

SUNSTONE OPPORTUNITY FUND (2005) LIMITED PARTNERSHIP

FORM 51-102F1 MANAGEMENT DISCUSSION AND ANALYSIS

YEAR ENDED DECEMBER 31, 2005

The following management discussion and analysis of the financial condition and results of operations prepared April 27, 2006 should be read together with the Sunstone Opportunity Fund (2005) Limited Partnership (the “Sunstone (2005) LP”) audited financial statements and notes thereto for the year ended December 31, 2005. All financial information is reported in Canadian dollars and in accordance with Canadian generally accepted accounting principles unless otherwise noted.

This discussion may contain forward-looking statements which are based on our expectations, estimates and forecasts. These statements are subject to risks and uncertainties that are difficult to predict or control. These risks and uncertainties could cause actual results to differ materially from those indicated. Readers should not place undue reliance on any such forward-looking statements.

Additional information about the Sunstone (2005) LP filed with Canadian securities commissions is available on-line at www.sedar.com.

1. DESCRIPTION OF BUSINESS

The Sunstone (2005) LP was established by the General Partner, Sunstone Realty Advisors (2005) Inc., for the purposes of owning and operating a diversified portfolio of high quality income-producing residential and/or commercial real estate properties in Canada. The majority of Sunstone (2005) LP’s investments are made in existing, operating properties and a small minority of investments, not to exceed 15% of the portfolio, may be made in real estate development opportunities.

An investment in the Sunstone (2005) LP is intended to provide purchasers (“Investors”) with the opportunity to receive cash flow from the ongoing operation of the income-producing properties (“Properties”) and the potential to realize long-term capital appreciation.

The Sunstone (2005) LP and SRAI Capital Corp. (“SRAI”), a subsidiary of Knightswood Financial Corp., obtain capital from Investors by selling \$12,500 units consisting of:

- Part 1—the price of one Sunstone (2005) LP Unit (“LPU”)\$2,500
- Part 2—the principal amount of one Series C Debenture issued by SRAI, maturing on October 31, 2010 bearing interest at a rate of 8% per annum.....\$10,000

SRAI loans to the Sunstone (2005) LP by way of a debenture loan, an amount equal to the net proceeds received by SRAI from subscriptions for the Series C Debentures, that is, gross proceeds of \$10,000 per debenture minus SRAI’s pro rata share of offering costs.

Sunstone (2005) LP invests the loan proceeds together with LPU net proceeds (gross proceeds of \$2,500 per LPU minus a pro rata share of offering costs), in a diversified portfolio of quality residential and/or commercial Properties that:

- generates positive annual cash flows from operations to cover debenture loan interest and other expenses incurred by Sunstone (2005) LP; and,
- has potential for long-term capital appreciation due to factors such as rental revenue growth, market growth and value-added capital enhancements.

Upon investment of all the proceeds, Sunstone (2005) LP provides quarterly cash flow distributions to Investors targeted at 8% of the \$2,500 LPU on an annual basis.

2. OVERALL PERFORMANCE

The following is a summary of significant events and transactions that occurred during the year ending December 31, 2005; however, since the Limited Partnership was essentially inactive in the first three quarters ending September 30, 2005, the events are concentrated in the fourth quarter.

- The initial public offering was fully subscribed and issued, generating gross proceeds of \$45,000,000 from October to December 2005. Proceeds of \$40,992,915 [see Table 1.2] will be used to acquire a portfolio of properties.
- Funds intended for the purchase of Properties are invested in short-term investments until required.
- The first Property was purchased on December 31, 2005 in Calgary, Alberta for a total of \$3,300,000 cash. A mortgage for this property was negotiated and secured in 2006.
- The Sunstone (2005) LP incurred a loss of \$583,898 for the year. Revenues consist of \$169,434 of interest revenue, but there were no rental revenues since the only Property purchased was acquired on December 31, 2005. Expenses of \$753,332 consist primarily of the Limited Partnership's debenture loan obligations and some property investigation costs, but no property operating costs.
- Sunstone (2005) LP did not make any quarterly cash distributions to its Investors in 2005 as it did not have property-related income yet.
- Sunstone (2005) LP was actively pursuing potential property acquisitions at year end as it had posted \$700,000 in refundable deposits in connection with ongoing property acquisition negotiations.

3. SELECTED ANNUAL INFORMATION

Selected Annual Information

Table 1.1

	Year Ended December 31, 2005	Year Ended December 31, 2004
Total revenue	\$ 169,434	\$ —
Net loss	(583,898)	—
Total assets	41,234,593	—
Total liabilities	33,615,820	—

Although the Sunstone (2005) LP was formed pursuant to the Partnership Act (British Columbia) on December 30, 2004, the Limited Partnership was essentially inactive until October 31, 2005 at which time the Limited Partnership began issuing its units of capital. The Limited Partnership closed the issue by December 14, 2005 and purchased its first Property on December 31, 2005.

4. RESULTS OF 2005 OPERATIONS

The Limited Partnership was inactive for the first three quarters of the year.

The Sunstone (2005) LP incurred a loss of \$583,898 for the year. Some of the significant expenses and revenue for the Sunstone (2005) LP are summarized as follows:

- a. Due to the timing of the first Property acquisition, Westview Building, the Sunstone (2005) LP did not recognize either of the following in 2005:
 - rental revenue and expenses related to income-producing properties, or
 - amortization of deferred finance costs, and property and acquisition costs.
- b. The Limited Partnership earned \$169,434 in interest from short-term investments.
- c. The Limited Partnership incurred expenses with SRAI for the following [see Table 1.6]:
 - debenture loan interest of \$483,517 for the 9% quarterly interest payment on the debenture loan;
 - annual loan fee of \$160,487 (prorated this period) due over the five-year term of the debenture loan and not expected to exceed in aggregate the offering costs of approximately \$3.2 million as incurred by SRAI with respect to the debenture offering of \$36 million; and,
 - ongoing debenture loan fee of \$26,862 (prorated this period) representing 0.5% of the debenture loan balance.
- d. The Limited Partnership incurred due diligence expenditures totaling \$70,403 in connection with the investigation of potential property acquisitions, and are in line with management expectations.

5. FINANCIAL POSITION

Units Subscribed and Issued

A revised and amended initial public offering prospectus contemplating the issue of 3,600 units was issued on October 17, 2005.

The initial public offering closed on December 14, 2005 and the gross proceeds raised were \$45,000,000. The net proceeds of \$40,992,915 [see Table 1.2] are to be used to purchase the Property portfolio, which is expected to generate positive cash flows for distributions to the Sunstone (2005) LP unit holders after coverage of:

- debenture loan (see below) interest and
- any other expenses incurred by the Sunstone (2005) LP.

The details regarding each of the three closings' units and equity-debenture split are provided in Table 1.2.

Proceeds of Offering—Gross and Net
Table 1.2

Date of Closing	Units	Limited Partnership Equity	SRAI Debenture Proceeds	Gross Proceeds
October 31, 2005	3,307	\$ 8,267,500	\$ 33,070,000	\$ 41,337,500
November 21, 2005	225	562,500	2,250,000	2,812,500
December 14, 2005	68	170,000	680,000	850,000
Gross proceeds	3,600	9,000,000	36,000,000	45,000,000
Issuance costs		(797,349)	(3,209,736)	(4,007,085)
Net proceeds	3,600	\$ 8,202,651	\$ 32,790,264	\$ 40,992,915

Debenture Loan

The Sunstone (2005) LP received a 9% debenture loan in the amount of \$32,764,000 [see Table 1.3] from SRAI and signed a promissory note to that effect. Interest is due quarterly and the principal is due on October 31, 2010.

9% Debenture Loan Issued by SRAI

Table 1.3

SRAI Series C Debenture proceeds	\$	36,000,000
Pro rata share of issuance costs [Table 1.2]		(3,209,736)
Other costs		(26,264)
SRAI's costs		(3,236,000)
9% Debenture loan issued to Sunstone (2005)	\$	32,764,000

Cash Distributions to Limited Partners

The Sunstone (2005) LP did not issue any cash distributions to its Limited Partners as it had not completed its placement of available funds as of December 31, 2005. The Limited Partnership anticipates making cash distributions to its Limited Partners in 2006 after it completes its acquisition of properties for the portfolio.

6. INCOME PRODUCING PROPERTIES

Property Portfolio Value to Date

Table 1.4

Property Description	Location	Purchase Date	Equity	Mortgage	% Rate	Purchase Price
Westview Building	Calgary, AB	Dec 2005	\$ 825,000	\$ 2,475,000	5.48	\$ 3,300,000
Camco Distribution Facility	Montreal, QC	Jan 2006	3,350,000	8,550,000	5.68	11,900,000
Total			\$ 4,175,000	\$ 11,025,000	5.64	\$15,200,000

Westview Building

On December 31, 2005, the first portfolio property, Westview Building, was acquired in Calgary, Alberta for cash totaling \$3,300,000 plus standard closing costs and adjustments. The 34,453 square foot facility is well situated ten minutes from downtown and in close proximity to the Calgary International Airport. Early in 2006, Sunstone (2005) LP secured a five-year term first mortgage in the amount of \$2,475,000. \$1,825,000 bearing interest at 5.48% per annum with Citizens Bank of Canada maturing 2011 was advanced initially, with the balance, bearing interest at prime less 1% per annum to be advanced as required.

Camco Distribution Facility

For details surrounding the acquisition of the second portfolio property, refer to Section 14. SUBSEQUENT EVENTS.

7. SUMMARY OF QUARTERLY RESULTS

Summary of Quarterly Results

Table 1.5

	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005
Total assets	\$ 41,234,593	\$ 20	\$ 20	\$ 20
Deferred expenses	49,500	—	—	—
Income producing property	3,313,907	—	—	—
Debenture debt	32,764,000	—	—	—
Partners' equity	7,618,773	20	20	20
Interest income	169,434	—	—	—
Net income (loss)	(583,898)	—	—	—

Significant changes in key financial data from October 1, 2005 to December 31, 2005 are attributed to the fact that the Limited Partnership was essentially inactive in previous quarters. During the current quarter, Sunstone (2005) LP issued 3,600 units, incurred costs associated with the issuance of the units, and acquired its first Property.

Deferred expenses of \$49,500 are costs associated with obtaining mortgage financing for the Westview Building.

Partners' equity includes net proceeds of \$8,202,651 consisting of \$9,000,000 gross proceeds minus issuance costs of \$797,349 [see Table 1.2].

8. LIQUIDITY

The Sunstone (2005) LP has financed its operations to date primarily through the issuance of LPUs.

Each Property acquired in the portfolio is purchased with the expectation that it generates sufficient cash flows to finance its own operating costs.

The statements have been prepared on a going concern basis which assumes that the Sunstone (2005) LP will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

9. CAPITAL RESOURCES

The Sunstone (2005) LP has issued 3,600 LPUs for gross proceeds of \$9,000,000.

The Limited Partnership and the debenture issuer, SRAI, raised a gross total of \$45,000,000 with the issue of 3,600 units.

After issuance costs, Sunstone (2005) LP has over \$40,000,000 (LP equity and debenture loan) to invest in the portfolio of Properties.

It is management's opinion that the Limited Partnership has sufficient funds to acquire the properties, and to cover anticipated costs associated with acquisition and securing financing.

10. OFF-BALANCE SHEET ARRANGEMENTS

The Sunstone (2005) LP has no off-balance sheet arrangements.

11. RELATED PARTY TRANSACTIONS

These following transactions occurred in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed to by the related parties.

Transactions with the Debenture Loan Issuer—SRAI

SRAI is related to the Limited Partnership by virtue of having officers and directors in common with the General Partner. Transactions between the Sunstone (2005) LP and SRAI are as follows:

- Sunstone (2005) LP received debenture loan proceeds totaling \$32,764,000 from SRAI.
- The Limited Partnership incurred the following expenses totaling \$670,846 with SRAI and owes the same amount at year end [see Table 1.6].

Related Party Transactions with SRAI

Table 1.6

Debenture loan interest expense	\$	483,517
Annual loan fee expense		160,487
Ongoing 0.5% debenture loan fee expense		26,862
Total Payable at December 31, 2005	\$	670,866

Transactions with the General Partner—Sunstone Realty Advisors (2005) Inc.

Pursuant to the General Partner Services Agreement, Sunstone (2005) LP is required to pay to the General Partner:

1. A one-time financing fee equal to 1.5% of the gross purchase price of each Property acquired. In 2005, the Limited Partnership paid \$49,500 in connection with the Westview Building; it is included in deferred expenses.
2. An annual asset management fee equal to 1.5% of the Net Asset Value of the Sunstone (2005) LP. The General Partner has waived these fees for the year ended December 31, 2005.

12. OUTSTANDING PARTNERSHIP UNIT DATA

As of this filing, the types of partnership units outstanding and their book values are summarized in Table 1.7.

Outstanding Partnership Unit Data

Table 1.7

Types of Outstanding Partnership Units	Units	Book Value Per Unit
Limited Partnership Units	3,600	\$ 2,500
Initial Limited Partner's Unit	1	\$ 10
General Partner's Unit	1	\$ 10
	3,602	

13. RISKS AND UNCERTAINTIES

All real property investments are subject to elements of risk. General economic conditions, local real estate markets, supply and demand for leased premises, competition from other available premises and various other factors affect such investments.

The Sunstone (2005) LP's primary risk is the potential for declining revenue arising from vacancies or rental rate declines. The Sunstone (2005) LP, while searching for properties, is focusing on a diversified portfolio of properties in various regions in Canada to reduce this risk.

14. FINANCIAL INSTRUMENTS

The Sunstone (2005) LP's financial instruments consist of cash and equivalents, cash held in trust, receivables, deposits, accounts payable and accrued liabilities, rental deposits, and debenture loan. Unless otherwise noted, it is management's opinion that the Sunstone (2005) LP is not exposed to significant interest, currency or credit risks arising from these financial instruments.

15. SUBSEQUENT EVENTS

Camco Distribution Facility

In January 2006, the second portfolio Property, Camco Distribution Facility at 1505 Dickson Street in Montreal, Quebec, was acquired for a total purchase price of \$11,900,000 plus standard closing costs and adjustments. The 164,308 square foot industrial distribution facility is newly constructed and is fully occupied by a single tenant on a long term lease with a national covenant. The acquisition was financed with an RBC ten-year term first mortgage of \$8,550,000 bearing interest at 5.68% per annum maturing 2016.