)	(\$5,569)

Consolidated Statements of Accumulated Other Comprehensive Loss

In thousands

For the year ended December 31,

	2009	2008
Balance, beginning of year	(\$550)	\$11
Fair value of fuel hedges, net of tax	535	(561)
Balance, end of year	(\$15)	(\$550)

Consolidated Statements of Cash Flows

In thousands

For the year ended December 31,

	2009	2008
OPERATING ACTIVITIES		
Net loss	(\$1,843)	(\$5,008)
Add (deduct) items not affecting cash		
Depreciation and amortization	28,831	28,712
Non-cash debenture interest	369	345
Non-cash compensation expense	450	370
Gain on debt retirement	(638)	-
Future income taxes	(830)	(1,958)
Net change in non-cash working capital items related to operations	(113)	(97)
Cash provided by operating activities	26,226	22,364
FINANCING ACTIVITIES		
Increase in deferred financing	(2,193)	(2,138)
Issue of common shares for cash	23,340	488
Repurchase of common shares for cash	(283)	(1,526)
Repayment of subordinated debentures	(8,900)	-
(Repayment of) increase in credit facility	(10,600)	10,600
Repayment of long-term debt - on refinancing	(70,254)	(34,736)
Regular principal repayments	(12,638)	(12,941)
Issuance of long-term debt	100,431	61,677
Cash dividends	(19,203)	(16,562)
Cash (used in) provided by financing activities	(300)	4,862
INVESTING ACTIVITIES		
Increase in restricted cash	(1,476)	(1,118)
Purchase of capital assets	(17,823)	(36,409)
Cash used in investing activities	(19,299)	(37,527)
Net increase (decrease) in cash and cash equivalents	6,627	(10,301)
Cash and cash equivalents, beginning of year	4,334	14,635
Cash and cash equivalents, end of year	\$10,961	\$4,334
<i>See accompanying notes</i>		
Supplemental disclosure of cash paid		
Interest	\$30,403	\$29,643
Capital taxes	\$693	\$432

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

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). The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries in accordance with CICA Handbook Section 1600.

Use of accounting estimates

The preparation of financial statements in conformity with GAAP 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. Estimates include, but are not limited to, the following;

- (i) Economic useful life of buildings for purposes of calculating depreciation.
- (ii) Forecast of economic indicators in order to measure undiscounted cash flows and fair values of buildings for purposes of determining net recoverable amounts under GAAP.
- (iii) The allocation of property acquisition purchase prices entails various estimates to determine the fair values of, and allocation of purchase prices to, the tangible and intangible assets and liabilities acquired.
- (iv) Amount of capitalized wages which relates to suite renovations and project improvements.

Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents consist of cash. As at December 31, 2009, the Company's cash balances were held in bank accounts, which the Company has full access to, and do not include any instruments related to asset-backed securities or commercial paper programs.

Revenue recognition

Revenue from rental properties is recognized when a tenant commences occupancy of a rental unit or site 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.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

2. Summary of Significant Accounting Policies (continued)

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.

Capital assets

Revenue producing real estate properties held as ongoing investments are recorded at cost less accumulated depreciation 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 including direct overhead costs, other than ordinary repairs and maintenance, are capitalized and amortized over terms appropriate to the expenditure. The purchase price of properties acquired is allocated to land, building, infrastructure, equipment and intangible assets based on the fair values of the respective assets.

Revenue producing properties are reviewed periodically for impairment. An impairment loss will be recognized in the period when the carrying amount of the property exceeds the net recoverable amount represented by the undiscounted estimated future cash flows expected to be received from the ongoing use of the property plus its residual value. If it is determined that impairment exists, the carrying value of the property will be reduced to its estimated fair value.

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 and driveways/Water and sewer	4% - 6%	declining balance
Suite renovations	20%	declining balance
Project improvements	10%	declining balance
Other assets	5% - 30%	declining balance
Intangibles		Remaining term of lease

Deferred financing costs

Financing fees and other costs incurred in connection with debt financing are deducted from the cost of the debt and amortized using the effective interest-rate method over the expected life 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.

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.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

2. Summary of Significant Accounting Policies (continued)

Inventory

Inventories of manufactured homes are valued at the lower of cost (purchase price plus delivery and set-up costs) and net realizable value.

Goodwill

Goodwill represents the excess of the purchase price of an acquired business over the net amount of the fair values assigned to its assets and liabilities and is not subject to amortization. The Company evaluates the carrying value of goodwill for potential impairment through an annual review and analysis of fair market value. Goodwill is also evaluated for potential impairment between annual tests if an event or circumstances occur that more likely than not reduces the fair value of a business below its carrying values. Fair market value is determined by use of net present value financial models, which incorporate management's assumptions of future profitability.

Hedges

Hedge accounting requires that the Company document its risk strategy objectives and the relationships between the hedging instrument and the hedged item. The Company is also required to assess the effectiveness of the hedging relationship throughout its term and that it remains consistent with the Company's risk strategy. As at December 31, 2009, the Company has entered into various fuel cash flow hedges and has concluded that the hedges are effective. The Company recognizes on its balance sheet the fair value of these hedges. The effective portion of the change in the fair value of the hedges is recorded in other comprehensive income and reclassified to fuel expense in the same period the related hedged transaction occurs. Any ineffective portion of the change in fair value of the hedge is recognized in net earnings in the reporting period.

Financial Instruments

Section 3855 prescribes when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and at what amount (i.e. requiring fair value or cost-based measures depending on classification). As described below, the Company classifies financial assets into one of four categories: held-for-trading, held to maturity, available-for-sale, or loans and receivables; and financial liabilities are classified into one of two categories: held-for-trading or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity financial assets and other financial liabilities which are measured at amortized cost. The Company adds transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability not held-for-trading to the initial fair value of the financial asset or financial liability. For loans and receivables, other financial liabilities and available for sale financial assets with fixed or determinable payments, such transaction costs are amortized to net income using the effective interest method. For available-for-sale financial assets that do not have fixed or determinable payments, the transaction costs are subsequently recognized in other comprehensive income and then in net income when the asset is sold or impaired. Transaction costs for held-for-trading financial assets are expensed as incurred.

In accordance with Section 3855, the Company conducted a search for embedded derivatives in its contractual arrangements and did not identify any embedded features that required separate presentation from the related host contract. The Company does not acquire, hold or issue derivative financial instruments for trading purposes. The Company may use derivative instruments from time to time to hedge its exposure to future fuel costs as described in the Hedge section of the accounting policy notes.

New Accounting Policies

Effective January 1, 2009, the Company has adopted the following sections of the Canadian Institute of Chartered Accountants (CICA) Handbook:

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

2. Summary of Significant Accounting Policies (continued)

Section 3064 – Goodwill and Intangible Assets

The new standard which replaces Section 3062, Goodwill and Other Intangible Assets, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's interim and annual financial statements commencing January 1, 2009. The adoption of this section did not have an impact on the Company's financial results.

Section 3862 - Financial Instruments – Disclosures

In June 2009, the CICA issued amendments to Section 3862, "Financial Instruments – Disclosures" to include additional disclosure requirements about the fair value measurement of financial instruments and to enhance liquidity risk disclosures. Further information can be found in note 15. The above accounting policy changes did not affect earnings.

EIC-173, Credit Risk and the Fair value of Financial Assets and Financial Liabilities

In January, 2009 the Emerging Issues Committee ("EIC") issued a new abstract EIC 173 "Credit risk and the fair value of financial assets and financial liabilities". This abstract concludes that an entity's own credit risk and the credit risk of the counterparty should be taken into account when determining the fair value of financial assets and financial liabilities, including derivative instruments. This abstract is to apply to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of this abstract did not impact the Company's financial statements.

Future Accounting Policy Changes

Business combinations

In January 2009, the CICA issued CICA Handbook Section 1582, Business Combinations, Section 1601, Consolidations, and Section 1602, Non-controlling Interests. These sections replace the former CICA Handbook Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. Section 1582 and 1602 will require net assets, non-controlling interests and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded and is described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners. Acquisition costs are not part of the consideration and are to be expensed when incurred. Section 1601 establishes standards for the preparation of consolidated financial statements.

These new sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. The Company is currently evaluating the impact of the adoption of these sections.

International Financial Reporting Standards (IFRS)

The Canadian Accounting Standards Board recently ratified a strategic plan that will see Canadian GAAP converged with, and replaced by, International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time. Further, the Company anticipates a significant increase in disclosures resulting from the adoption of IFRS and is continuing to assess the level of disclosure required and any necessary system changes to gather and process information.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

3. Real Estate Properties

As at December 31,	2009		2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land	\$ 85,691	\$ —	\$ 85,320	\$ —
Buildings	489,490	50,339	487,172	38,639
Roads and driveways	71,175	10,317	71,160	7,782
Water and sewer	71,924	15,087	71,909	11,460
Equipment	7,610	1,987	7,009	1,432
Suite renovations	32,356	14,337	28,421	10,325
Project improvements	48,521	11,305	39,619	7,666
Other assets	8,268	2,743	6,384	2,075
Intangibles	3,552	3,158	3,549	2,614
	\$818,587	\$109,273	\$800,543	\$81,993
Less: accumulated depreciation	(109,273)		(81,993)	
	\$709,314		\$718,550	

During the year ended December 31, 2009, the Company capitalized indirect costs of \$1.0 million (2008 - \$0.9 million) as part of its project improvement and suite renovation program.

4. Cash and Restricted Cash

Cash

As at December 31,	2009	2008
Cash	\$10,961	\$4,334

As at December 31, 2009, the Company's cash balances were held in bank accounts, which the Company has full access to, and do not include any instruments related to asset-backed securities or commercial paper programs.

Restricted Cash

As at December 31,	2009	2008
Real estate deposits and property tax reserves	\$5,330	\$4,128
Tenant security deposits	1,690	1,416
Restricted cash	\$7,020	\$5,544

5. Other Assets

As at December 31,	2009	2008
Prepays	\$1,501	\$1,704
Inventory	2,117	2,461
Deferred charges	160	163
Goodwill	4,500	4,500
	\$8,278	\$8,828

Inventory relates to manufactured homes for which sales have not closed at year-end, as well as a number of stock homes. Approximately \$0.1 million of the inventory is pledged as collateral related to short-term financing on the purchase of new manufactured homes for future sale. Goodwill presented above is the tax effect of the Company's acquisition of a property business through a share purchase transaction. The off-setting liability is presented in future income taxes.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

6. Mortgages and Loans Payable

As at December 31,	Maturities	Interest Rates	2009	2008
Mortgages	Jan 2010 – July 2019	3.36% - 8.47%	\$497,816	\$478,367
Vendor financing	Apr 2010 – June 2016	0.00% - 9.20%	8,369	10,692
Total mortgages and loans			\$506,185	\$489,059
Less: deferred financing charges			(6,105)	(4,967)
			\$500,080	\$484,092

Mortgages are secured by a first charge on the properties of the Company and vendor mortgages are secured by either a second charge on the property and/or a general corporate guarantee. The weighted average mortgage rate at December 31, 2009 was 5.2% (December 31, 2008 – 5.3%).

Regular Principal and Maturity Repayments		Average Interest Rate by Year of Maturity	
Year	Amount	Balance December 31, 2009	Weighted Avg. Int. Rate
2010	\$61,030	\$48,850	5.24%
2011	60,856	51,169	5.58%
2012	61,713	50,381	5.45%
2013	79,980	76,750	4.84%
2014	99,170	121,233	4.81%
Thereafter	143,436	157,802	5.30%
	\$506,185	\$506,185	5.15%

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 \$12.40 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%. The balance sheet amount at December 31, 2009 is net of \$0.8 million of deferred financing charges (2008 - \$1.1 million).

8. Subordinated Debentures

The Company's unsecured subordinated debentures mature January 2013 and consist of the following;

Face Interest Rate %	2009		2008	
	Face Amount	Balance	Face Amount	Balance
5.92%	\$ 2,500	\$2,451	\$ 5,000	\$ 4,874
6.06%	2,500	2,449	5,000	4,869
6.33%	5,000	4,869	10,000	9,662
	\$10,000	\$9,769	\$20,000	\$19,405
Less: Deferred financing charges		(217)		(568)
		\$9,552		\$18,837

The \$0.9 million fair value of warrants issued in association with the subordinated debentures is reflected in "Other paid-in capital". Information on the warrants is presented in Note 11. The weighted average effective interest rate on the remaining liability component of the debentures is calculated at 6.8%.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

9. Credit Facilities

The Company has credit facilities set out as follows:

- I. A credit facility with a major financial institution that can be used to finance the Company's on-going acquisition program. The amount available under the revolving facility varies with the value of pledged assets, to a maximum of \$15 million. The facility includes the option for a commitment increase, allowing Killam a one-time opportunity to increase the credit limit to \$40 million. The interest rate on the debt is either prime plus 300 basis points on prime rate advances or 400 basis points over Banker's Acceptances (BAs). Killam has the right to choose between prime rate advances and BAs based on available rates and timing requirements. As at December 31, 2009 the Company has \$1.7 million of assets pledged to the line and had a balance outstanding at December 31, 2009 of \$Nil. This facility expires in May 2010 and includes an opportunity to extend the maturity date by an additional year.
- II. An operating facility which consists of a \$1.0 million revolving demand facility for general business purposes, bearing interest at the lender's prime rate plus 2%. As at December 31, 2009, the Company had letters of credit totaling \$0.4 million outstanding against this facility (December 31, 2008 - \$0.4 million). 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:

For the year ended December 31,	2009		2008	
	Number of Shares	Value	Number of Shares	Value
Balance, beginning of year	34,027,582	\$218,057	33,392,730	\$214,565
Issued for cash ⁽ⁱ⁾	4,255,000	23,350	—	—
Issued on property acquisitions ⁽ⁱⁱ⁾	85,273	598	388,037	1,997
Stock options exercised	—	—	3,625	19
Warrants exercised	—	—	125,000	475
Dividend reinvestment plan ⁽ⁱⁱⁱ⁾	204,510	1,172	343,290	2,444
Normal course issuer bid	(53,600)	(343)	(225,100)	(1,446)
Tax benefit of issuance costs	—	371	—	3
Balance, end of year	38,518,765	\$243,205	34,027,582	\$218,057

(i) Net of issue costs of \$1,300

(ii) Net of issue costs of \$3 (2008 - \$4)

(iii) Net of issue costs of \$7 (2008 - \$6)

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

10. Capital Stock and Contributed Surplus (continued)

Dividend Reinvestment Plan

The Company's Dividend Reinvestment Plan ("DRIP") allows common shareholders to elect to have all cash dividends from the Company reinvested in additional common shares. Shareholders who participate in the DRIP receive an additional dividend of common shares equal to 3% of each cash dividend that was reinvested. The price per share is calculated by reference to a ten day weighted average closing price of the Company's common shares on the Toronto Stock Exchange preceding the relevant dividend date, which typically is on or about the 15th day of the month following the dividend declaration (prior to December 2009 a five day weighted average was used).

Normal Course Issuer Bid

In August 2009, the Company announced that the Toronto Stock Exchange (the "TSX") had accepted Killam's notice of intention to renew its normal course issuer bid for its common shares. Under the normal course issuer bid, Killam may acquire up to 3.1 million common shares commencing on August 22, 2009, and ending on August 21, 2010. All purchases of common shares are made through the facilities of the TSX at the market price of the shares at the time of acquisition. Daily repurchases by Killam are limited to 32,171 common shares, other than block purchase exceptions. Any shares acquired are cancelled.

For the year ended December 31, 2009, 53,600 common shares were purchased and cancelled (2008 - 225,100 common shares). The shares were purchased at an average price of \$5.28 per share (2008 - \$6.78 per share). The aggregate cost of the common shares purchased and cancelled for the year ended December 31, 2009 was \$0.3 million (2008 - \$1.5 million). For the year ended December 31, 2009, \$0.3 million was recorded as a charge against share capital for the average carrying value of the common shares (2008 - \$1.4 million) with the remainder charged against retained earnings and contributed surplus.

Contributed Surplus

<i>For the year ended December 31,</i>	2009	2008
Balance, beginning of year	\$1,332	\$ 863
Stock options expensed	450	429
Stock options exercised	—	(7)
Stock options forfeited	—	(59)
Normal course issuer bid	60	106
Balance, end of year	\$1,842	\$1,332

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

11. Stock Options and Warrants

Under the terms of the stock option plan:

- (i) from time to time the Company designates 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 2,125,000 (December 31, 2008 – 2,125,000) 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 years ended December 31 are as follows:

<i>For the year ended December 31,</i>	2009		2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	926,875	\$8.40	828,500	\$8.43
Granted	405,000	5.32	138,750	8.03
Exercised	—	—	(3,625)	3.68
Forfeited	—	—	(36,750)	8.06
Outstanding, end of year	1,331,875	\$7.46	926,875	\$8.40

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

	2009	2008
Expected volatility	26.5%	24.4%
Risk-free interest rate	2.00%	3.10%
Expected lives	5 years	5 years
Expected dividend yield	10%	7%

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

11. Stock Options and Warrants (continued)

The following table summarizes the stock options outstanding at December 31:

As at December 31,		2009		2008		
Exercise Prices	Number of Options Outstanding	Remaining Contractual Life	Options Exercisable	Number of Options Outstanding	Remaining Contractual Life	Options Exercisable
\$5.32	405,000	4.33 years	128,250	—	—	—
\$7.94	40,000	2.54 years	6,292	40,000	3.54 years	4,292
\$8.03	137,500	3.42 years	71,048	137,500	4.42 years	43,544
\$8.06	137,500	2.63 years	67,146	137,500	3.63 years	39,646
\$8.11	1,250	3.09 years	479	1,250	4.09 years	227
\$8.20	420,750	0.42 years	393,816	420,750	1.42 years	310,192
\$9.40	137,500	1.61 years	93,157	137,500	2.61 years	65,657
\$9.60	48,625	1.55 years	34,481	48,625	2.55 years	24,729
\$9.92	2,500	1.50 years	1,744	2,500	2.50 years	1,248
\$10.04	1,250	2.25 years	681	1,250	3.25 years	433
	1,331,875		797,094	926,875		489,968

The exercisable options had a weighted average exercise price of \$7.91 at December 31, 2009 (\$8.41 as at December 31, 2008).

Warrants

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

As at December 31,		2009		2008	
Exercise price	Number of Warrants Outstanding	Remaining Contractual Life	Number of Warrants Outstanding	Remaining Contractual Life	
\$14.40	347,222	3.01 years	347,222	4.01 years	
\$15.20	328,947	3.01 years	328,947	4.01 years	
\$12.24	816,993	3.01 years	816,993	4.01 years	
	1,493,162		1,493,162		

The above warrants were granted in connection with the subordinated debentures issued by the Company during 2006 (see note 8).

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

12. Income Taxes

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

<i>For the year ended December 31,</i>	2009		2008	
Net loss before income taxes	\$(2,673)		\$(6,966)	
Income tax recovery at statutory rates	\$897	33.6%	\$2,187	31.4%
Non-deductible share compensation	(151)	(5.6)%	(116)	(1.7)%
Non-deductible debenture interest	(124)	(4.6)%	(108)	(1.5)%
Other differences	208	7.8%	(5)	(0.0)%
Future tax recovery	\$830		\$1,958	28.2%

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:

<i>As at December 31,</i>	2009	2008
Share issue costs	\$ 906	\$1,110
Loss carryforwards	3,541	—
Fair value of hedges	6	252
Deferred financing costs	(71)	—
Real estate properties	(3,742)	(1,678)
Net future income tax asset (liability)	\$ 640	\$ (316)

13. Per Share Information

The following are the weighted average number of shares outstanding for the years ended December 31, 2009 and 2008. The fully diluted amounts shown below exclude the convertible debentures as they are considered anti-dilutive as well as stock options and warrants whose exercise price exceeded the average market price for the period.

<i>For the year ended December 31,</i>	2009	2008
Basic	36,247,130	33,604,410
Fully diluted	36,340,763	33,630,272

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

14. Segmented Information

The Company operates in two rental segments of the multi-family residential industry: apartments and manufactured home communities. The Company also operated in the manufactured home sales segment, information on this segment is provided in the consolidated statements of income.

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 income from property operations before interest and amortization. The operating results and capital assets of the segments are set out as follows:

As at and for the year ended December 31, 2009

	Apartments	Manufactured Home Communities	Total
Rental revenue	\$80,056	\$23,843	\$103,899
Other income	220	255	475
	80,276	24,098	104,374
Property operating expenses	(33,246)	(8,522)	(41,768)
Income from property operations	\$47,030	\$15,576	\$62,606
Capital assets (net)	\$544,258	\$163,989	\$708,247
Corporate assets (net)			1,067
Total capital assets (net)			\$709,314
Capital expenditures	\$8,392	\$6,779	\$15,171

As at and for the year ended December 31, 2008

	Apartments	Manufactured Home Communities	Total
Rental revenue	\$74,835	\$22,619	\$97,454
Other income	281	193	474
	75,116	22,812	97,928
Property operating expenses	(33,406)	(8,064)	(41,470)
Income from property operations	\$41,710	\$14,748	\$56,458
Capital assets (net)	\$552,230	\$165,353	\$717,583
Corporate assets (net)			967
Total capital assets (net)			\$718,550
Capital expenditures	\$9,119	\$4,378	\$13,497

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

15. Financial Risk Management Objectives and Policies

The Company's principal financial liabilities, other than derivatives, comprise mortgages, debentures and trade payables. The main purpose of these financial liabilities is to finance the Company's operations. The Company has various financial assets such as trade receivables and cash which arise directly from its operations.

The Company will also enter into derivative transactions, primarily natural gas and oil swap contracts, to manage the price risk arising from fluctuations in these commodities. It is, and has been, the Company's policy that no speculative trading in derivatives shall be undertaken.

The main risks arising from the Company's financial instruments are cash flow interest rate risk, credit risk, and liquidity risk. 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 attempt to 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. As at December 31, 2009 no mortgages or vendor debt have floating interest rates (December 31, 2008 - 1.3%). An annualized 1% change in the interest rate on Killam's entire mortgage and vendor debt at December 31, 2009 would affect financing costs by approximately \$5.1 million per year. However, only \$48.9 million of Killam's mortgage and vendor debt matures in the next twelve months and that same interest rate change would impact Killam by \$0.5 million per annum.

(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. In addition, the receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debt is not significant. The Company's bad debt expense experience over the last number of years has been less than 0.4% of revenues. The Company's policy is to write-off tenant receivables when the tenant vacates the unit and any subsequent receipt of funds is netted against bad debts. As a result of the low bad debt experience, no allowance for doubtful accounts is recorded in the accounts.

Pursuant to their respective terms, tenant receivables are aged as follows:

<i>As at December 31,</i>	2009	2008
0-30 days	\$ 25	\$ 68
31-60 days	296	313
61-90 days	40	86
Over 90 days	103	187
Total tenant receivables	464	654
Other receivables	863	630
Insurance receivables	1,349	109
Total	\$2,676	\$1,392

Included in other receivables are accruals for laundry revenue, commission revenues and other non-rental income. The vast majority of these receivables are less than 60 days old. The insurance receivable in 2009 relates to a property fire in September 2009.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

15. Financial Risk Management Objectives and Policies (continued)

(iii) *Liquidity risk*

The Company is exposed to the risk of being unable to honour its financial commitments by the deadlines set out under the terms of such commitments and at a reasonable price. Senior management manages the Company's cash resources based on financial forecasts and anticipated cash flows. The maturities of the Company's long-term financial liabilities are set out in Notes 6 to 8 of the consolidated financial statements. The Company structures its financings so as to stagger the maturities of its debt, thereby minimizing the Company's exposure to liquidity risk in any one year. In addition, the Company's apartments qualify for Canada Mortgage and Housing Corporation (CMHC) insured debt, reducing the refinancing risk on mortgage maturities. The Company's MHCs do not qualify for CMHC insured debt, however, they continue to have access to mortgage debt. Management does not expect to be faced with liquidity concerns on the maturity of its mortgages as funds continue to be accessible in the multi-residential sector. During 2009, the Company refinanced \$52.2 million of maturing apartment mortgages with new mortgages totaling \$68.1 million for net proceeds of \$15.9 million. In addition the Company refinanced \$16.0 million of maturing MHC mortgages with new mortgages totaling \$19.6 million for net proceeds of \$3.6 million. Subsequent to December 31, 2009, Killam has refinanced an additional \$5.5 million of maturing apartment debt with new mortgages totaling \$7.6 million for net proceeds of \$2.1 million.

Capital Management

The primary objective of the Company's capital management is to ensure that it maintains a healthy capital ratio in order to support its business and maximize shareholder value. The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, issue new shares, issue debt securities or adjust mortgage financing on properties.

The Company monitors capital using a total gross debt to gross book value ratio. The Company's strategy is to maintain its total gross debt to gross book value ratio between 65%-70%. The calculation of the total gross debt to gross book value is summarized as follows:

<i>As at December 31,</i>	2009	2008
Mortgages and vendor financing	\$506,185	\$489,059
Convertible debentures	41,575	41,338
Subordinated debentures	9,769	19,405
Credit facility	-	10,600
Total Gross Debt	\$557,529	\$560,402
Totals assets	\$739,373	\$738,668
Plus: Deferred financing re-allocated	7,076	6,739
Plus: Accumulated depreciation	109,273	81,993
Gross Book Value (GBV)	\$855,722	\$827,400
Total Gross Debt as a Percentage of GBV	65.2%	67.7%

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

15. Financial Risk Management Objectives and Policies (continued)

Fair Value

Financial instruments are defined as a contractual right or obligation to receive or deliver cash or another financial asset. The fair values of the Company's financial instruments, except for mortgages and loans payable, approximate their recorded values at December 31, 2009 and December 31, 2008 due to their short-term nature and or the credit terms of those instruments.

The following table presents the classification, subsequent measurement, carrying values and fair values (where available) of the Company's financial assets and liabilities.

Classification	Subsequent Measurement	2009		2008	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Held for Trading:					
Cash and cash equivalents (a)	Fair Value (Level 1)	\$10,961	\$10,961	\$4,334	\$4,334
Derivative instrument liability (a)	Fair Value (Level 1)	—	\$(21)	—	(802)
Loans and Receivables:					
Receivables and other (b)	Amortized cost	\$9,696	\$9,696	\$6,936	\$6,936
Other Financial Liabilities:					
Accounts payable and other (b)	Amortized cost	\$11,717	\$11,717	\$11,496	\$11,496
Mortgages (c)	Amortized cost	\$506,185	\$510,300	\$489,059	\$529,000
Convertible debentures (c)	Amortized cost	\$41,575	\$43,654	\$41,338	\$37,833
Subordinated debentures (c)	Amortized cost	\$9,769	\$9,717	\$19,406	\$20,080

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation techniques:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.
- Level 2: other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs that have significant effect on the recorded fair value that are not based on observable market data

- (a) Cash and cash equivalents and derivative instrument liabilities are classified as held for trading and carried at their fair values. The Company recorded a loss of \$1.0 million during 2009 against net earnings related to the settlement of commodity swaps (2008 – loss of \$0.1 million).
- (b) The Company's short-term financial instruments, comprising amounts receivable, restricted cash, accounts payable and other liabilities and dividends payable are carried at amortized cost which, due to their short-term nature, approximates their fair value.
- (c) Long-term financial instruments include mortgages and debentures. The fair values of these financial instruments are based upon discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks. Such fair value estimates are not necessarily indicative of the amounts the Company might pay or receive in actual market transactions. These estimates are subjective in nature and therefore cannot be determined with precision.

Notes to Consolidated Financial Statements

Dollar amounts in thousands (except per share amounts)

15. Financial Risk Management Objectives and Policies (continued)

As at December 31, 2009, the Company had entered into natural gas and oil swap contracts to hedge portions of its fuel requirements for various periods, as follows;

Hedge Period	Quantity Hedged	% of estimated usage hedged	NYMEX Price	Fair Value
Oil	(litres)		(C\$)	
Jan-March 2010	220,000	21%	\$0.60	(\$2.0)
Natural Gas	(MMBTUs)			
Jan-March 2010	6,300	10%	\$8.90	(19.0)
				<u>(\$21.0)</u>

The fair value presented above represents the estimated cost if the Company were to unwind the hedge positions as at December 31, 2009. The actual costs to settle the hedge contracts is recorded to fuel expense in the same period the related hedged transaction occurs.

16. Subsequent Events

During the period January 1 to February 26, 2010 the Company has refinanced \$5.5 million of maturing apartment debt for net proceeds of \$7.6 million. The previous weighted average interest rate was 5.99% and the interest rate on the new debt is 4.16%.

Subsequent to December 31, 2009, Killam acquired an additional 8.3% of Garden Park Apartments in Halifax for \$1.8 million, increasing Killam's ownership in the building to 39%. The purchase price was satisfied with a \$0.9 million vendor mortgage with the remainder in cash.

On January 18, 2010 and February 18, 2010, the Company announced dividends of \$0.046668 per share, payable on February 15, 2010 and March 15, 2010 respectively, to shareholders of record on January 29, 2010 and February 26, 2010 respectively.