

# 2011 ANNUAL REPORT



**INREIT**

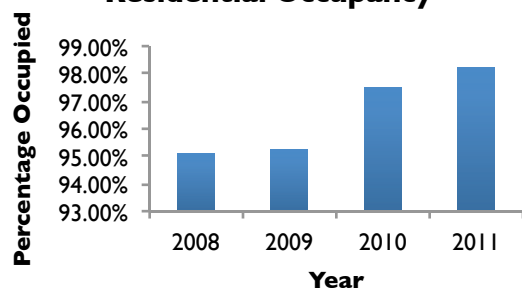
**REAL ESTATE INVESTMENT TRUST**

## Financial Highlights

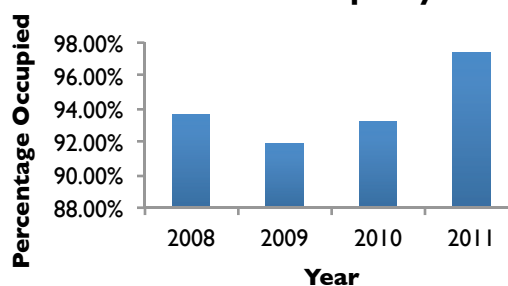
(in thousands except per share data)

	2011	% Change	2010	2009
<b>RESULTS OF OPERATIONS</b>				
Rental income	\$49,316	13.5%	\$43,438	\$39,418
FFO	\$16,649	11.9%	\$14,884	\$12,678
Net Income	\$6,618	(13.1%)	\$7,613	\$6,351
<b>PER SHARE</b>				
FFO	\$1.13	6.5%	\$1.06	\$0.99
Dividends paid	\$0.805	4.5%	\$0.770	\$0.745
Payout Ratio	69.9%	1.8%	68.1%	73.4%
<b>YEAR END</b>				
Total Assets	\$381,383	10.8%	\$343,982	\$326,150
Total Liabilities	\$237,042	16.0%	\$204,319	\$200,300
Equity	\$144,226	3.3%	\$139,663	\$125,849

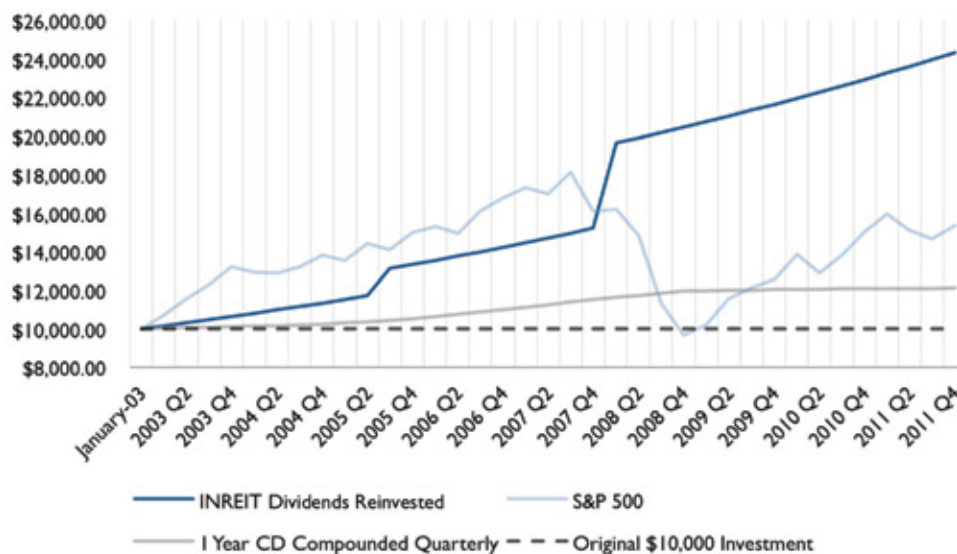
### Residential Occupancy



### Commercial Occupancy



### Comparison of 8-Year Cumulative Return on a \$10,000 Investment



## TO OUR SHAREHOLDERS:

THINKING, INVESTING AND MANAGING LIKE AN **OWNER**. This mindset sets INREIT apart from the risk-seekers captivated by Wall Street's volatility or the spendthrifts who consume but don't build wealth. Owners are patient and seek out real value in exchange for their hard-earned dollars. They don't buy for the thrill. They see a purchase as the beginning of an investment, not the end-goal. Owners know growing the value of an asset requires constant focus and determined management that only commences once the deal closes. Being an owner means **long-term** commitment.

We've always believed in owning **real estate**: the land and the buildings on it. Real estate is special. You can touch it. It is real: dirt, trees, bricks and mortar; a far cry from securitized derivatives or debenture warrants. Not only does it have its own intrinsic value, but, when **well-managed** and maintained, produces steady and reliable income.

These fundamental principals drive us forward and we feel fortunate our investors share these principals. The singleness of purpose among our **investor-owners** is unique and a key to our success. As each year passes, we continue to be thrilled to offer investors ownership in our Real Estate Investment Trust, allowing them to participate in quality investment real estate. Creating ownership **opportunities**, providing consistent and reliable returns, and serving investors are our goals and a source of pride for your Board of Trustees, Management, and all of INREIT's staff.

2011 was another strong year for INREIT and its investor-owners. Investor equity, FFO per share, and dividends paid, all showed positive gains. Below are a few highlights:

- Investor Equity grew 3.3% from \$139,663,177 (2010) to \$144,226,267 (2011).
- Funds from Operations (FFO) per weighted average share grew 1.8% from \$1.13 (2010) to \$1.15 (2011).



BRUCE FURNESS, CHAIRMAN OF THE BOARD

- Dividend Yield increased from 5.50% (2010) to 5.75% (2011).
- Dividends paid grew from \$10,132,080 (2010) to \$11,631,728 (2011).
- Dividend Coverage remained strong at 143.1%; meaning our FFO covered the dividends paid by a substantial margin.

We completed several transactions in 2011, all advancing our investment strategies and objectives. Quality additions to our multifamily portfolio in Fargo, Grand Forks, and Bismarck, North Dakota reinforce our already strong presence in these healthy communities. Attractive triple net lease ("NNN") commercial property investments in Apple Valley and Marshall, Minnesota, and Denver, Colorado, strengthen the geographic diversity and composition of our portfolio.



KENNETH P. REGAN, CEO

We are particularly pleased with our acquisition of Glen Pond Apartments in Eagan, Minnesota. For many years, we have been looking toward the Minneapolis market as an area where we would like to grow our multifamily portfolio. Glen Pond, a 414 unit, apartment property is attractively located along the Interstate 35E corridor, near the Minneapolis-St. Paul International Airport and numerous shopping centers, including the Mall of America. In addition to its huge employment base, Eagan's limited supply of entry-level single family homes, further supports Glen Pond's prospects for long-term quality performance.

Operationally, INREIT also performed well in 2011, achieving over 97% occupancy across its commercial and over 98% across its multifamily portfolio. These achievements are especially noteworthy if one considers the slow recovery and high jobless rates across the nation. The results are evidence of our acquisition discipline, focus on operational performance, and our long-term perspective in caring for and managing each property we own.

Likewise, we have taken advantage of our Class-A borrower's status and historically low interest rates to work with our valued lenders to modify rates, adjust terms and in some cases refinance our obligations. These efforts, which will continue into 2012, will save the Trust several hundred thousand dollars in interest costs over the next few years. With interest cost being our single largest expense, skill and focus in this area significantly rewards INREIT.

INREIT also took an important step forward in its governance and accounting practices by registering as a public company with the United States Securities and Exchange Commission ("SEC"). With this change came greater independence, transparency and regular reporting of our performance results. Although it has been more work for all, it has been good work and we are largely pleased with the ongoing changes and results. We encourage you to visit INREIT's or the SEC's website and view our quarterly 10-Q and annual 10-K reports as they are published. These comprehensive reports are a valuable new means of disclosure and communication with our investors.

In summary, we are extremely pleased with our 2011 results. We have increased our position through strategic acquisitions and strengthened our operations. We will continue this track of making acquisitions that meet our disciplined investment criteria. The current marketplace is providing us opportunity to do so, but not without heavy analysis, solid negotiations, and savvy decision-making.





INREIT's **future** is bright. Our public structure, strong financial position, well-managed properties and strong relationships, position us to capitalize on opportunities. Equally important, the loyalty and **shared vision** of our investor-owners inspires and empowers us to stay the course, hold to our investment principals and grow with discipline and confidence.

When you strip away all the numbers and details it boils down to this: In 2011, we added quality properties to our portfolio at an excellent price; and are hard at work managing and growing their **income-producing** capacities.

Why? **Because it's what owners, like you, would do.** Thank you again for your investment, loyalty and support.

A handwritten signature in dark ink that reads "Bruce W. Furness". The signature is written in a cursive, flowing style.

**Bruce Furness**  
Chairman of the Board  
December 31, 2011

A handwritten signature in dark ink that reads "Kenneth P. Regan". The signature is written in a cursive, flowing style.

**Kenneth P. Regan**  
Chief Executive Officer  
December 31, 2011

## OUR BUSINESS

### The REIT Structure

A REIT is an investment vehicle created in 1960 by the United States Congress with the Real Estate Investment Trust Act. This Act authorized a real estate ownership structure with tax treatment similar to that of mutual funds; a tax-exempt pass-through entity with broad based ownership distributing most of its earnings and capital gains to investors. Investment in a REIT offers diversification benefits, since REITs often offer differing investment strategies in terms of property type and geographic focus.

### INREIT Real Estate Investment Trust

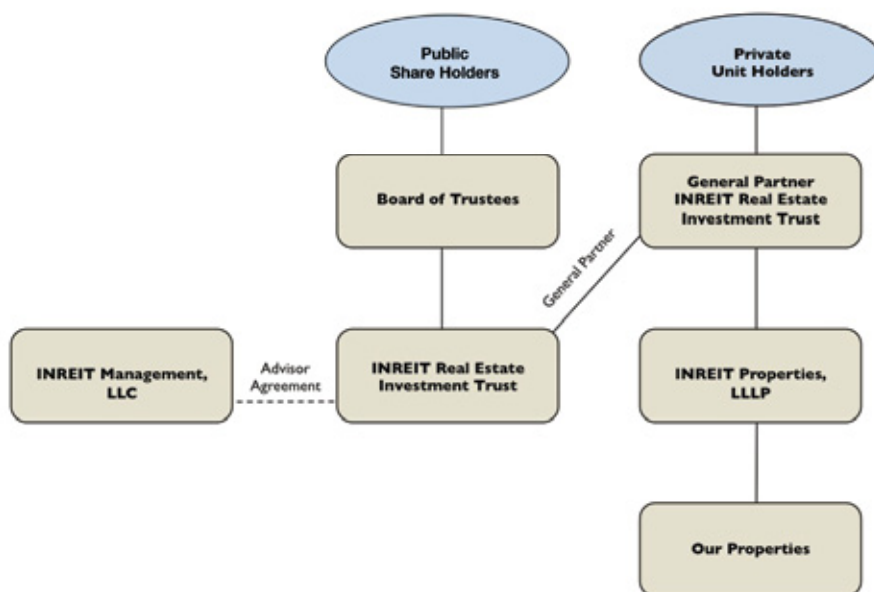
In 2002, INREIT Real Estate Investment Trust ("INREIT") was formed to invest in a diversified portfolio of primarily multifamily (apartments and assisted or independent living centers) and commercial properties (retail, office and medical). INREIT elected to be taxed as a Real Estate Investment Trust ("REIT") under Sections 856-860 of the Internal Revenue Code.

### INREIT Properties, LLLP

INREIT is an Umbrella Partnership Real Estate Investment Trust, and holds all of its properties in a separate partnership, INREIT Properties, LLLP ("INREIT Properties"). INREIT controls INREIT Properties and acts as its general partner. INREIT uses INREIT Properties to acquire properties, including through the exchange of limited partnership units for properties. These "UPREIT" exchanges can be advantageous, as the seller may be able to defer taxation of gain until the seller later resells the limited partnership units received in the exchange. By offering sellers the ability to defer taxation, INREIT gains an advantage in acquiring quality properties.

### INREIT Management, LLC

INREIT operates under the direction of the Board of Trustees, the members of which are accountable to the Trust and its shareholders as fiduciaries. However, INREIT has no paid employees and therefore retains a management company to manage INREIT's, and INREIT Properties' day-to-day affairs. For the period 2003 – 2011, INREIT has relied upon INREIT Management, LLC as its external management company. INREIT Management's CEO, President and CFO serve concurrently as the Trust's executive officers.







### **Public Company Status**

From inception through 2010, INREIT has operated as a private REIT. However, when a private REIT grows to more than 500 shareholders and more than \$10 million in assets, it is required to file with the Securities and Exchange Commission ("SEC") and become a public company. INREIT's ongoing growth and success necessitated our registration and transition to public company status.

Although INREIT's registration process ended in October 2011, the requirement to file required reports with the SEC began immediately. INREIT filed its first report on Form 10-Q on May 15, 2011. The report details the Trust's performance during

the first quarter of 2011. INREIT's registration and reports are all available to investors on the SEC's website.

It is important to note there are two forms of Public REIT: Traded and Non-Traded. A traded REIT is a public company whose shares are traded on major stock exchanges such as NYSE or NASDAQ. Non-traded REITs are also public companies but their shares are not traded on major exchanges and are, instead, offered directly to investors through representatives/broker dealers registered to sell the shares. INREIT continues to operate as a public "non-traded" REIT.

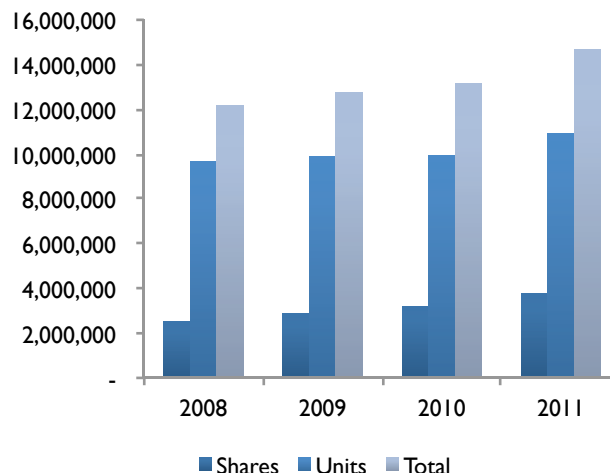
## OUR INVESTORS

We are grateful for the continuing confidence and loyalty of our investors. Each day we recognize how fortunate we are to have investors that truly share INREIT's philosophy of investing and managing for the long-term. This shared philosophy is evident in INREIT's investor totals from 2008 to 2011. The trend is positive, consistent and stable. In 2011, the total number of investors rose from 1,183 to 1,249.

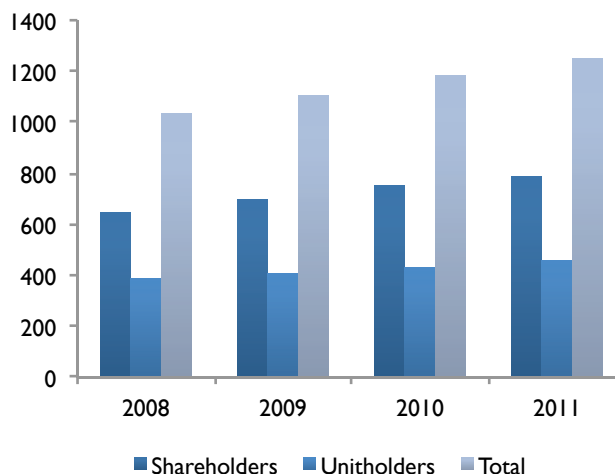
At the end of 2011, INREIT issued its first stock offering in over one year. The \$8.4 million offering to accredited investors is expected to sell out in early 2012 and drive additional growth in investor and share totals.

Investor confidence is also evident in the growth of shares and limited partnership units. Despite the lack of a common share offering in 2011, both share and unit totals continued to rise. These increases were driven by existing investors choosing to reinvest their dividends in additional common shares and owners exchanging real estate for units in INREIT Properties. In 2011, total securities moved up from 13,110,324 to 14,485,822.

**Total Investors**



**Total Securities**







## OUR PORTFOLIO

### New Additions in 2011

INREIT expanded its real estate portfolio in 2011 with the addition of thirteen (13) new properties. Most significant was the purchase of Glen Pond, a 414 unit apartment complex in Eagan, Minnesota. This complex, located near Interstate 35E, the Minneapolis-St. Paul International Airport, and major shopping centers, included seven separate buildings, numerous amenities, and additional land suitable for expansion. The Glen Pond acquisition marked the single largest purchase in INREIT's history, topping Twenty-Six Million dollars (\$26,000,000).

This signature Minneapolis metro property reflects the strategic geographic expansion of the Trust's multifamily holdings. 2011 multifamily acquisitions also included high quality properties located in Grand Forks (1), Fargo (3), and Bismarck (1), North Dakota.

INREIT also added to its commercial properties with the acquisition of long-term absolute Triple-Net ("NNN") leased properties in Minnesota (4) and Colorado (1) and a Taco Bell Restaurant land lease in Denver, Colorado. As in the past, INREIT continued its strategy of acquiring high quality commercial properties with nationally recognized tenants capable of successfully managing their own operations and preserving our real estate asset. NNN lease tenants in 2011 included: Applebee's, Bank of the West, Dairy Queen, Titan Machinery and Walgreens.

Noteworthy among the Trust's commercial acquisitions, is the Five Million dollar (\$5,000,000) purchase of a newly constructed Titan Machinery facility, located in Marshall, Minnesota. This purchase and lease-back transaction incorporated a 15-year absolute NNN lease with Titan Machinery, a NASDAQ Exchange ("TITN") listed company headquartered in Fargo, North Dakota. We are extremely proud of our relationship with Titan Machinery and excited about the potential for future purchase and lease-back transactions with this respected company.

## OBJECTIVES AND STRATEGY

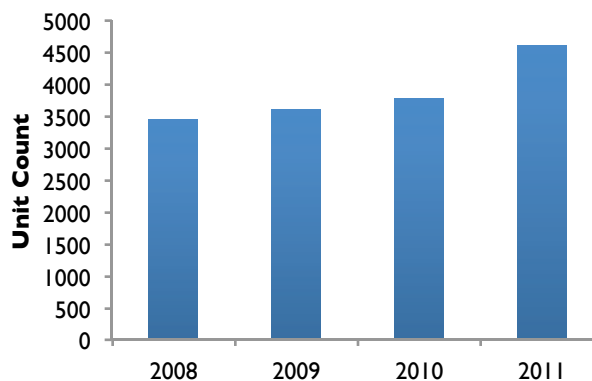
Our primary investment objectives are to:

- Acquire real estate properties that will provide a stable cash flow for distribution to our investors, preserve capital and realize long-term capital appreciation upon the sale of such properties;
- Offer an investment option in which common share value is correlated to multifamily/commercial real estate as an asset class, rather than traditional asset classes such as stocks and bonds;
- Provide a hedge against inflation through short-term and long-term lease arrangements with tenants; work to achieve scheduled rental increases throughout lease terms.

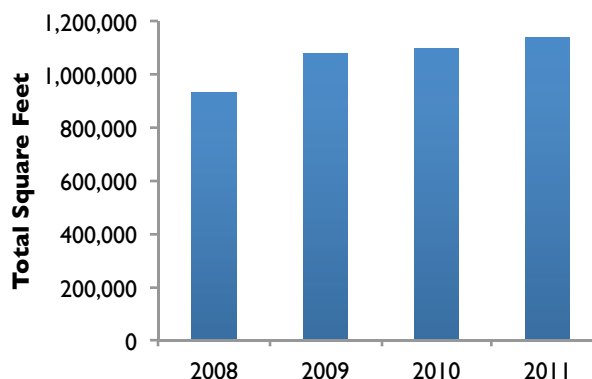
Our primary investment strategy is to acquire and hold:

- Commercial real estate properties, including multifamily residential, senior housing, retail, office, medical and restaurants, primarily located in North Dakota and the central United States;
- Ownership interests in real estate properties in various sectors, including multifamily residential, senior housing, retail, office, medical and restaurants or other commercial properties located in these markets.
- As of December 31, 2011, INREIT owned 92 properties, containing more than 4,400 residential units and over 1.1 Million square feet of leasable commercial space.

**Multifamily units**



**Commercial Space**





### **Public-Private Partnership: Multimodal Transportation Center (2012-13)**

In November 2011, the Duluth Transit Authority (DTA) approached INREIT concerning the possibility of partnering in the development of a Multimodal Transportation Center in Duluth, Minnesota. The DTA sought out INREIT due to the strategic location of INREIT's parking ramp, adjacent and connected to INREIT's Wells Fargo Tower in downtown Duluth. If successful, the centralized location and state of the art design of a downtown Multimodal Transportation Center would provide our Wells Fargo office tower, the City of Duluth and the region improved economic competitiveness, safety, sustainability and accessibility.

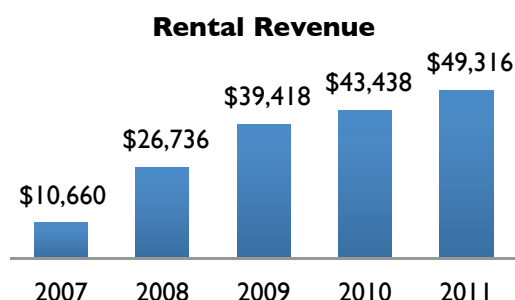
As currently programed, the \$26 million dollar project will be funded with Federal, State, and Local dollars. INREIT's contribution to the project would be its existing parking ramp and the strategic site at the corner of 3rd Avenue West and Michigan Street in downtown Duluth. As proposed by the DTA, INREIT would control and own the facility subject to a perpetual use easement for the benefit of the DTA. INREIT would also continue to generate parking and rental revenue from the newly constructed parking and banking amenities within the facility. While there is much left to explore, the concept is an intriguing new way to bring additional value to one of our flagship properties.



## Our Operations

### Rental Revenues

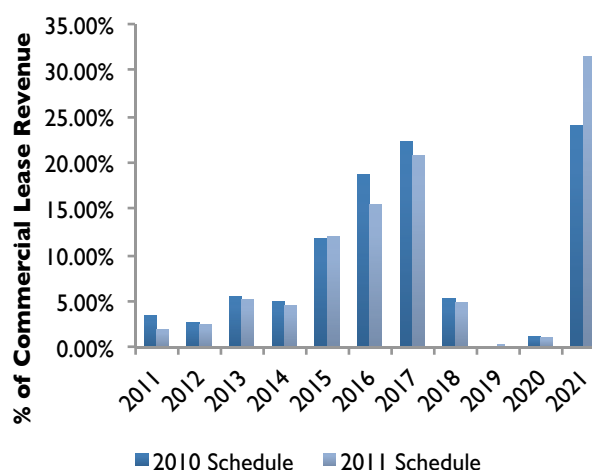
Rental revenues were strong in 2011, increasing 13.5% over 2010 or approximately \$5.9 million. This increase continues INREIT's multi-year trend of consistent revenue growth. It is important to note nearly \$1.0 million of the 2011 revenue increase is the result of INREIT's stabilized properties (those purchased prior to 2010) producing 2.3% more revenue than in 2010. This increase is a direct result of our continual efforts to improve occupancy, strengthen tenant relationships and increase rents where possible and appropriate. Properties acquired in 2010 and 2011 accounted for \$4.9 million of our 2011 increase in rental revenues.



### Commercial Lease Expirations

One of the most reliable measures of future performance for commercial real estate portfolios is to track and measure the future impact of lease expirations. We track this impact as a percentage of annualized base rents needed to be re-leased when existing lease terms end. In general, our goal is to push commercial lease expirations as far into the future as possible, while still maintaining strong rental rates. During 2011 we made significant progress in our efforts to reduce our exposure to near term lease expirations. The results are evident in the chart following which depicts a notable shift to later years over exposure faced by the Trust in 2010.

### Commercial Lease Expirations



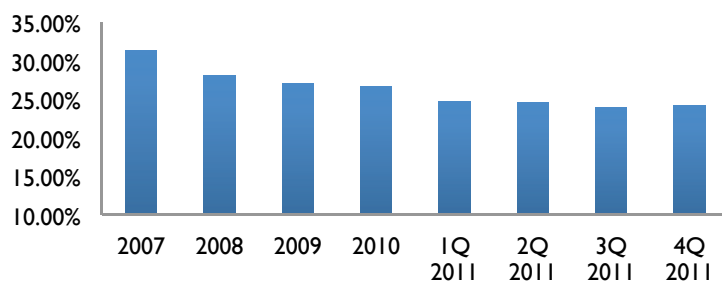
### Expenses

While increasing revenue is always a positive, managing expenses and optimizing how we use our cash is equally important to our long term success. INREIT's expenses grew in 2011 primarily as a result of adding properties to its portfolio (additional real estate taxes, property management fees, repairs and maintenance, and utility costs). However, one notable group of expenses was not related to INREIT's growing portfolio.

With the transition to a public company, INREIT incurred nearly \$0.3 million in additional legal and accounting expense. Although many of these expenses were one-time events, some relating to our new reporting requirements will be a new cost of doing business. Still, despite the added expense of a growing portfolio, the one-time costs of SEC registration, and the new costs associated with reporting, INREIT's total 2011 expenses as a percent of revenue were 87.6%; lower than the 88.8% experienced in 2010.

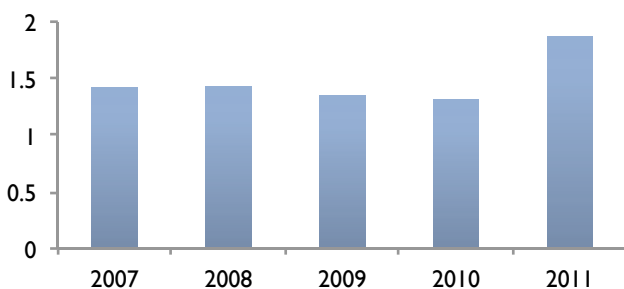


### Interest to Gross Revenue



One very bright area for INREIT in 2011, and looking forward, is in the category of interest expense, which accounts for nearly thirty percent (30%) of the Trust's total expenses. With interest rates at historic lows, INREIT has been aggressive in modifying existing loan terms, refinancing eligible properties, using available cash to pay down or off higher interest arrangements, and establishing lines of credit to maximize our interest savings. As a result, our interest expense as a percentage of revenue has declined significantly, promising significant savings in 2011 and in the future.

### Debt Service Coverage Ratio



### Debt Service

We value our banking relationships and understand the importance placed on the ability to service debt as a key factor in obtaining competitive financing rates and terms. Investors as well want to know INREIT is financially strong and able to pay its obligations. Most of INREIT's lenders require a debt service coverage ratio of 1.20 or greater. Historically INREIT's ratio has ranged from 1.42 to 1.31. In 2011, INREIT ratio's was 1.87. This, as well, is a bright spot for the Trust and a strong indicator of our ability to cover our obligations.

## OUR RESULTS

From inception, INREIT has experienced significant and consistent growth resulting in increasing wealth to our investors. Highlights from the year include:

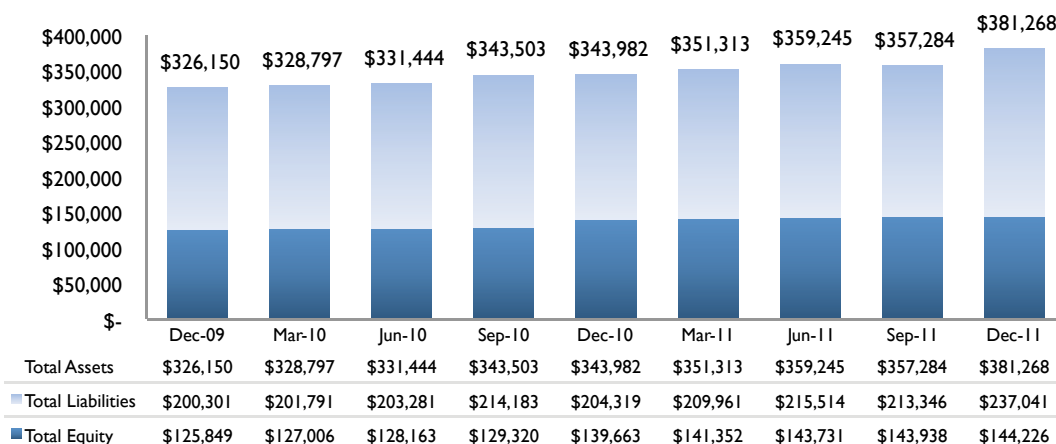
- Increased investor's equity from \$139.7 million (2010) to \$144.2 million (2011).
- Increased dividends paid from \$10,132,081 (2010) to \$11,631,729 (2011).
- Maintained strong dividend yield at 5.75%; with upward move to 5.90% in Q1 2012.
- Maintained strong FFO and MFFO payout ratios of 69.9% and 66.3%, respectively.

## Equity

Equity is the residual interest in the assets of an entity that remains after deducting its liabilities. INREIT's Q4 2011 Equity was \$144.2 million and representing a 3.2% increase over 2010. This consistent growth in equity combined with dividend/distribution payouts, means increasing wealth to our investors.

In 2012, INREIT will make a small, but noteworthy change in how it accounts for and presents tenant in common ("TIC") properties (shift to equity method accounting). This change, required by the Trust's Independent Auditor, may impact shareholder equity totals in 2012, but Net Operating Income (the bottom line) will remain unaffected.

### Assets, Liabilities and Equity

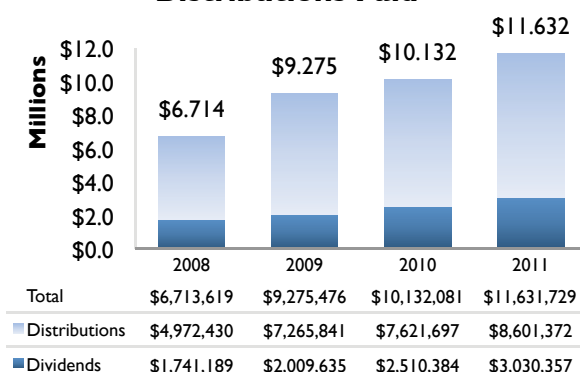




## Dividends

In 2011, INREIT paid its investors dividends (on common shares) and distributions (on limited partnership units) equal to \$0.805 per share and unit for a total of \$11.632 million. These dividends/distributions, paid in quarterly installments, represented an increase of 14.8% over dividend/distributions paid to investors in 2010. In total, INREIT paid out more than \$15.1 million in dividends and liquidations in 2011, affirming our strong commitment to returning capital to our investors.

### Total Dividends and Distributions Paid



INREIT's dividend has consistently increased on an annual basis, growing 34.2% from inception of the REIT. 2011 was no exception, with the dividend increasing from \$0.770 per share to \$0.805 per share. Looking ahead, the INREIT's Board of Trustees has already voted to increase its annual dividend again in the first quarter of 2012 from \$0.20125 to \$0.2065 per share (annualized 5.75% to 5.90%).

When Investors choose to reinvest their dividends it is a reaffirmation of their confidence in INREIT. We are sincerely grateful for the confidence our investors have and continue to show with their high levels of dividend reinvestment. Of the \$3.0 million paid in dividends to our common shareholders, nearly 63.4% or \$1.9 million were immediately reinvested in the Trust for additional common shares. Unitholders did not have the

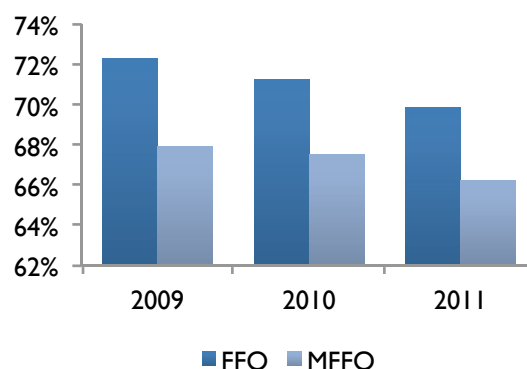
option of reinvesting distributions in common shares in 2011 and received their distributions in cash. In 2012, however, we will be exploring means to provide unitholders this reinvestment opportunity as well.

## Dividend Coverage

Funds from Operations (FFO) is a measurement specific to REITs and often used to define cash flow from operations and is calculated by adding back depreciation and amortization expenses to earnings. Modified Funds from Operations (MFFO) is yet another variation of earnings performance. The MFFO calculation adds back acquisition expenses to FFO.

FFO and MFFO coverage ratios are helpful in understanding how much of INREIT's Funds from Operations (FFO) or Modified Funds from Operations (MFFO) are used to pay investor dividend/distributions. Coverage Ratios over 100% typically indicates a REIT is using money from other sources (outside of income) to pay dividends/distributions. INREIT's 2011 coverage ratios as a percentage of Funds from Operations (FFO) or Modified Funds from Operations (MFFO) remain strong and have even improved over 2010.

### Dividend Coverage Ratios







## DIRECTORS AND EXECUTIVE OFFICERS OF INREIT REAL ESTATE INVESTMENT TRUST

### DIRECTORS



**Bruce W. Furness**<sup>3\*,4</sup>  
*Chairman of the Board*  
INREIT Real Estate  
Investment Trust



**Peggy Becker**<sup>1,2</sup>  
*President*  
Armstrong Sanitation  
Plus, Inc.



**Clifford Fearing**<sup>1,2</sup>  
*Former Chief Financial  
Officer*  
Fairview Health Services



**James R. Hansen**<sup>3,4</sup>  
*President*  
Hansen Investments, Inc.



**Timothy Hunt**<sup>1\*,3</sup>  
*Chief Executive Officer*  
Alexandria Clinic, PA



**Lawrence R.  
O'Callaghan**<sup>2,4</sup>  
*Investments and Securities  
Advisor*  
Financial Advantage  
Wealth Management



**Kenneth P. Regan**  
*Chief Executive Officer*  
INREIT Real Estate  
Investment Trust



**Richard Savageau**<sup>3,4\*</sup>  
*Former President*  
Butler Machinery  
Company



**James S. Wieland**<sup>3,4</sup>  
*President*  
Goldmark Schlossman  
Commercial Real Estate  
Services



**Lance R. Wolf**<sup>1,2\*</sup>  
*Executive Vice President and  
Director of Retail Banking*  
Gate City Bank

The INREIT Real Estate Investment Trust Board of Trustees met four times in 2011 and held twelve interim committee meetings. Board members focus on areas of importance to investors – strategy, performance, risk management and regulatory matters. In 2011, the Board of Trustees received briefings on a variety of issues including: trust financial performance, acquisition and disposition of assets, state and federal tax issues, regulatory and compliance matters, litigation, emerging SEC rules, and managing the transition from a private to public company.

#### Legend – Board Committees

- 1. Audit Committee
- 2. Disclosure Committee
- 3. Executive Committee
- 4. Nominating and Governance Committee
- \* Committee Chair

### EXECUTIVE OFFICERS OF INREIT REAL ESTATE INVESTMENT TRUST

**Kenneth P. Regan**  
*Chief Executive Officer*

**Bradley J. Swenson**  
*President*

**Pete Winger**  
*Chief Financial Officer*

**Darla Iverson**  
*Secretary*





## SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial information and should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our audited and unaudited consolidated financial statements and the notes thereto, both of which appear after this section.

(in thousands except per share data)

	2007	2008	2009	2010	2011
<b>BALANCE SHEET DATA</b>					
Total assets	\$149,389	\$273,913	\$326,150	\$343,982	\$381,268
Mortgage loans payable, net	\$ 76,815	\$141,532	\$190,965	\$192,172	\$217,480
Total liabilities	81,101	152,496	200,300	204,319	237,041
Stockholder’s equity	68,289	121,419	125,849	139,663	144,226
Weighted average shares outstanding	1,664,053	2,322,468	2,659,825	3,190,716	3,771,326
<b>RESULTS OF OPERATIONS</b>					
Rental income	\$10,541	\$26,440	\$39,417	\$43,438	\$49,318
Total expenses	9,212	23,158	35,066	38,577	43,218
Total other income (expense)	284	416	1,999	897	403
Loss on impairment of property	-	-	(312)	(363)	(264)
Discontinued operations	-	345	-	1,854	116
Net income	1,613	4,042	6,351	7,613	6,618
Non-controlling interest in income	(912)	(2,991)	(4,992)	(5,740)	(4,891)
Net income attributable to common shareholders	\$ 701	\$ 1,052	\$ 1,358	\$ 1,872	\$ 1,727
<b>PER SHARE DATA</b>					
Net income per common share	\$0.42	\$0.45	\$0.51	\$0.59	\$ 0.46
Dividends declared (shares)	\$ 1,314	\$1,741	\$2,010	\$2,511	\$3,030
Dividends declared per share	\$0.7150	\$0.7350	\$0.7450	\$0.7700	\$0.8050



## SELECTED EXCERPTS FROM OUR FORM 10-K

The following sections and financial statements have been taken directly from our Annual Report on Form 10-K that was filed with the SEC on March 30, 2012.

**Shareholders may request a copy of the full form 10-K, at no cost, by sending a written request to Investor Relations either by email at [information@inreit.com](mailto:information@inreit.com) or mail to INREIT Real Estate Investment Trust, 216 South Broadway, Suite 202, Minot, ND 58701.**

## NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements included in this Annual Report on Form 10-K and the documents incorporated into this document by reference contain certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such forward-looking statements include statements regarding our plans and objectives, including, among other things, our future financial condition, anticipated capital expenditures, anticipated distributions to our shareholders and other matters. Forward-looking statements are typically identified by the use of terms such as “may,” “will,” “should,” “expect,” “intend,” “plan,” “anticipate,” “estimate,” “believe,” “continue,” “predict,” “potential” or the negative of such terms and other comparable terminology. These statements are only predictions and are not historical facts. Actual events or results may differ materially.

The forward-looking statements included herein are based on our current expectations, plans, estimates and beliefs that involve numerous risks and uncertainties. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Any of the assumptions underlying the forward-looking statements contained herein could be inaccurate. Although we believe the expectations reflected in such forward-looking statements are based on reasonable assumptions, we cannot assure readers that the forward-looking statements included in this filing will prove to be accurate. The accompanying information contained in this Annual Report on Form 10-K, including, without limitation, the information set forth under the section entitled “Risk Factors” in Item 1A, identifies important additional factors that could materially

adversely affect actual results and performance. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results.

## OUR COMPANY

INREIT Real Estate Investment Trust (“we,” “us” or “our”) is a real estate investment trust (“REIT”), formed in North Dakota as an unincorporated business trust on December 3, 2002. References in this Annual Report on Form 10-K to the “Company,” “INREIT,” “we,” “us,” or “our” include consolidated subsidiaries, unless the context indicates otherwise. We were formed for the purpose of investing in a diversified portfolio primarily of commercial properties (such as retail, office and medical) and multifamily dwellings (such as apartment buildings and senior assisted or independent living centers). As a REIT, we are not subject to U.S. federal income taxation as long as we satisfy certain requirements, principally relating to the nature of our income, the level of our distributions and other factors.

### UPREIT Structure

We operate as an Umbrella Partnership Real Estate Investment Trust, which is a REIT that holds all or substantially all of its assets through a partnership which the REIT controls as general partner. Therefore, we conduct substantially all of our investment activities and hold all or substantially all of our assets through our operating partnership INREIT Properties, LLLP. We control the operating partnership as the general partner and own approximately 25.8% of the operating partnership as of December 31, 2011. For purposes of satisfying the asset and income tests for qualification as a REIT for tax purposes, our proportionate shares of the assets and income of our operating partnership are deemed to be our assets and income.

### Operating Partnership

Our operating partnership, INREIT Properties, LLLP, was formed as a North Dakota limited liability limited partnership on April 25, 2003 to acquire, own and operate properties on our behalf. The operating partnership holds a diversified portfolio of commercial properties and multifamily dwellings located principally in the upper and central Midwest United States.

Since our formation, our focus has consisted of owning and operating income-producing real estate properties. In 2006, we held 23 total properties approximating \$56 million in total assets. Between 2007 and 2011, we focused extensively on strengthening the multifamily component of our portfolio, acquiring properties directly or through UPREIT transactions. A majority of these multifamily



properties were located in North Dakota. By the end of 2011, our portfolio has grown to over 92 properties, approximating \$356.1 million in total assets, which includes assets held for sale, and book equity, including noncontrolling interests, of approximately \$144.3 million as of December 31, 2011. As of December 31, 2011, our portfolio contained approximately 4,276 apartments, 193 assisted living units and 1,139,304 square feet of leasable commercial space.

As of December 31, 2011, approximately 54.3% of the properties were apartment communities and senior assisted living communities located primarily in North Dakota with others located in Minnesota and Nebraska. Most multifamily dwelling properties are leased to a variety of tenants under short-term leases.

As of December 31, 2011, approximately 45.7% of the properties were comprised of office, retail and medical commercial property located primarily in North Dakota with others located in Arkansas, Colorado, Louisiana, Michigan, Mississippi, Minnesota, Nebraska, Texas and Wisconsin. Most commercial properties are leased to a variety of tenants under long-term leases.

## OUR PEOPLE

We do not have any employees. Instead, we rely on our external Advisor to conduct our day-to-day affairs.

### Our Advisor

Our external Advisor is INREIT Management, LLC, a North Dakota limited liability company formed on November 14, 2002. Our Advisor is responsible for managing our day-to-day affairs and for identifying, acquiring and disposing investments on our behalf. The Advisor is owned in part by Kenneth Regan, a trustee and our Chief Executive Officer, and by James Wieland, also one of our trustees, who owns indirectly through an entity. In addition, Messrs. Regan and Wieland serve on the Board of Governors of the Advisor. From 2007 to 2011, our Advisor's staff increased in number and expertise, growing from 4 to 8 full-time employees including a president, chief financial officer, financial reporting manager, property accountant and internal auditor.

### Our Board of Trustees and Executive Officers

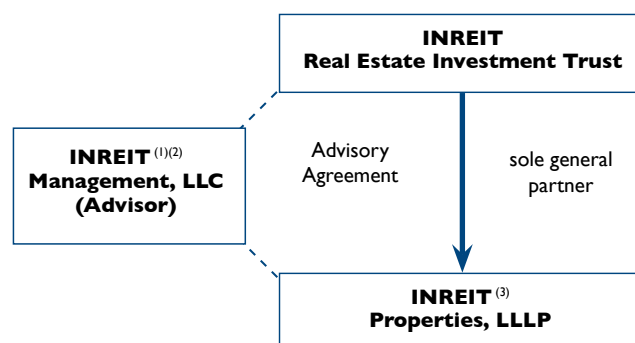
We operate under the direction of our Board of Trustees, the members of which are accountable to us and our shareholders as fiduciaries. In addition, the Board has a specific fiduciary duty to supervise our relationship with the Advisor, and will evaluate the performance of the Advisor on an annual basis prior to renewing the

Advisory Agreement with the Advisor and evaluate the fees paid to the Advisor. Our Board of Trustees has provided investment guidance for the Advisor to follow, and must approve each investment recommended by the Advisor. Currently, we have ten members on our board, seven of whom are independent of our Advisor. Our trustees are elected annually by our shareholders.

Although we have executive officers, we do not have any paid employees. Our President, Chief Executive Officer, Chief Financial Officer, Treasurer and Secretary are also officers, employees, owners or governors of our Advisor. Among others, such executive officers oversee our Advisor's day-to-day operations with respect to us. However, when doing so, such executive officers are acting on behalf of our Advisor in performing the Advisor's obligations under the Advisory Agreement. Generally, the only services performed by our executive officers in their capacity as executive officers are those required by law or regulation, such as executing documents as required by North Dakota law and providing certifications required by the federal securities laws.

## Organizational Structure

The following chart shows our structure:



- (1) The Advisor is owned in part by our Chief Executive Officer and Trustee Mr. Kenneth P. Regan (33.00%) and by our Trustee Mr. James S. Wieland indirectly through Wieland Investments, LLLP, to which Mr. Wieland serves as the general partner (33.00%). In addition, Mr. Regan serves as the Chief Executive Officer and Chairman of the Board of the Advisor, and Mr. Wieland serves on the Board of Governors of the Advisor.
- (2) INREIT Management, LLC serves as both INREIT'S and our operating partnership's advisor. The Advisor does not own any of our shares. Messrs. Regan and Wieland each beneficially own approximately 0.8% of our shares as of December 31, 2011.
- (3) We control the operating partnership as the general partner, and own approximately 25.8% of the operating partnership as of December 31, 2011. Mr. Regan and Mr. Wieland beneficially owned and had voting power over approximately 12.99% and 9.4%, respectively, of the operating partnership as of December 31, 2011.

# OUR CORE INVESTMENT OBJECTIVES AND STRATEGY

## Investment Objectives

Our primary investment objectives are to:

- acquire quality real estate properties or interests in real estate properties that can provide stable cash flow for distribution to our shareholders, preservation of capital and realization of long-term capital appreciation upon the sale of such properties;
- offer an investment option in which the value of the common shares is correlated to real estate as an asset class rather than traditional asset classes such as stocks and bonds; and
- provide a hedge against inflation through use of month-to-month rentals or short-term and long-term lease arrangements with rental properties tenants.

We may change our investment objectives only with the approval of holders of a majority of the outstanding common shares.

## Investment Strategy

Our investment strategy is primarily to acquire and hold a diverse portfolio of:

- commercial real estate properties or portfolios or real estate properties in various sectors, including multifamily residential, senior housing, retail, office, medical and other commercial properties, including restaurants, primarily located in the central corridor of the contiguous 48 states; and
- ownership interests in real estate properties in various sectors, including multifamily residential, senior housing, retail, office, medical and other commercial properties located in these markets.

The majority of our acquisitions are located in or near metropolitan areas. However, there is no limitation on the geographic areas in which we may acquire targeted investments.

We may acquire portfolios of real estate properties held by individual owners and real estate properties held by funds, including hedge funds. We anticipate such property owners will primarily sell the properties in exchange for limited partnership interests of the operating partnership.

We may make investments alone or together with other investors, including with affiliates of the Advisor, through holding company structures or joint ventures, real estate partnerships, tenant-in-common deals, REITs or other collective investment vehicles.

## Investment Guidance

Our Board of Trustees has provided investment guidance to the Advisor to direct our investment strategy. Changes to our investment guidance must be approved by our Board. The Advisor has been authorized to execute (1) commercial real estate property acquisitions and dispositions and (2) investments in other real estate related assets, in each case so long as such investments are approved by our Board. Our Board will at all times have ultimate oversight over our investments and may change from time to time the scope of authority delegated to our Advisor with respect to acquisition and disposition transactions.

Currently, our investment guidance is that our real estate investments be allocated approximately as follows:

- up to 50% in multifamily and apartment properties;
- up to 20% in commercial office properties;
- up to 10% in retail properties;
- up to 10% in medical properties;
- up to 10% in industrial properties; and
- up to 5% in restaurant properties.

Despite our intentions, the actual percentage of our portfolio invested in each investment type may fluctuate above or below such levels due to factors such as a large inflow of capital (including from additional capital raises or sales of investments), lack of attractive investment opportunities in an investment type or an increase in anticipated cash requirements (including repayment of outstanding debt obligations or REIT distribution requirements).

## Investments in Real Estate Properties

Our investment guidance provides we will primarily invest in existing or newly constructed real estate properties and interests in real estate properties in a multiple of sectors, including multifamily residential and senior housing properties, retail, office, medical, industrial, and restaurant properties by acquiring direct ownership or ownership interests through equity interests or other joint venture structures. We may also invest in other real estate property types, including undeveloped land or other development opportunities if the land is acquired for the purpose of producing rental or other operating income and either development or construction is in process or development or construction is planned to commence on the land within one year. We primarily invest in real estate properties with existing rent and expense schedules or newly constructed properties with predictable cash flows or in which a seller agrees to provide certain minimum income levels. We concentrate our efforts on real estate properties located primarily in North Dakota, the central corridor of the contiguous 48 states and in or near metropolitan areas.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Results Of Operations

Comparison of the Years ended December 31, 2011 and 2010. The following table provides a general comparison of our results of operations for years ended December 31, 2011 and 2010:

	2011	2010
Property Revenues	\$49,316,318	\$43,437,785
Property Expenses	(40,661,358)	(36,674,225)
Other Expenses	(2,556,589)	(1,902,794)
Other Income	403,133	897,458
Income (Loss) from Discontinued Operations	116,445	1,854,351
	<u>\$6,617,949</u>	<u>\$7,612,575</u>
Net Income attributable to Non-Controlling Interest	\$4,890,662	\$5,740,308
Net Income attributable to INREIT Real Estate Investment Trust	\$1,727,288	\$1,872,267
Distributions paid per share (1)	\$0.80500	\$0.77000

(1) Does not take into consideration the amounts paid by the operating partnership to limited partners.

## Property Revenues

Property revenues increased 13.5% or approximately \$5.9 million from \$43.4 million in 2010 to \$49.3 million in 2011, primarily as a result of properties acquired in 2010 and 2011. Properties acquired in 2010 increased rental revenues by approximately \$2.6 during 2011 due to one full year of ownership and properties acquired in 2011 increased rental revenues by approximately \$2.3 million. In 2011 rental revenues from stabilized properties increased by approximately \$.9 million or 2.3% over 2010.

Overall physical occupancy in our multifamily properties was 98.2% as of December 31, 2011 compared to 96.0% as of December 31, 2010, an improvement of 2.2% during the year. During 2010, overall physical occupancy in multifamily properties improved by 0.8% from 95.2% as of December 31, 2009.

Overall physical occupancy in our commercial properties was 97.4% as of December 31, 2011 compared to 93.9% as of December 31, 2010, an improvement of 3.5%. The improvement was primarily driven by the September 2011 sale of a retail property in Norfolk, Nebraska, which had an occupancy rate of less than 20% prior to sale.

Tenant concessions improved from 0.6% in 2010 to 0.5% in 2011.

## Property Expenses

The following table summarizes our significant property expenses in 2011 and 2010:

	2011	2010
Real Estate Taxes	\$5,573,732	\$4,822,036
Property Management Fees	3,851,298	3,344,295
Repairs and Maintenance	4,763,456	4,147,014
Utilities	3,312,721	2,961,726
	<u>\$17,501,207</u>	<u>\$15,275,071</u>

## Real estate taxes

Our real estate tax expenses increased 15.6% in 2011 from \$4.8 million to \$5.6 million as of December 31, 2010 and 2011. Approximately \$260,000 and \$281,000 respectively of the \$752,000 increase was due to properties acquired in 2010 and 2011. Real estate taxes as a percentage of rental income increased slightly from approximately 11.1% in 2010 to 11.3% in 2011.

## Property management fees

Property management fees, which is the expense incurred for day-to-day management of our properties, increased 15.2% from \$3.3 million in 2010 to \$3.9 million in 2011 as a result of the increase in number of properties held in our portfolio. Approximately \$176,000 and \$184,000 respectively of the \$507,000 increase was due to properties acquired in 2010 and 2011. Property management expenses as a percentage of rental income increased slightly from 7.7% in 2010 to 7.8% in 2011.

## Repairs and Maintenance

Repairs and maintenance expenses were \$4.8 million and \$4.1 million for 2011 and 2010, respectively. The increase of 14.9% in 2011 was a result of an increase in the number of properties in our portfolio along with additional snow removal and painting costs incurred during the early part of 2011 compared to 2010. Approximately \$269,000 and \$17,000 respectively of the \$616,000 increase was due to properties acquired in 2010 and 2011. Repairs and maintenance expense as a percentage of rental income increased slightly from approximately 9.5% in 2010 to 9.7% in 2011.

## Utilities

Utilities expense increased approximately 11.9% from \$3.0 million in 2010 to \$3.3 million in 2011. The change is a result of the increase in number of properties held in our portfolio. Approximately \$174,000 and \$88,000 respectively of the \$351,000 increase was due to properties acquired in 2010 and 2011. Utilities expense as percentage of rental income decreased slightly from 6.8% in 2010 to 6.7% in 2011.

## Other income and expenses

The following table summarizes our other income and expenses for 2011 and 2010:

	2011	2010
General & Administrative	\$2,556,589	\$1,902,794
Depreciation & Amortization	10,247,270	9,013,681
Interest Expense	12,031,134	11,628,388
Interest Income	(239,028)	(250,058)
Other	(164,105)	(647,400)
	<u>\$24,431,860</u>	<u>\$21,647,405</u>



## General and administrative

General and administrative expenses were \$1.9 million in 2010 and \$2.6 million in 2011. The increase of \$0.7 million or 34.4% in 2011 was a result of increased acquisition and disposition expenses of \$0.4 million and increased legal and accounting fees of \$0.3 million in comparison to 2010.

## Depreciation and amortization

Depreciation and amortization expense increased 13.7% from approximately \$9.0 million in 2010 to approximately \$10.2 million in 2011. The \$1.2 million increase was primarily a result of the depreciation and amortization impact of properties added to our portfolio. Depreciation and amortization expense as a percentage of rental income was 20.8% in 2011 and 2010.

## Interest expenses, net

Interest expense, net, of approximately \$11.8 million in 2011 and \$11.4 million in 2010, was approximately 23.9% and 26.2% of rental income for 2011 and 2010, respectively. The decrease of interest expense as a percentage of rental income during the year was a result of lower interest rates for mortgage notes payable and increased rental revenues from acquired properties.

## Other

Other income for 2011 is comprised of the proportional equity from the unconsolidated affiliate acquired July 2011 and the bargain purchase gain of \$100,000. Other income for 2010 is the bargain purchase gain of \$608,500 recorded on an acquired property and a small gain on insurance proceeds.

# LIQUIDITY AND CAPITAL RESOURCES

## Lease Expirations and Occupancy

No significant leases are scheduled to expire or renew in the near term. Our Advisor actively manages our real estate portfolio and begins discussing options with tenants in advance of scheduled lease expirations. In certain cases, we may obtain lease renewals from our tenants; however, tenants may elect to move out at the end of their term. In the cases where tenants elect not to renew, we may seek replacement tenants or try to sell the property.

The vast majority of our multifamily leases are for one year periods. The following table lists, on an aggregate basis, all of our scheduled lease expirations on non-multifamily properties. Base rents do not include CAM (common area maintenance) income and unless otherwise provided, the information set forth in the table assumes that tenants exercise no renewal options or early termination rights.

Year	# of Leases Expiring	Expiring Base Rent
Month-to-Month	5	\$470,663
2012	5	157,227
2013	9	393,465
2014	15	665,187
2015	16	1,806,231
2016	19	2,216,049
2017	6	2,959,311
2018	3	704,672
2019	0	-
2020 and Thereafter	17	\$4,594,799
	95	\$13,967,604

## Debt Maturity

One of our principal long-term liquidity requirements includes repayment of maturing debt. The following table provides information with respect to the maturities and scheduled principal payments of our indebtedness as of December 31, 2011. The table does not consider any extension options.

Years Ending December 31,	Amount
2012	\$8,750,852
2013	32,523,269
2014	11,871,601
2015	39,877,910
2016	48,099,207
Thereafter	76,357,023
Total Payments	\$217,479,862

## HISTORICAL CASH FLOWS

### Cash Resources

At December 31, 2011, our cash resources consisted of cash and cash equivalents totaling \$3.2 million and had unencumbered properties with a gross book value of \$10.5 million. Our unencumbered properties may be used as collateral to secure additional financing in future periods, although there can be no assurance we will be able to obtain financing for these properties.

We also have three lines of credit: (i) an \$11.0 million line of credit with Wells Fargo Bank secured by an office property in Duluth, Minnesota and four Applebees, (ii) a \$1.93 million line of credit with Bremer Bank secured by an office property in St. Cloud, Minnesota and (iii) a \$2.0 million line of credit with State Bank and Trust secured by a multifamily property in Fargo, North Dakota. As of December 31, 2011, there was \$8.0 million outstanding on the lines of credit and \$6.93 million available. There were no outstanding balances on the lines of credit as of December 31, 2010. Our cash resources can be used for working capital needs and other commitments.

The issuance of limited partnership units of the operating partnership in exchange for property acquisitions is also expected to be a source of long-term capital for us. During 2011, we issued 690,280 limited partnership units valued at approximately \$9.7 million in connection with the acquisitions of a 4,997 square foot restaurant in Apple Valley, Minnesota, a 40 unit and two 24 unit apartment complexes in Fargo, North Dakota, a 2,712 square foot restaurant and 3,510 square foot office building in Moorhead, Minnesota, a 40.26% interest in a 144 unit apartment complex in Bismarck, North Dakota, an 18 unit apartment complex in Grand Forks, North Dakota and a 42,000 square foot implement dealership in Marshall, Minnesota.

### Cash Requirements

During the next twelve months, we expect cash payments will include paying dividends to our shareholders and to others who hold non-controlling interests in our operations, making scheduled mortgage loan principal payments, reimbursing the advisor for costs incurred on our behalf and paying normal recurring operating expenses. We expect to continue to use excess funds to invest in new properties. We expect our cash resources will be adequate to cover our cash requirements over the next twelve months.

### Operating Activities

Our real estate properties generate cash flow in the form of rental revenues, which are reduced by interest payments, direct lease costs and property-level operating expenses. Property-level operating expenses consist primarily of property management fees including salaries and wages of property management personnel, utilities, cleaning, repairs, insurance, security and building maintenance costs, and property taxes. Additionally, we incur general and administrative expenses, advisory fees and acquisition and disposition expenses.

Net cash from operating activities for 2011 was \$15.4 million and primarily related to rental receipts offset by the payment of property management fees, property operating expenses, acquisition-related expenses and general administrative expenses.

Net cash from operating activities for 2010 was \$14.7 million and primarily related to rental receipts offset by the payment of property management fees, property operating expenses, acquisition-related expenses and general administrative expenses.

### Investing Activities

Our investing activities are generally comprised of real estate-related transactions (purchases and sales) and payments of capitalized property-related costs such as intangible assets and real estate tax and insurance escrows.

Net cash used in 2011 investing activities for 2011 was \$11.5 million primarily due to the aggregated payment of \$16.8 million for the acquisitions of properties including related intangible assets offset by proceeds (\$1.825 million) from the sale of two properties: (i) a retail property in Norfolk, Nebraska; and (ii) an assisted living facility in Williston, North Dakota.

Net cash used in 2010 investing activities for 2010 was \$17.4 million primarily due to the aggregated payment of \$21.6 million for the acquisitions of properties including related intangible assets offset by proceeds (\$10.091 million) from the sale of three properties: (i) an apartment complex in Carrington, North Dakota; (ii) an apartment complex in Fargo, North Dakota; and (iii) an assisted living facility in Minot, North Dakota.

## PROPERTY ACQUISITIONS AND DISPOSITIONS

- In January 2011, the operating partnership purchased a 4,997 square foot restaurant in Apple Valley, Minnesota for approximately \$2.5 million. The purchase was financed through the issuance of limited partnership units valued at approximately \$1.7 million and cash.
- In January 2011, the operating partnership purchased the remaining 65.44% interest in Sierra Ridge, a 136 unit apartment complex in Bismarck, North Dakota for approximately \$6.5 million. The purchase was financed with approximately \$2.2 million in cash and the assumption of \$4.3 million in debt. The debt assumption was finalized on April 1, 2011.
- In May 2011, the operating partnership purchased a 40 unit apartment complex and a 24 unit apartment complex in Fargo, North Dakota for approximately \$2.5 million. The purchase was financed through the assumption of approximately \$0.8 million in debt and the issuance of limited partnership units valued at approximately \$1.7 million. The properties were purchased from entities affiliated with Kenneth Regan and James Wieland, related parties who each received limited partnership units valued at approximately \$419,000.
- In May 2011, the operating partnership purchased a 2,712 square foot restaurant and a 3,510 square foot office building in Moorhead, Minnesota for approximately \$2.2 million. The purchase was financed with a combination of a new \$575,000 loan and the issuance of limited partnership units valued at approximately \$1.6 million.
- In June 2011, the operating partnership purchased a 13,390 square foot retail store and 36,432 square feet of adjacent land in Denver, Colorado for approximately \$5.9 million. The purchase was financed with a combination of \$4.6 million mortgage financing and approximately \$1.3 million in cash.
- In July 2011, the operating partnership purchased a 24 unit apartment complex in Fargo, North Dakota for approximately \$1.0 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$503,000, the assumption of approximately \$531,000 in mortgage financing, and cash.
- In July 2011, the operating partnership purchased a 40.26% interest in a 144 unit apartment building in Bismarck, North Dakota. The sales price was approximately \$2.3 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$1.2 million, the assumption of approximately \$1.0 million in mortgage debt and \$125,000. The remaining ownership consists of Mr. Regan and Mr. Wieland, related parties. The investment is recorded under the equity method of accounting.
- In August 2011, the operating partnership purchased an 18 unit apartment building in Grand Forks, North Dakota for approximately \$640,000. The purchase was financed with the issuance of limited partnership units valued at approximately \$382,000, new mortgage financing of \$249,000 and cash.
- In September 2011, the operating partnership purchased a single tenant 8,000 square foot office building in Norfolk, Nebraska for \$600,000. The purchase was financed with cash.
- In October 2011, the operating partnership purchased a 42,000 square foot implement dealership in Marshall, Minnesota for approximately \$5.0 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$2.6 million, approximately \$2.4 million in new mortgage financing and cash. The purchase price allocation is not yet complete.
- In December 2011, the operating partnership purchased a 414 unit apartment complex in Eagan, Minnesota for approximately \$26.2 million. The purchase was financed with the assumption of an existing \$16.7 million mortgage, an \$8.0 million advance from the Wells Fargo line of credit and cash.
- During 2011, we sold an assisted living facility in Williston, North Dakota for \$1.4 million and recognized a gain of approximately \$0.4 million.
- During 2011, we sold a retail property in Norfolk, Nebraska for approximately \$1.4 million and recognized a loss of \$66,921.
- In January 2010, the operating partnership purchased a 14 unit apartment building in Hawley, Minnesota. The approximate purchase price was \$425,000. The purchase was financed with limited partnership units valued at approximately \$213,000 and cash.
- In March 2010, the operating partnership purchased a 5,043 square foot restaurant in Bloomington, Minnesota. The approximate purchase price was \$2.2 million, paid in cash.

- In March 2010, the operating partnership purchased a 5,576 square foot restaurant in Coon Rapids, Minnesota. The approximate purchase price was \$2.4 million. The purchase was financed with limited partnership units valued at approximately \$2.1 million and cash.
- In March 2010, the operating partnership purchased a 4,936 square foot restaurant in Savage, Minnesota. The approximate purchase price was \$1.6 million, paid in cash.
- In July 2010, the operating partnership purchased a 14,830 square foot retail store in Laurel, Mississippi. The approximate purchase price was \$3.9 million. The purchase was financed with new mortgage financing of approximately \$2.5 million and cash.
- In July 2010, the operating partnership purchased a 7,296 square foot restaurant in Austin, Texas. The approximate purchase price was \$2.5 million. The purchase was financed with limited partnership units valued at approximately \$1.7 million and cash.
- In August 2010, the operating partnership purchased an 81.25% partnership interest in a 144 unit apartment building in West Fargo, North Dakota. The approximate purchase price was \$6.6 million. The purchase was financed with new mortgage financing of approximately \$6.6 million.
- In November 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota. The purchase price was \$844,000. The purchase was financed with limited partnership units valued at \$844,000.
- In December 2010, the operating partnership purchased an additional 1.34% interest in a 172 unit apartment building in Bismarck, North Dakota. The approximate purchase price was \$121,000. The operating partnership had previously held a 1/3 interest in the property.
- In December 2010, the operating partnership purchased a 9,100 square foot commercial property in Mandan, North Dakota. The approximate purchase price was \$1.5 million, paid in cash.
- In December 2010, the operating partnership purchased a 24 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland, a related party. The approximate purchase price was \$820,000. The purchase was financed with limited partnership units valued at \$506,000 and cash.
- In December 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$665,000. The purchase was financed with limited partnership units valued at \$665,000.
- In December 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland and Kenneth Regan, related parties. The approximate purchase price was \$665,000. The purchase was financed with limited partnership units valued at \$665,000.
- In December 2010, the operating partnership purchased a 16 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland, a related party. The approximate purchase price was \$620,000. The purchase was financed with limited partnership units valued at \$530,000 and cash.
- In December 2010, the operating partnership purchased a 20 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$780,000. The purchase was financed with limited partnership units valued at \$360,000 and cash.
- In December 2010, the operating partnership purchased a 20 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$780,000. The purchase was financed with limited partnership units valued at \$780,000.
- In December 2010, the operating partnership purchased a 24 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland and Kenneth Regan, related parties. The approximate purchase price was \$1,300,000. The purchase was financed with limited partnership units valued at \$855,000 and cash.
- During 2010, we sold an apartment complex in Fargo, North Dakota for approximately \$1.6 million and recognized a gain of \$574,644.
- During 2010, we sold an assisted living facility in Minot, North Dakota for approximately \$7.8 million and recognized a gain of \$1,228,798.



## FINANCING ACTIVITIES

- During 2011, we paid \$9.5 million in dividends to shareholders and others with non-controlling interests in our operations. We also made scheduled mortgage principal installments of \$12.8 million. We received \$8.0 million in proceeds from mortgage financings and drew \$8.0 million on a line of credit, both related to investment activity.
- During 2010, we paid \$8.5 million in dividends to shareholders and others with non-controlling interests in our operations. We made scheduled mortgage principal installments of \$17.4 million. We received \$10.7 million from the issuance of shares and \$21.7 million in proceeds from mortgage financings related to investment activity.

Our objectives are to generate sufficient cash flow over time to provide shareholders and others with non-controlling interests in our operations with increasing dividends and to seek investments with potential for strong returns and capital appreciation throughout varying economic cycles. During 2010 and 2011, we have funded 100% of the dividends from operating cash flows. In setting a dividend rate, we focus primarily on expected returns from those investments we have already made to assess the sustainability of a particular dividend rate over time.

## FFO/MFFO RECONCILIATION

Funds From Operations (FFO) applicable to common shares and limited partnership units means net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures will be calculated to reflect funds from operations on the same basis.

Historical cost accounting for real estate assets implicitly assumes the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors have considered presentations of operating results for real estate companies use historical cost accounting to be insufficient by themselves. The term Funds From Operations was created to address this problem. It was intended to be a standard supplemental measure of REIT operating performance that excluded historical cost depreciation from — or “added it back” to — GAAP net income.

Our management believes this non-GAAP measure is useful to investors because it provides supplemental information that facilitates comparisons to prior periods and for the evaluation of financial results. Management uses this non-GAAP measure to evaluate our financial results, develop budgets and manage expenditures. The method used to produce non-GAAP results is not computed according to GAAP, is likely to differ from the methods used by other companies and should not be regarded as a replacement for corresponding GAAP measures. Management encourages the review of the reconciliation of this non-GAAP financial measure to the comparable preliminary GAAP results.

Since the introduction of the definition of FFO, the term has come to be widely used by REITs. In the view of NAREIT, this use (combined with the primary GAAP presentations required by the Securities and Exchange Commission) has been fundamentally beneficial, improving the understanding of operating results of REITs among the investing public and making it easier than before to compare the results of one REIT with another.

In addition to FFO, management also uses Modified Funds From Operations (“MFFO”) as a non-GAAP supplemental performance measure. MFFO as defined by our Company excludes from FFO acquisition related costs which are required to be expensed in accordance with GAAP. Prior to 2009, acquisition costs for business combinations were capitalized; however, beginning in 2009, acquisition costs related to business combinations are now expensed. Our definition of MFFO also excludes disposition costs related to sales of investment properties. Acquisition and disposition related expenses include those paid to our Advisor and third parties. Management believes that excluding acquisition and disposition related costs from MFFO provides useful supplemental performance information that is comparable over the long-term and this is consistent with management’s analysis of the operating performance of the REIT.

While FFO and MFFO applicable to common shares and limited partnership units are widely used by REITs as performance metrics, not all real estate investment trusts use the same definition of FFO and MFFO or calculate FFO and MFFO in the same way. The FFO and MFFO reconciliation presented here is not necessarily comparable to FFO and MFFO presented by other real estate investment trusts. FFO and MFFO should also not be considered as an alternative to net income as determined in accordance with GAAP as a measure of a real estate investment trust’s performance, but rather should be considered as an additional, supplemental measure, and should be viewed in conjunction with net income as presented in the consolidated financial statements included in this report. FFO and MFFO

applicable to common shares and limited partnership units does not represent cash generated from operating activities in accordance with GAAP, and is not necessarily indicative of sufficient cash flow to fund a real estate investment trust's needs or its ability to service indebtedness or to make cash distributions to shareholders.

The following tables include calculations of FFO and MFFO, and the reconciliations to net income for the years ended December 31, 2011 and 2010, respectively. We believe this calculation is the most comparable GAAP financial measure (in thousands):

	2011			2010		
	Amount	Weighted Avg Shares & Units <sup>(1)</sup>	Per Share & Unit <sup>(2)</sup>	Amount	Weighted Avg Shares & Units <sup>(1)</sup>	Per Share & Unit <sup>(2)</sup>
Net Income attributable to INREIT Real Estate Investment Trust	\$1,727,288	3,771,326	\$0.46	\$1,872,267	3,190,716	\$0.59
Add back:						
Noncontrolling Interest - OPU	4,894,778	10,714,496		5,761,202	9,919,608	
Depreciation & Amortization from continuing operations	10,247,270			9,013,681		
Depreciation & Amortization from discontinued operations	52,608			229,629		
Pro rata share of unconsolidated affiliate depreciation & amortization	26,891			-		
Loss on depreciable asset sales	66,921					
Subtract:						
Gains on depreciable asset sales	(366,990)			(1,992,816)		
Funds from Operations (FFO) applicable to common shares and limited partnership units	\$16,648,766	14,485,822	\$1.15	\$14,883,963	13,110,324	\$1.13
Add back:						
Acquisition and disposition expenses	917,621			733,120		
Modified Funds from Operations (MFFO)	\$17,566,387	14,485,822	\$1.21	\$15,617,083	13,110,324	\$1.19

(1) UPREIT Units of the Operating Partnership are exchangeable for shares of beneficial interest on a one-for-one basis.

(2) Net Income is calculated on a per share basis. FFO is calculated on a per share and unit basis.

## OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2011, we had no significant off-balance sheet arrangements, as defined in Item 303(a)(4) (ii) of SEC Regulation S-K.

## CRITICAL ACCOUNTING ESTIMATES

Preparation of our financial statements requires estimates and judgments to be made affecting the amounts of assets, liabilities, revenues and expenses reported. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. We evaluate these estimates based on assumptions we believe to be reasonable under the circumstances.

The difficulty in applying these policies arises from the assumptions, estimates and judgments that have to be made currently about inherently uncertain matters, such as future economic conditions, operating results and valuations as well as management intentions. As the difficulty increases, the level of precision decreases, meaning actual results can and probably will be different from those currently estimated.

There have been no material changes in our Critical Accounting Policies as disclosed in Note 2 to our financial statements for the year ended December 31, 2011 included elsewhere in this report.

## RECENT DEVELOPMENTS

On January 15, 2012, we paid a dividend or distribution of \$0.20125 per share on our common shares of beneficial interest, to common shareholders and limited unit holders of record on December 31, 2011. Subsequent to December 31, 2011, our Board of Trustees approved a plan to increase our quarterly dividend or distribution to \$0.2065 from \$0.20125 per common share and limited partnership unit, effective with the next quarterly dividend planned for April 15, 2012. All future dividends remain subject to the discretion of our Board of Trustees.

In January 2012, the operating partnership purchased a 2,811 square foot restaurant in Dickinson, North Dakota for approximately \$1,330,000. The purchase was financed primarily with limited partnership units valued at approximately \$1.3 million and cash.

In February 2012, the operating partnership sold a 4,500 square foot retail property in Norfolk, Nebraska for approximately \$335,000 and recognized a loss of approximately \$88,000.

In February 2012, the operating partnership received full payment, including interest, in the amount of \$1,509,000 on the Minot Land note that was outstanding as of December 31, 2011.

## MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

### Market Information

Our common shares of beneficial interest are not listed on any national exchange or over-the-counter market or quoted on any national securities market, and we currently do not have plans to list or have our common shares quoted.

### Shareholders and Limited Unit Holders

As of March 20, 2012, we had 4,246,122.860 common shares of beneficial interests outstanding, held by a total of 811 common shareholders and no outstanding options or warrants to purchase our common shares.

In addition, as of March 20, 2012, there were approximately 10,982,076.387 limited partnership units of our operating partnership outstanding held by three classes of limited partners that in the aggregate total approximately 463 limited partners. Pursuant to the exchange rights under the LLLP Agreement of the operating partnership, we have the option, upon redemption requests by the holders of the limited partnership units, to acquire the limited partnership units by paying the holders with our common shares of beneficial interest on a one-for-one exchange basis. The numbers of common shareholders and limited partners is based on the Company's records.

### Quarterly Distribution Data

We have declared and intend to continue to declare regular quarterly dividends to our common shareholders. Because all of our operations are conducted through our operating partnership, our ability to pay dividends depends on the operating partnership's ability to make dividends to us and its other limited partners. We pay declared dividends quarterly, whereby the dividend attributable to a calendar quarter would be paid during the next quarter. Dividends will be paid to common shareholders as of the record dates selected by the Board of Trustees. We intend to make dividends sufficiently to satisfy the requirements for qualification as a REIT for federal tax purposes.



We expect that the dividend will be maintained at least at the present rate, unless our results of operations, our general financial condition, general economic conditions or other factors prohibit us from doing so or the Board determines other action prudent. The following tables show the dividends we have paid (including the total amount paid and the amount paid on a per share basis) during the last two fiscal years.

2011 Quarter Ended	Dividends Per Common Share	Total Dividends
December 31	\$0.201250	\$759,762
September 30	\$0.201250	\$755,830
June 30	\$0.201250	\$750,775
March 31	\$0.192500	\$693,549

2010 Quarter Ended	Dividends Per Common Share	Total Dividends
December 31	\$0.192500	\$633,716
September 30	\$0.192500	\$610,423
June 30	\$0.192500	\$572,694
March 31	\$0.186250	\$532,496

## Issuer Purchases of Equity Securities

Our Board of Trustees has approved a share repurchase plan that may enable shareholders to sell their shares to us in limited circumstances.

### Issuer Purchases Of Equity Securities

Period	Total # of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total # of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(1)	Maximum # (or Appropriate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (October 1, 2011 - October 31, 2011)	408.120	\$12.60	68,455.799	\$4,137,456.90
Month #2 (November 1, 2011 - November 30, 2011)	8,844.350	\$12.86	75,628.737	\$4,047,077.881
Month #3 (December 1, 2011 - December 31, 2011)	17,317.152	\$12.60	92,945.889	\$3,828,881.77
Total	26,569.622			

- (1) In our Registration Statement on Form 10 filed with the SEC on March 11, 2011, we had disclosed that our Board of Trustees had approved a share repurchase plan, whereby our shareholders would be permitted to sell their shares back to us, up to a maximum amount of \$5,000,000 worth of shares, after they have held them for at least one year and subject to other conditions and limitations described in the plan. The repurchase price for such shares repurchased under the plan is fixed at \$12.60 per share. The repurchase plan will terminate in the event the shares become listed on any national securities exchange, the subject of bona fide quotes on any inter-dealer quotation system or electronic communications network or are the subject of bona fide quotes in the pink sheets. Additionally, the Board, in its sole discretion, may terminate, amend or suspend the repurchase plan if it determines to do so is in our best interest.

## Issuer's Sale of Shares

Under the terms of our operating partnership's LLLP Agreement, if a member requests the operating partnership to redeem his units, we have the right to purchase such units and elect to pay for such units with either cash or our common shares of beneficial interest, in our discretion, at an exchange rate of one unit for one share ("Redemption Right"). On December 28, 2011,

under the Redemption Right, we acquired 13,855.823 units of membership interests in exchange for 13,855.823 shares. For this sale, we relied on exemptions under Section 4(2) of the 1933 Act.

## Equity Compensation Plans

We do not presently have any equity compensation plans.

## **CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Annual Report on Form 10-K (the “Evaluation Date”). Based upon the evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective to ensure that information required to be disclosed in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms, and is accumulated and communicated to management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

### **Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) during the fourth quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Management’s Report on Internal Control Over Financial Reporting**

This annual report does not include a report of management’s assessment regarding internal control over financial reporting or an attestation report of our registered public accounting firm due to a transition period established by rules of the Securities and Exchange Commission for newly registered public companies.





## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors  
**INREIT Real Estate Investment Trust**  
Minot, North Dakota

We have audited the accompanying consolidated balance sheets of **INREIT Real Estate Investment Trust** as of December 31, 2011 and 2010, and the related statements of operations, shareholders' equity and comprehensive income and cash flows for the years ended December 31, 2011 and 2010. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15. INREIT Real Estate Investment Trust's management is responsible for these statements. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **INREIT Real Estate Investment Trust**, as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ Widmer Roel PC

Fargo, North Dakota  
March 12, 2012

# INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2011 AND 2010

	As of December 31,	
	2011	2010
<b>ASSETS</b>		
PROPERTY AND EQUIPMENT, less accumulated depreciation	\$ 355,661,993	\$ 312,567,343
CASH AND CASH EQUIVALENTS	3,192,785	10,010,564
RESTRICTED DEPOSITS AND FUNDED RESERVES	3,397,991	5,814,623
INVESTMENT IN UNCONSOLIDATED AFFILIATES	1,506,776	-
DUE FROM RELATED PARTY	367,642	350,707
RECEIVABLES	2,629,452	2,198,140
PREPAID EXPENSES	709,061	474,602
NOTES RECEIVABLE	1,807,159	1,917,573
FINANCING COSTS, less accumulated amortization of \$1,011,602 in 2011 and \$559,017 in 2010	2,359,556	1,713,903
ASSETS HELD FOR SALE	449,734	1,115,618
RENT INCENTIVE, less accumulated amortization of \$216,667 in 2011 and \$116,667 in 2010	1,283,333	1,383,333
INTANGIBLE ASSETS, less accumulated amortization of \$1,660,688 in 2011 and \$953,481 in 2010	7,177,854	6,290,576
OTHER ASSETS	724,229	145,201
	<u>\$ 381,267,565</u>	<u>\$ 343,982,183</u>

**INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
AT DECEMBER 31, 2011 AND 2010

	<b>As of December 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>LIABILITIES</b>		
MORTGAGE NOTES PAYABLE	\$ 217,479,862	\$ 192,171,523
NOTES PAYABLE	8,000,000	-
SPECIAL ASSESSMENTS PAYABLE	1,574,376	1,582,610
DIVIDENDS PAYABLE	2,945,560	2,606,033
DUE TO RELATED PARTY	66,734	544,988
TENANT SECURITY DEPOSITS PAYABLE	1,529,891	1,213,102
INVESTMENT CERTIFICATES	1,443,899	2,455,534
UNFAVORABLE LEASES, net	519,305	583,350
ACCOUNTS PAYABLE - TRADE	9,151	152,833
LIABILITIES RELATED TO ASSETS HELD FOR SALE	6,324	48,062
FAIR VALUE OF INTEREST RATE SWAP	452,586	194,499
DEFERRED INSURANCE PROCEEDS	49,189	6,816
ACCRUED EXPENSES	2,964,421	2,759,658
Total liabilities	<u>237,041,298</u>	<u>204,319,008</u>
<b>COMMITMENTS - NOTE 15</b>		
<b>SHAREHOLDERS' EQUITY</b>		
NONCONTROLLING INTEREST IN OPERATING PARTNERSHIP	108,542,389	105,012,439
BENEFICIAL INTEREST	36,136,464	34,845,235
ACCUMULATED COMPREHENSIVE LOSS	(452,586)	(194,499)
	<u>144,226,267</u>	<u>139,663,175</u>
	<u>\$ 381,267,565</u>	<u>\$ 343,982,183</u>

# INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
INCOME FROM RENTAL OPERATIONS	\$ 49,316,318	\$ 43,437,785
EXPENSES		
Expenses from rental operations		
Interest	12,031,134	11,628,388
Depreciation and amortization	10,247,270	9,013,681
Real estate taxes	5,573,732	4,822,036
Property management fees	3,851,298	3,344,295
Utilities	3,312,721	2,961,725
Repairs and maintenance	4,763,456	4,147,014
Insurance	798,782	668,317
Administrative	82,965	88,768
	40,661,358	36,674,225
Administration of REIT		
Administrative expenses	51,441	50,494
Advisory fees	764,925	683,840
Acquisition expenses	794,121	430,402
Director fees	41,400	41,600
Legal and accounting	641,133	333,458
Loss on impairment of property	263,569	363,000
	2,556,589	1,902,794
Total expenses	43,217,946	38,577,019
INCOME FROM OPERATIONS	6,098,372	4,860,766
OTHER INCOME		
Equity in income of unconsolidated affiliates	64,105	-
Interest income	239,028	250,058
Insurance proceeds	-	38,900
Gain on bargain purchase	100,000	608,500
	403,133	897,458
INCOME FROM CONTINUING OPERATIONS	6,501,505	5,758,224
DISCONTINUED OPERATIONS - <b>NOTE 16</b>	116,445	1,854,351
NET INCOME	6,617,950	7,612,575
NET INCOME ATTRIBUTABLE TO THE NONCONTROLLING INTEREST	4,890,662	5,740,308
NET INCOME ATTRIBUTABLE TO INREIT REAL ESTATE INVESTMENT TRUST	\$ 1,727,288	\$ 1,872,267
NET INCOME PER COMMON SHARE		
Basic and diluted	\$ 0.46	\$ 0.59



**INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
FOR THE YEAR ENDED DECEMBER 31, 2010

	Common Shares	Common Shares Amount	Accumulated Earnings (Deficit)	Total Beneficial Interest	Noncontrolling Interest	Accumulated Comprehensive Loss	Total
BALANCE, DECEMBER 31, 2009	\$2,859,039	\$32,038,916	\$ (6,067,369)	\$25,971,547	\$100,046,173	\$ (168,332)	\$125,849,388
Issuance of common shares	777,996	10,685,427		10,685,427			10,685,427
REIT common shares converted to UPREIT units	(50,395)	(705,525)		(705,525)	705,525		-
Contribution of assets in exchange for the issuance of noncontrolling interest share					7,830,176		7,830,176
Repurchase of shares	(195,166)	(2,519,778)		(2,519,778)			(2,519,778)
Dividends			(1,817,152)	(1,817,152)	(5,753,384)		(7,570,536)
Dividends declared			(693,549)	(693,549)	(1,912,483)		(2,606,032)
Dividends reinvested - stock dividend	109,320	1,453,955		1,453,955			1,453,955
UPREIT units converted to REIT common shares	102,059	1,331,489		1,331,489	(1,331,489)		-
Syndication costs			(733,446)	(733,446)	(312,387)		(1,045,833)
Decrease in fair value of interest rate swap						(26,167)	(26,167)
Net income			1,872,267	1,872,267	5,740,308		7,612,575
BALANCE, DECEMBER 31, 2010	\$3,602,853	\$42,284,484	\$ (7,439,249)	\$34,845,235	\$105,012,439	\$ (194,499)	\$139,663,175

# INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2011

	Common Shares	Common Shares Amount	Accumulated Earnings (Deficit)	Total Beneficial Interest	Noncontrolling Interest	Accumulated Comprehensive Loss	Total
BALANCE, DECEMBER 31, 2010	\$3,602,853	\$42,284,483	\$(7,439,249)	\$34,845,235	\$105,012,439	\$(194,499)	\$139,663,175
Issuance of common shares	150,824	2,075,445		2,075,445			2,075,445
Contribution of assets in exchange for the issuance of noncontrolling interest share					9,663,931		9,663,931
Repurchase of shares	(275,191)	(3,469,736)		(3,469,736)			(3,469,736)
Dividends			(2,266,367)	(2,266,367)	(6,419,802)		(8,686,169)
Dividends declared			(763,990)	(763,990)	(2,181,570)		(2,945,560)
Dividends reinvested - stock dividend	137,877	1,833,742		1,833,742			1,833,742
UPREIT units converted to REIT common shares	179,860	2,285,643		2,285,643	(2,285,643)		-
Syndication costs			(130,796)	(130,796)	(137,628)		(268,424)
Decrease in fair value of interest rate swap						(258,087)	(258,087)
Net income			1,727,288	1,727,288	4,890,662		6,617,950
BALANCE, DECEMBER 31, 2011	\$3,796,223	\$45,009,577	\$(8,873,114)	\$36,136,464	\$108,542,389	\$(452,586)	\$144,226,267

**INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
FOR THE YEAR ENDED DECEMBER 31, 2011 and 2010

	2011	2010
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 6,617,950	\$ 7,612,575
Adjustments to reconcile net income to net cash from operating activities		
Gain on sale of property and equipment	(366,990)	(1,992,816)
Loss on sale of property and equipment	66,921	-
Gain due to insurance proceeds	-	(38,900)
Bargain purchase on business combinations	(100,000)	(608,500)
Loss on impairment of property	263,569	363,000
Equity in income of unconsolidated affiliates	(64,105)	-
Depreciation	8,931,165	8,335,599
Amortization	1,391,381	907,711
Effects on operating cash flows due to changes in		
Tenant security deposits	(238,175)	(155,092)
Due from related party	(16,935)	572,051
Receivables	(441,958)	(620,993)
Prepaid expenses	(234,459)	(32,994)
Rent Incentive	-	-
Other assets	(579,028)	(60,225)
Due to related party	(166,362)	5,699
Tenant security deposits payable	316,789	142,328
Accounts payable	(143,682)	140,061
Accrued expenses	163,026	130,078
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>15,399,107</b>	<b>14,699,582</b>

# INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

### FOR THE YEAR ENDED DECEMBER 31, 2011 and 2010

INVESTING ACTIVITIES	2011	2010
Purchase of property and equipment	(15,222,434)	(18,999,425)
Purchase of intangible assets	(1,588,139)	(2,642,286)
Due to related party for acquisition fees	-	172,537
Proceeds from sale of property and equipment	2,825,000	4,620,940
Investment in unconsolidated affiliates	(272,659)	-
Distributions received from unconsolidated affiliates	17,500	-
Insurance proceeds received	-	414,463
Proceeds from lease buyout	-	410,000
Real estate tax and insurance escrows	521,769	20,036
Notes receivable payments received	54,065	48,823
Notes receivable issued for tenant improvements	(33,000)	-
Proceeds from sale of securities	-	-
Deferred insurance proceeds	42,373	(142,064)
Net payments from (deposits to) replacement reserve	(156,381)	308,329
Net payments from exchange escrow	2,312,927	(1,659,885)
NET CASH USED FOR INVESTING ACTIVITIES	(11,498,979)	(17,448,532)
	2011	2010
FINANCING ACTIVITIES		
Payments for financing costs	(1,300,216)	(667,025)
Proceeds from investment certificates issued	-	2,241,955
Payments on investment certificates	(1,011,635)	(254,499)
Principal payments on special assessments payable	(169,334)	(205,535)
Proceeds from issuance of mortgage notes payable	7,969,857	21,718,059
Principal payments on mortgage notes payable	(12,773,510)	(17,379,946)
Net change in short-term notes payable	8,000,000	-
Payments on construction payable	-	(332,116)
Proceeds from issuance of shares	2,075,445	10,685,427
Repurchase of shares	(3,469,736)	(2,519,778)
Distributions paid	(9,458,461)	(8,489,787)
Payment of syndication costs	(580,317)	(739,516)
NET CASH FLOWS USED FOR FINANCING ACTIVITIES	(10,717,907)	4,057,239



**INREIT REAL ESTATE INVESTMENT TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
FOR THE YEAR ENDED DECEMBER 31, 2011 and 2010

	2011	2010
NET CHANGE IN CASH AND CASH EQUIVALENTS	(6,817,779)	1,308,289
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	10,010,564	8,702,274
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 3,192,785	\$ 10,010,564
SCHEDULE OF CASH FLOW INFORMATION		
Cash paid during the period for interest	\$ 12,021,905	\$ 11,998,754
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Distributions reinvested	\$ 1,833,742	\$ 1,453,955
Distributions declared and not paid	\$ 763,990	\$ 693,549
UPREIT distributions declared and not paid	\$ 2,181,570	\$ 1,912,483
UPREIT units converted to REIT common shares	\$ 2,285,643	\$ 625,964
Acquisition of assets in exchange for the issuance of noncontrolling interest shares in UPREIT	\$ 9,663,931	\$ 7,830,176
Mortgage assumed on sale of property	\$ -	\$ 5,607,368
Acquisition of assets through assumption of debt and property purchased with financing	\$ 30,111,992	\$ 2,477,849
Acquisition of assets included in payables	\$ -	\$ -
Increase in land improvements due to increase in special assessments payable	\$ 161,000	\$ 240,531
Unrealized (gain) loss on interest rate swap	\$ 258,087	\$ 26,167
Acquisition of assets with reduction of notes receivable	\$ 89,349	\$ -

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - ORGANIZATION

INREIT Real Estate Investment Trust ("INREIT") is a registered, but unincorporated business trust organized in North Dakota in November 2002. INREIT has elected to be taxed as a Real Estate Investment Trust ("REIT") under Sections 856-860 of the Internal Revenue Code, which requires that 75% of the assets of a REIT must consist of real estate assets and that 75% of its gross income must be derived from real estate. The net income of the REIT is allocated in accordance with the stock ownership in the same fashion as a regular corporation.

INREIT previously established an operating partnership (INREIT Properties, LLLP) and transferred all of its assets and liabilities to the operating partnership in exchange for general partnership units. The general partner has management responsibility for all activities of the operating partnership. As of December 31, 2011 and 2010, INREIT owned approximately 25.8% and 25.7%, respectively, of the operating partnership. The operating partnership is the 100% owner of Grand Forks INREIT, LLC, Autumn Ridge INREIT, LLC, Bismarck Interstate INREIT, LLC, 32nd Avenue INREIT, LLC, INREIT BL Mankato, LLC, INREIT BL Janesville, LLC, INREIT BL Eau Claire, LLC, INREIT BL Stevens Point, LLC, INREIT BL Sheboygan, LLC, INREIT BL Oshkosh, LLC, INREIT BL Onalaska, LLC, INREIT BL Grand Forks, LLC, INREIT BL Marquette, LLC, INREIT BL Bismarck, LLC, INREIT Stonybrook, LLC, INREIT Alexandria, LLC, INREIT Batesville, LLC, INREIT Fayetteville, LLC, INREIT Laurel, LLC, INREIT Somerset, LLC, Sierra Ridge, LLC, INREIT Maple Ridge, LLC, INREIT Fed-3 LLC, INREIT Sunset Ridge, LLC, the 81.25% owner of Eagle Run Partnership, LLLP, the 50% owner of Marketplace Investors, LLC and the 40.26% interest in Highland Meadows, LLLP.

### NOTE 2 – PRINCIPAL ACTIVITY AND SIGNIFICANT ACCOUNTING POLICIES

#### *Basis of presentation*

The accompanying consolidated financial statements include the accounts of INREIT Real Estate Investment Trust and all subsidiaries for which we maintain a controlling interest.

The accompanying consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles ("U.S.

GAAP") and require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could differ from those estimates.

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of INREIT; INREIT Properties, LLLP; Grand Forks INREIT, LLC; Autumn Ridge INREIT, LLC; Bismarck Interstate INREIT, LLC; 32nd Avenue INREIT, LLC; INREIT BL Mankato, LLC; INREIT BL Janesville, LLC; INREIT BL Eau Claire, LLC; INREIT BL Stevens Point, LLC; INREIT BL Sheboygan, LLC; INREIT BL Oshkosh, LLC; INREIT BL Onalaska, LLC; INREIT BL Grand Forks, LLC; INREIT BL Marquette, LLC; INREIT BL Bismarck, LLC; INREIT Stonybrook, LLC; INREIT Alexandria, LLC; INREIT Batesville, LLC; INREIT Fayetteville, LLC; INREIT Laurel, LLC; Sierra Ridge, LLC; INREIT Maple Ridge, LLC; INREIT FED-3, LLC; Sunset Ridge, LLC; and Marketplace Investors, LLC. All significant intercompany transactions and balances have been eliminated in consolidation.

Additionally, we evaluate the need to consolidate affiliates based on standards set forth in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, Consolidation ("ASC 810"). In determining whether we have a controlling interest in an affiliate and the requirement to consolidate the accounts of that entity, management considers factors such as ownership interest, authority to make decisions and contractual and substantive participating rights of the limited partners and shareholders as well as whether the entity is a variable interest entity for which we are the primary beneficiary.

#### *Principal Business Activity*

INREIT has a sole general partner interest in the operating partnership, which owns and operates the following properties:

- 2,307 and 204 units respectively in Fargo and West Fargo, North Dakota.
- 551 units in Grand Forks, North Dakota.
- 470 units in Bismarck, North Dakota.
- 316 units in Omaha, Nebraska.
- 14 units in Hawley, Minnesota.
- 414 units in Eagan, Minnesota.
- 193 unit assisted living facility in Bismarck, North Dakota.

## NOTE TO CONSOLIDATED FINIANCIAL STATEMENTS

- 15,010 square foot office building in Minot, North Dakota.
- 8,000 square foot office building in Norfolk, Nebraska.
- 15,000 square foot office and retail complex in Fargo, North Dakota.
- 28,500 square foot office and retail complex in Fargo, North Dakota.
- 30,200 square foot retail facility in Waite Park, Minnesota.
- 17,000 square foot office building in Fargo, North Dakota.
- 124,306 square foot office complex in Fargo, North Dakota.
- 10,810 square foot office building in St. Cloud, Minnesota.
- 95,961 square foot office building in Duluth, Minnesota.
- 11,973 square foot office building in Fargo, North Dakota.
- 21,492 square foot office building and 1,625 square foot storage area in Grand Forks, North Dakota.
- 102,448 square foot office building in Edina, Minnesota.
- 2,200 square foot restaurant in Norfolk, Nebraska.
- 5,043 square foot restaurant in Bloomington, Minnesota.
- 5,576 square foot restaurant in Coon Rapids, Minnesota.
- 4,936 square foot restaurant in Savage, Minnesota.
- 7,296 square foot restaurant in Austin, Texas.
- 15,400 square foot commercial building in Mandan, North Dakota.
- 4,997 square foot restaurant in Apple Valley, Minnesota.
- 2,712 square foot restaurant in Moorhead, Minnesota.
- 3,510 square foot office building in Moorhead, Minnesota.
- 42,000 square foot retail building in Marshall, Minnesota.

The operating partnership is the 100% owner of Grand Forks INREIT, LLC, which owns a 1/3 interest as a tenant in common of Grand Forks Marketplace

Retail Center. The operating partnership is also the 50% owner of Marketplace Investors, LLC, which owns a 1/3 interest as a tenant in common of Grand Forks Marketplace Retail Center. Grand Forks Marketplace Retail Center has approximately 183,000 square feet of commercial space in Grand Forks, North Dakota.

The operating partnership is the owner of 32<sup>nd</sup> Avenue INREIT, LLC, which owns and leases a commercial building with approximately 31,000 square feet of rental space in Fargo, North Dakota.

The operating partnership is the owner of Autumn Ridge INREIT, LLC which owns and leases two 36 unit residential apartment buildings in Grand Forks, North Dakota.

The operating partnership is the owner of Sierra Ridge, LLC which owns and leases a 136 unit residential apartment complex in Bismarck, North Dakota.

The operating partnership owns a 2/3 interest as a tenant in common of a commercial building with approximately 75,000 square feet of rental space in Fargo, North Dakota.

The operating partnership is the owner of Bismarck Interstate INREIT, LLC, which owns and leases two commercial buildings with approximately 75,000 square feet of rental space in Bismarck, North Dakota.

The operating partnership is the owner of INREIT Maple Ridge, LLC which owns and leases a 168 unit residential apartment complex in Omaha, Nebraska.

The operating partnership is the owner of INREIT Somerset, LLC, which owns and leases a 75 unit residential apartment complex in Fargo, North Dakota.

The operating partnership is the owner of INREIT Stonybrook, LLC, which owns and leases a 148 unit residential apartment complex in Omaha, Nebraska.

The operating partnership is the owner of INREIT Sunset Ridge, LLC, which owns and leases a 179 unit residential apartment complex in Bismarck, North Dakota.

The operating partnership is the owner of INREIT Alexandria, LLC, INREIT Batesville, LLC, INREIT Fayetteville, LLC, INREIT Laurel, LLC, and INREIT FED-3, LLC which own a total of five separate commercial properties totaling 72,140 square feet. These properties are located in Alexandria, Louisiana; Batesville, Arkansas; Fayetteville, Arkansas; Laurel, Mississippi; and Denver, Colorado.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

The operating partnership is the owner of INREIT BL Mankato, LLC, INREIT BL Janesville, LLC, INREIT BL Eau Claire, LLC, INREIT BL Stevens Point, LLC, INREIT BL Sheboygan, LLC, INREIT BL Oshkosh, LLC, INREIT BL Onalaska, LLC, INREIT BL Grand Forks, LLC, INREIT BL Marquette, LLC, and INREIT BL Bismarck, LLC, which own a total of ten separate commercial properties totaling 124,686 square feet. These properties are located in Mankato, Minnesota; Janesville, Wisconsin; Eau Claire, Wisconsin; Stevens Point, Wisconsin; Sheboygan, Wisconsin; Oshkosh, Wisconsin; Onalaska, Wisconsin; Grand Forks, North Dakota; Marquette, Michigan; and Bismarck, North Dakota.

The operating partnership is the 81.25% owner of Eagle Run Partnership, which owns and leases a 144 unit residential apartment complex in West Fargo, North Dakota. The remaining ownership consists of Kenneth Regan, James Wieland and James Echtenkamp, related parties.

### *Tenant in Common Interest*

We own two properties through a tenant in common interest with unaffiliated third parties. For such properties, the approval of the other party is not required to finance, develop, sell, or operate the property. We proportionally consolidate our ownership interest in the property, which reflects our proportional share of assets, liabilities, revenue, and expenses of those properties in our consolidated financial statements.

### *Investment in Unconsolidated Affiliates*

Investment in unconsolidated affiliates as of December 31, 2011 consists of our 40.26% interest in Highland Meadows, LLLP, owner of one 144 unit residential, multi-tenant apartment complex in Bismarck, North Dakota. Consolidation of this investment is not required as the entity does not qualify as a variable interest entity and does not meet the control requirements for consolidation, as defined in ASC 810. We and the respective affiliate partners must approve significant decisions about the applicable entity's activities. As of December 31, 2011, the unconsolidated affiliate held total assets of \$3.3 million and mortgage notes payable of \$2.5 million.

We account for unconsolidated affiliates using the equity method of accounting per guidance established under ASC 323, Investments – Equity Method and Joint Ventures ("ASC 323"). The equity method of accounting requires the investment to be initially recorded at cost

and subsequently adjusted for our share of equity in the affiliates' earnings and distributions. We evaluate the carrying amount of the investments for impairment in accordance with ASC 323. Unconsolidated affiliates are reviewed for potential impairment if the carrying amount of the investment exceeds its fair value. An impairment charge is recorded when an impairment is deemed to be other-than-temporary. To determine whether impairment is other-than-temporary, we consider whether we have the ability and intent to hold the investment until the carrying amount is fully recovered. The evaluation of an investment in an affiliate for potential impairment can require our management to exercise significant judgments. No impairment losses were recorded related to the unconsolidated affiliate for the years ended December 31, 2011 and 2010.

### *Concentration of Credit Risk*

Our cash balances are maintained in various bank deposit accounts. The bank deposit amounts in these accounts may exceed federally insured limits at various times throughout the year.

### *Use of Estimates*

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

### *Property and Equipment*

We account for our property acquisitions by allocating the purchase price of a property to the property's assets based on management's estimates of their fair value. Techniques used to estimate fair value include appraisals of the properties by a certified independent appraiser at the time of acquisition.

Equipment, furniture and fixtures purchased are stated at cost less accumulated depreciation. All costs associated with the development and construction of real estate investments, including acquisition fees and interest, are capitalized as a cost of the property. Expenditures for renewals and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Expenditures for routine maintenance and repairs, which do not add to the value or extend useful lives, are charged to expense as incurred.



## NOTE TO CONSOLIDATED FINIANCIAL STATEMENTS

Depreciation is provided for over the estimated useful lives of the individual assets using the straight-line method over the following estimated useful lives:

Buildings and improvements	40 years
Furniture and fixtures	9 years

Depreciation expense for the years ended December 31, 2011 and 2010, totaled \$8,931,165 and \$8,335,599, respectively.

Annually, we evaluate our real estate investments for significant operational changes to assess whether any impairment indications are present, including recurring operating losses or significant adverse changes in legal factors or business climate that affect the recovery of the recorded value. If any real estate investment is considered impaired, a loss is provided to reduce the carrying value of the property to its estimated fair value.

### *Cash and Cash Equivalents*

We classify highly liquid investments with a maturity of three months or less when purchased as cash equivalents.

### *Receivables*

Receivables consist primarily of amounts due for rent and real estate taxes. The receivables are non-interest bearing. The carrying amount of receivables is reduced by an amount that reflects management's best estimates of the amounts that will not be collected. As of December 31, 2011 and 2010 management determined that no allowance was necessary for uncollectible receivables.

### *Other assets*

Lease intangibles represent a proportional purchase price allocation of a property acquisition. The lease intangibles represent the estimated value of in-place leases and above-market lease terms. Intangible assets are comprised of finite-lived and indefinite-lived assets. Indefinite-lived assets are not amortized. Finite-lived intangibles are amortized over their expected useful lives.

Other intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. The carrying amount of intangible assets that are not deemed to have an indefinite useful life is regularly reviewed for indicators of impairments in value. Impairment is recognized only if the carrying amount of the intangible asset is considered to be unrecoverable from its undiscounted cash flows and is measured as the difference between the carrying

amount and the estimated fair value of the asset. Based on the review, management determined that impairment was unnecessary at December 31, 2011 or 2010.

### *Rental Incentives*

Rental incentives consist of up-front cash payments to lessees to sign the lease. Rental incentives are amortized against rental income over the term of the lease.

### *Non-controlling Interest*

Interests in the operating partnership held by limited partners are represented by operating partnership units. The operating partnerships' income is allocated to holders of units based upon the ratio of their holdings to the total units outstanding during the period. Capital contributions, distributions, syndication costs, and profits and losses are allocated to non-controlling interests in accordance with the terms of the operating partnership agreement.

### *Financing Costs*

Financing costs incurred in connection with financing have been capitalized and are being amortized over the life of the financing using the effective interest rate method.

### *Syndication Costs*

Syndication costs consist of costs paid to attorneys, accountants, and selling agents, related to the raising of capital. These fees are paid based on management's discretion. Syndication costs are recorded as a reduction to equity and non-controlling interest.

### *Federal Income Taxes*

We have elected to be taxed as a real estate investment trust under the Internal Revenue Code ("REIT"). A REIT calculates taxable income similar to other domestic corporations, with the major difference being that a REIT is entitled to a deduction for dividends paid. A REIT is generally required to distribute each year at least 90% of its taxable income. If it chooses to retain the remaining 10% of taxable income, it may do so, but it will be subject to a corporate tax on such income. REIT shareholders are taxed on REIT distributions of ordinary income in the same manner as they are taxed on other corporate distributions.

Tax status of distributions	2011	2010
Ordinary income	68.77%	68.59%
Return of capital	31.23%	31.41%
	100.00%	100.00%

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

We intend to continue to qualify as a REIT and, as such, will not be taxed on the portion of the income that is distributed to the shareholders. In addition, we intend to distribute all of our taxable income; therefore, no provisions or liabilities for income taxes have been recorded in the financial statements.

The operating partnership is organized as a limited partnership. Income or loss is allocated to the partners in accordance with the provisions of the Internal Revenue Code 704(b) and 704(c). UPREIT status allows non-recognition of gain by an owner of appreciated real estate if that owner contributes the real estate to a partnership in exchange for partnership interest. The conversion of partnership interest to shares of beneficial interest in the REIT will be a taxable event to the limited partner.

We have adopted the provisions of FASB Accounting Standards Codification Topic ASC 740-10, on January 1, 2009. The implementation of this standard had no impact on the financial statements. As of both the date of adoption and as of December 31, 2011, the unrecognized tax benefit accrual was zero. We are no longer subject to Federal and State tax examinations by tax authorities for years before 2008.

### *Recent Accounting Pronouncements*

In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update, or ASU, No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. Effective for periods beginning after December 15, 2011, ASU No. 2011-04 clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks and the concept of valuation premise and highest and best use, extends the prohibition on blockage factors to all three levels of the fair value hierarchy, and requires additional disclosures. ASU No. 2011-04 will only apply to our disclosures in Note 8 related to fair value assets and liabilities and is not expected to have a significant impact on our footnote disclosures.

### *Revenue Recognition*

Generally, housing units are rented under short-term lease agreements. Generally, commercial space is rented under long-term lease agreements.

We derive over 95% of our revenues from tenant rents and other tenant-related activities. Commercial tenant

rents include base rents, expense reimbursements (such as common area maintenance, real estate taxes and utilities), and straight-line rents. We record base rents on a straight-line basis, which means that the monthly base rent income according to the terms of our leases with tenants is adjusted so that an average monthly rent is recorded for each tenant over the term of its lease. The straight-line rent adjustment increased revenue by \$308,464 and \$509,699 for the years ended December 31, 2011 and 2010, respectively. The straight-line receivable balance included in receivables on the consolidated balance sheet as of December 31, 2011 and December 31, 2010 was \$1,718,527 and \$1,410,063, respectively. We receive payments for these reimbursements from substantially all our multi-tenant commercial tenants throughout the year based on estimates. Differences between estimated recoveries and the final billed amounts, which have been immaterial, are recognized in the subsequent year.

### *Segment Information*

We assess and measure operating results on an individual property basis for each of our investment properties based on property net operating income. However, management internally evaluates the operating performance of the properties as a whole and does not differentiate properties by geography, size or type. In accordance with existing guidance, under the aggregation criteria of this guidance, our properties are considered one reportable segment.

### *Earnings per Common Share*

Basic earnings per common share ("Basic EPS") is computed by dividing net income available to common shareholders (the "numerator") by the weighted average number of common shares outstanding (the "denominator") during the period. INREIT had no dilutive potential common shares as of December 31, 2011 or 2010, and therefore, basic earnings per common share were equal to diluted earnings per common share for both periods.

For the years ended December 31, 2011 and 2010, INREIT's denominators for the basic and diluted earnings per common share were approximately 3,771,326 and 3,190,716 shares, respectively.

### *Reclassifications*

Certain amounts in the prior period consolidated financial statements have been reclassified to conform to current year presentation. The reclassifications had no impact on the statement of operations.

## NOTE TO CONSOLIDATED FINIANCIAL STATEMENTS

### NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2011 and 2010:

	2011	2010
Land and land improvements	<b>\$50,932,145</b>	\$42,021,838
Building and improvements	<b>321,175,128</b>	281,669,671
Furniture and fixtures	<b>15,275,298</b>	12,989,679
	<b>387,382,571</b>	336,681,188
Less accumulated depreciation	<b>(31,281,490)</b>	(23,021,736)
	<b>\$356,101,081</b>	\$313,659,452
Less: property and equipment included in assets held for sale	<b>(439,088)</b>	(1,092,109)
	<b>\$355,661,993</b>	\$312,567,343

- During 2011, we recorded an impairment loss of \$263,569 on one property due to the net book value of the property and equipment exceeding its fair market value. The impairment of the property and equipment was as a result of incurring recurring losses, vacancies and negative cash flows. We estimated the undiscounted cash flows from the property and compared them to the carrying value resulting in an impairment loss. Also, during 2011, we received insurance proceeds in the amount of \$491,676 for damages caused by a wind storm. The proceeds were used to repair damages to the buildings.
- During 2010, we recorded an impairment loss of \$363,000 on one property due to the net book value of the property and equipment exceeding its fair market value. The impairment of the property and equipment was as a result of incurring recurring losses, vacancies and negative cash flows. We estimated the undiscounted cash flows from the property and compared them to the carrying value resulting in an impairment loss. Also, during 2010, we received insurance proceeds in the amount of \$414,463 for damages caused by a storm on twenty properties. We reduced the book value of the property and equipment by \$375,563 and recorded income in the amount of \$38,900.

### Note 4 - RESTRICTED DEPOSITS AND FUNDED RESERVES

	2011	2010
Tenant security deposits	<b>\$1,512,239</b>	\$1,250,555
Real estate tax and insurance escrows	<b>1,033,622</b>	1,555,391
Replacement reserves	<b>852,130</b>	695,749
Exchange escrow	<b>-</b>	2,312,928
	<b>\$3,397,991</b>	\$5,814,623

#### *Tenant Security Deposits*

Pursuant to management policy, INREIT has set aside funds to repay tenant security deposits upon tenant move-out.

#### *Real Estate Tax and Insurance Escrows*

Pursuant to the terms of certain mortgages and management policy, INREIT established and maintains real estate tax escrows and insurance escrows to pay real estate taxes and insurance. INREIT is to contribute to the account monthly an amount equal to 1/12 of the estimated real estate taxes and insurance premiums.

#### *Replacement Reserves*

Pursuant to the terms of certain mortgages and management policy, INREIT established and maintains several replacement reserve accounts. INREIT makes monthly deposits into the replacement reserve accounts to be used for repairs and replacements on the property. Certain replacement reserve accounts require authorization from the mortgage company for withdrawals.

#### *Exchange Escrow*

INREIT established an exchange escrow account in order to facilitate a Section 1031 exchange upon the sale of qualifying properties. The cash proceeds from the property sales are held in escrow until qualifying properties are purchased at which time, the cash necessary to purchase the replacement property is transferred to the seller.

The balance in the exchange escrow was used in 2011 to purchase qualifying like-kind properties.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 5 - HEDGING ACTIVITIES

As part of our interest rate risk management strategy, we use a derivative instrument to minimize significant unanticipated earnings fluctuations that may arise from rising variable interest rate costs associated with existing borrowings. To meet these objectives, we have entered into interest rate swaps in the amount of \$1,293,900 and \$2,429,044 to provide a fixed rate of 7.25% and 2.57%, respectively. The swaps mature on April 15, 2020 and December 2017, respectively. The swaps were issued at approximate market terms and thus no fair value adjustment was recorded at inception. The carrying amount of the swaps have been

adjusted to their fair values at the end of the quarter, which because of changes in forecasted levels of LIBOR resulted in reporting a liability for the fair value of the future net payments forecasted under the swaps. The interest rate swaps are accounted for as effective hedges in accordance with ASC 815-20 whereby they are recorded at fair value and changes in fair value are recorded to comprehensive income. As of December 31, 2011 and 2010, we have recorded a liability and other comprehensive loss of \$452,586 and \$194,499, respectively.

### NOTE 6 - LEASE INTANGIBLES

The following table summarizes the net value of other intangible assets and the accumulated amortization for each class of intangible asset:

	December 31, 2011		
	Lease Intangibles	Accumulated Amortization	Lease Intangibles, net
In-place leases	\$ 7,250,261	\$ (1,523,986)	\$ 5,726,275
Above-market leases	1,588,281	(136,702)	1,451,579
Below-market leases	(688,844)	169,539	(519,305)
	<u>\$ 8,149,698</u>	<u>\$ (1,491,149)</u>	<u>\$ 6,658,549</u>
	December 31, 2010		
	Lease Intangibles	Accumulated Amortization	Lease Intangibles, net
In-place leases	\$ 6,116,650	\$ (902,685)	\$ 5,213,965
Above-market leases	1,127,407	(50,796)	1,076,611
Below-market leases	(682,497)	99,147	(583,350)
	<u>\$ 6,561,560</u>	<u>\$ (854,334)</u>	<u>\$ 5,707,226</u>

The estimated aggregate amortization expense for each of the five succeeding fiscal years and thereafter is as follows:

Years ending December 31,	Amount
2012	\$676,942
2013	676,942
2014	676,942
2015	676,942
2016	676,942
Thereafter	<u>3,273,836</u>
	<u>\$6,658,549</u>



## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

The weighted average amortization period for the intangible assets, in-place leases, above-market leases, and below-market leases acquired as of December 31, 2011 was 11.5 years.

### NOTE 7 - SHORT TERM NOTES PAYABLE

We have a \$11,000,000 variable rate (1-month LIBOR plus 2.50%) line of credit agreement with Wells Fargo Bank, which expires in November 2013; a \$1,925,000

fixed rate (4.50%) line of credit agreement with Bremer Bank, which expires in June 2016; and a \$2,000,000 variable rate (prime rate or floor of 4.25%) line of credit agreement with State Bank and Trust of Fargo, which expires in June 2012. The lines of credit are secured by properties in Duluth, Minnesota; St. Cloud, Minnesota; and Fargo, North Dakota, respectively. At December 31, 2011, the cumulative balance outstanding on the lines of credit was \$8,000,000, leaving \$6,925,000 unused under the agreements. At December 31, 2010, there was no outstanding balance on the lines of credit.

### NOTE 8 - MORTGAGE NOTES PAYABLE

Mortgage notes payable consist of:

Maturity Date	Property Name (a)	Interest Rate Per Annum	Principal Balance At December 31,	
			2011	2010
July 2013	Grand Forks Marketplace	5.26%	\$ 5,974,655	\$ 6,111,450
March 2011	Midtown Plaza	7.15%	-	722,603
April 2020	Great American Building	7.25%	1,136,368	1,165,072
July 2025	Colonial Plaza	6.25%	-	1,763,803
January 2016	Autumn Ridge Apartments	5.74%	2,981,073	3,033,277
November 2019	Sierra Ridge Phase II	5.92%	3,491,138	1,183,348 (b)
August 2019	Sierra Ridge Phase I	5.46%	2,790,426	948,892
May 2022	Banner Building	7.04%	5,052,762	5,121,897
August 2017	Aetna Building	5.93%	7,178,722	7,286,288
February 2015	Echelon Building	4.25%	1,286,105	1,330,240
September 2020	Goldmark Building	5.33%	5,753,990	6,256,916
July 2021	Southgate Apartments	5.96%	3,139,094	3,193,791
December 2013	Richfield	6.67%	2,664,804	2,746,540
January 2013	Sunwood	7.18%	1,858,047	1,917,407
October 2017	Auburn I	6.30%	645,938	655,605
October 2017	Hunter's Run I	6.30%	310,665	315,315
December 2017	Southview Villages	6.10%	2,166,400	2,199,492
December 2017	Library Lane	6.10%	1,981,723	2,011,994
December 2012	Ear Acres	6.59%	-	924,753
July 2016	SSA Building	6.23%	-	1,942,926
December 2013	Bayview	6.73%	2,100,796	2,164,828
October 2019	Danbury	5.03%	3,182,862	3,250,378
March 2016	BioLife Properties	7.06-7.65%	12,509,057	13,519,564 (c)
January 2013	Pebble Creek	5.72%	2,595,793	2,657,576
September 2036	Carling Manor	4.40%	564,533	577,634
September 2017	Oak Court	5.98%	1,919,916	1,946,227
September 2017	Rosegate	5.93%	2,446,864	2,480,731
July 2016	Village Park	6.15%	936,141	960,104
June 2016	Westwood	4.75%	5,409,723	5,526,684
May 2015	Village West	6.00%	-	2,092,259
June 2018	Westwind	5.25%	384,163	392,490
June 2018	Prairiewood	5.25%	1,668,991	1,707,794
April 2018	Gate City Bank	5.95%	1,114,788	1,139,135 (d)
June 2018	Emerald Court	5.25%	690,771	706,255
June 2018	Berkshire	5.25%	337,723	345,354

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

December 2012	Somerset Apartments	5.60%	1,889,144	1,932,446
July 2016	Autumn Ridge	4.50%	3,551,730	3,638,170
October 2015	Parkwood	5.96%	977,791	998,908
October 2015	Brookfield	5.96%	-	1,705,818
June 2013	Carlton Place	6.96%	1,986,250	2,048,400
September 2014	Columbia West	7.80%	1,487,005	1,524,394
December 2013	Sunset Ridge	4.00%	-	5,610,116 (d)
December 2013	Westpointe Center	5.50%	2,433,166	2,488,100
December 2013	Carlton I-3	5.60%	2,241,563	2,291,940
June 2013	Flickertail	6.96%	2,920,958	3,012,356
July 2013	Willow Park	6.96%	2,616,412	2,697,589
June 2015	Edgewood Vista	5.64%	15,327,299	15,670,622
January 2016	Colony Manor	5.96%	869,372	887,416
September 2036	Saddlebrook	4.40%	1,161,291	1,186,677
April 2015	Stonybrook	5.40%	5,786,446	5,884,498
May 2019	Sunview	5.75%	1,289,752	1,317,330
March 2014	Twin Parks	5.75%	1,660,966	1,714,798 (e)
May 2019	Village	5.75%	1,137,984	1,162,319
October 2015	Regis	5.68%	9,938,892	10,128,451
April 2025	Walgreens - Alexandria	5.69%	2,346,633	2,461,070
March 2034	Walgreens - Batesville	6.85%	6,735,726	6,860,254
August 2033	Walgreens - Fayetteville	6.85%	5,185,468	5,286,382
March 2015	Fairview	5.40%	3,386,596	3,435,885
October 2024	Walgreens - Laurel	6.07%	2,321,749	2,433,614
August 2011	Eagle Run	4.25%	-	6,549,222
August 2015	Maplewood Bend 2& 5	4.95%	-	1,015,326
December 2017	Galleria III	4.75%	660,752	675,340
December 2013	Bank of the West	4.00%	2,401,144	2,450,000
January 2016	Mandan Commercial	5.25%	1,087,056	1,114,500
December 2013	Sunset Ridge #2	4.25%	-	3,690,960
March 2016	Hunter	5.00%	1,266,694	-
April 2016	Midtown Plaza	5.31%	703,705	-
May 2021	Maple Ridge	5.69%	4,469,145	-
November 2024	Country Club	4.37%	705,271	-
December 2012	Moorhead Commercial	3.00%	553,939	-
June 2021	Walgreens - Denver	4.50%	4,549,719	-
August 2016	Southview III	4.50%	247,617	-
August 2016	Eagle Run	4.48%	4,955,117	-
August 2016	Maplewood Bend	4.48%	3,597,985	-
September 2014	Islander	6.00%	522,787	-
September 2021	Brookfield	3.75%	1,657,972	-
January 2017	Titan Machinery	4.55%	2,445,391	-
August 2016	Glen Pond	6.30%	16,694,344	-
January 2022	Sunset Ridge	4.44%	9,435,000	-
			217,479,862	192,171,523

- (a) Mortgages are secured by the respective properties, assignment of rents, business assets, deeds to secure debt, deeds of trust and/or cash deposits with lender unless otherwise noted in (b) – (e).
- (b) Mortgage is secured by the property and guaranty of owners.
- (c) Interest rates ranged from 7.06% to 7.65%.
- (d) Variable rate mortgage notes payable, adjusted every three years.
- (e) Secured by mortgage on property and corporate guaranty.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

The mortgage note agreements include covenants that, in part, impose maintenance of certain debt service coverage and debt to worth ratios. As of December 31, 2011 and 2010, we were in compliance with all covenants with the exception of one loan on a retail property in Fargo, North Dakota for which we have received a one year waiver on January 1, 2012 from the lender. The property was out of compliance with the lender's debt service coverage ratio requirement as of December 31, 2011 and 2010, respectively.

We are required to make the following principal payments on our outstanding mortgage notes payable for each of the five succeeding fiscal years and thereafter as follows:

Years Ending December 31,	Amount
2012	\$8,750,852
2013	32,523,269
2014	11,871,601
2015	39,877,910
2016	48,099,207
Thereafter	76,357,023
<b>Total Payments</b>	<b>\$217,479,862</b>

### NOTE 9 - FAIR VALUE MEASUREMENT

FASB issued ASC 820-10 in September 2006 and ASC 825-10 in February 2007. Both standards address the aspects of the expanding application of fair value accounting. Effective January 1, 2008, INREIT

adopted ASC 820-10 and ASC 825-10. There were no adjustments to accumulated deficit as a result of the adoption of ASC 820-10. ASC 825-10 permits a company to measure certain financial assets and financial liabilities at fair value that were not previously required to be measured at fair value. INREIT has elected not to measure any financial assets or financial liabilities at fair value which were not previously required to be measured at fair value.

ASC 820-10 established a three-level valuation hierarchy for fair value measurement. Management uses these valuation techniques to establish the fair value of the assets at the measurement date. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect management's assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable;
- Level 3 – Instruments whose significant inputs are unobservable.

Assets measured at fair value on a recurring basis in accordance with ASC 820-10:

Liabilities	Total 12/31/11	Quoted Prices: Level 1	Significant Other Inputs: Level 2	Significant Nonobservable Inputs: Level 3
Fair value of interest rate swaps	\$452,586	\$ -	\$452,586	\$ -

Liabilities	Total 12/31/10	Quoted Prices: Level 1	Significant Other Inputs: Level 2	Significant Nonobservable Inputs: Level 3
Fair value of interest rate swap	\$194,499	\$ -	\$194,499	\$ -

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 10 - NONCONTROLLING INTEREST OF UNITHOLDERS IN OPERATING PARTNERSHIP

As of December 31, 2011 and 2010, limited partnership units totaled 10,899,598 and 10,389,178, respectively. As of December 31, 2011 and 2010, the limited partnership declared distributions of \$2,181,570 and \$1,912,483, respectively, to limited partners to be paid in full each January following the end of the calendar year. Distributions per unit were \$0.805000 and \$0.770000 for 2011 and 2010, respectively.

During the 2011 and 2010, limited partners converted 179,860 and 102,059 limited partnership units into 179,860 and 102,059 INREIT common shares valued at \$2,285,643 and \$1,331,489, respectively.

Limited partners in the operating partnership have the right to require the operating partnership to redeem their limited partnership units for cash. Upon such a redemption request, INREIT has the right to purchase the limited partnership units either with cash or INREIT common shares, in its discretion, on the basis of one limited partnership unit for one INREIT common share. However, payment will be in cash if the issuance of INREIT common shares will cause the shareholder to exceed the ownership limitations, among other reasons. No limited partner will be permitted more

than two redemptions during any calendar year, and no redemptions may be made for less than 1,000 limited partnership units or, if such limited partner owns less than 1,000 limited partnership units, all of the limited partnership units held by such limited partner.

Limited partnership units are held in one of three classes: Class A, Class B and Class C. The holders of Class A units have a redemption right after a three-year holding period. The holders of Class B units have a redemption right after a two-year holding period. The holders of Class C units have a redemption right after a one-year holding period.

### NOTE 11 - BENEFICIAL INTEREST

We are authorized to issue 100,000,000 common shares of beneficial interest with \$.01 par value and 50,000,000 preferred shares with \$.01 par value, which collectively represent the beneficial interest of INREIT. As of December 31, 2011 and 2010, there were 3,796,223 and 3,602,853, respectively, common shares outstanding. We had no preferred shares outstanding as of either date.

Dividends paid to holders of common shares were \$0.805000 and \$0.770000 per share for the years ending December 31, 2011 and 2010, respectively.

### NOTE 12 - RELATED PARTY TRANSACTIONS

#### *Property Management Fee*

Due from related party as of December 31, 2011 and 2010 is as follows:

	2011	2010
Goldmark Property Management	\$60,074	\$44,601
EMG Investment Group	44,042	-
Edgewood Vista Senior Living, Inc.	263,526	262,350
	<u>\$367,642</u>	<u>\$306,951</u>

Due to related party as of December 31, 2011 and 2010 is as follows:

	2011	2010
DL/JKD, LLC	\$ -	\$200,835
INREIT Management, LLC	66,733	233,095
HSC Partners, LLC	-	111,058
	<u>\$66,733</u>	<u>\$544,988</u>



## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

During 2011 and 2010, we paid property management fees to INREIT Management, LLC for properties managed by INREIT Management, LLC in an amount equal to 5% of rents. The management team of INREIT Management, LLC consists of Board of Trustee members Kenneth Regan and James Wieland. For the years ended December 31, 2011 and 2010, we paid management fees of \$3,175 and \$13,423, respectively, to INREIT Management, LLC.

During 2011 and 2010, we paid property management fees to GOLDMARK Property Management for properties managed by INREIT Management, LLC in an amount equal to 5% of rents. The management team of GOLDMARK Property Management consists of Board of Trustee members Kenneth Regan and James Wieland. For the years ended December 31, 2011 and 2010, we paid management fees of \$3,740,483 and \$3,209,325, respectively, to GOLDMARK Property Management.

### *Board of Trustee Fees*

We paid Trustee fees of \$41,400 and \$41,600 during the years ended December 31, 2011 and 2010, respectively.

### *Advisory Management Fees*

For years ended December 31, 2011 and 2010, we incurred \$764,925 and \$683,840 to INREIT Management, LLC for advisory management fees, respectively. As of December 31, 2011 and 2010, we owed INREIT Management, LLC \$66,733 and \$60,558, respectively, for unpaid advisory management fees. These fees cover the office facilities, equipment, supplies, and staff required to manage our day-to-day operations, and is paid based on 0.50% of net invested assets during 2011 and 2010.

### *Acquisition and Disposition Fees*

Our agreement with our advisor requires that we pay 3% of the acquisition, construction or disposition costs to our advisor upon successful completion of an acquisition, construction or disposition of real estate properties and the related obtaining of mortgages to finance the acquisition or construction. With the adoption of ASC 805, Business Combinations, we were required to expense a certain amount of the fees related to the acquisition or construction costs. Accordingly, we were required to determine what portion of the 3% fee related to acquisition or construction and to the obtaining of financing. We have evaluated the services provided and determined that it is appropriate to attribute 50% of the 3% fee to financing costs for the administration of obtaining a loan to fund the acquisition or construction of a

property. We believe this is an appropriate allocation of the total fee as our advisor has informed us that approximately equal time is spent on discovering the potential property or construction project as is spent on successfully coordinating financing.

### *Acquisition Fees*

During 2011 and 2010, we incurred \$1,174,078 and \$937,842, respectively, to INREIT Management, LLC for acquisition and financing fees. These fees are for performing due diligence on properties acquired in an I.R.C Section 721 exchange, and are paid on 3% of the purchase price up to a maximum of \$300,000 per individual property. There was no acquisition fees owed to INREIT Management, LLC as of December 31, 2011. As of December 31, 2010, INREIT owed \$172,537 to INREIT Management, LLC for acquisition and financing fees.

### *Disposition Fees*

In 2011 and 2010, we incurred \$84,500 and \$302,718 to INREIT Management, LLC for disposition fees. There was no disposition fees owed to INREIT Management, LLC as of December 31, 2011 and 2010, respectively.

### *Property Acquisitions*

In May 2011, we purchased a 40 unit apartment complex and a 24 unit apartment complex in Fargo, North Dakota for approximately \$2,464,000. The properties were purchased from entities affiliated with Kenneth Regan and James Wieland, related parties. Mr. Regan and Mr. Wieland each received limited partnership units valued at \$419,232 in the purchase transaction.

### *Investments in Affiliates*

In July 2011, we purchased a 40.26% interest in Highland Meadows, LLLP, a 144 unit apartment complex in Bismarck, North Dakota. Our proportional share of the purchase was \$2,325,861 with the remaining interest in the property held by Messrs. Regan and Wieland.

### *Commissions*

During 2011 and 2010, we incurred brokerage fees of \$82,833 and \$222,783, respectively, to Roger Domres, or entities owned by Roger Domres, shareholder of INREIT, and a former governor and member of INREIT Management, LLC. Brokerage fees are paid based on 4% of the purchase price of limited partnership units and 8% of the purchase price of INREIT common shares sold. During the years ended December 31, 2011 and 2010, we incurred marketing fees of \$19,063 and \$139,111, respectively, to HSC Partners, LLC, an entity owned

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

by Roger Domres. Marketing fees are paid based on 2% of the purchase price of INREIT common shares sold. As of December 31, 2010, we owed \$111,058, to HSC Partners, LLC for brokerage and marketing fees. As of December 31, 2011, there were no outstanding brokerage or marketing fees owed to HSC Partners, LLC or entities owned by Roger Domres.

During 2011 and 2010, we incurred brokerage fees of \$54,701 and \$534,919, respectively, to Dale Lian of JKJD, LLC, an entity controlled by Kenneth Regan, James Wieland, James Echtenkamp and Dale Lian, related parties. Brokerage fees are paid based on 4% of the purchase price of limited partnership units and 8% of the purchase price of INREIT common shares sold. As of December 31, 2011, there were no outstanding brokerage fees owed to Dale Lian of JKJD, LLC. As of December 31, 2010, we owed \$200,835 to Dale Lian of JKJD, LLC.

During 2011 and 2010, we incurred brokerage commissions of \$92,487 and \$27,824, respectively, to a broker-dealer benefitting Larry O'Callaghan, a member of the Board of Trustees. As of December 31, 2010, we owed \$1,440 to the broker-dealer. As of December 31, 2011, there were no outstanding brokerage fees owed to the broker-dealer.

During 2011 and 2010, we incurred real estate commissions of \$265,260 and \$284,888, respectively, to Goldmark Schlossman Commercial Real Estate Services, Inc., which is controlled by Board of Trustee members Kenneth Regan and James Wieland. There were no outstanding commissions owed as of December 31, 2011 and 2010, respectively.

### *Rental Income*

During 2011 and 2010, we received rental income of \$2,160,070 and \$2,763,863, respectively, under various lease agreements with Edgewood Vista Senior Living, Inc., an entity affiliated with Philip Gisi and Rex Carlson, former members of the Board of Trustees. As of December 31, 2011 and 2010, we were owed \$263,526 and \$262,350, respectively, from Edgewood Vista Senior Living, Inc. for real estate taxes related to the properties.

During 2011 and 2010, we received rental income each year of \$102,500 under a lease agreement for an office building with EMG Investment Group, an entity affiliated with Philip Gisi and Rex Carlson, former members of the Board of Trustees. Gate City Bank, a tenant in the building, is an entity affiliated with

Lance Wolfe, current member of the Board of Trustees and the Executive Vice President of the Bank. As of December 31, 2011 and 2010, we were owed \$44,042 and \$43,756, respectively, from EMG Investment Group for real estate taxes related to the property.

During 2011 and 2010, we received rental income of \$179,051 and \$179,052, respectively, under an operating lease agreement with GOLDMARK Property Management.

During 2011 and 2010, we received rental income of \$51,713 and \$42,427, respectively, under an operating lease agreement with INREIT Management, LLC.

### *Rental Incentive*

During 2009, we provided a rent incentive of \$1,500,000 to a property owned by Edgewood Development Group, an entity affiliated with Philip Gisi, a former member of the Board of Trustees. The rent incentive is being amortized against rental income over the term of the lease. During 2011 and 2010, we amortized \$100,000 against income, respectively.

### *Restricted Deposits*

As of December 31, 2011 and 2010, INREIT owed \$0 and \$53,253, respectively, to Goldmark Property Management for security deposits maintained by INREIT, which were owed to Goldmark Property Management.

### *Construction Costs / Development Fees*

During 2011 and 2010, INREIT incurred construction costs of \$0 and \$3,135,905, respectively, to Goldmark Property Management.

## **NOTE 13 - RENTALS UNDER OPERATING LEASES / RENTAL INCOME**

Residential apartment units are rented to individual tenants with lease terms up to one year. Gross revenues from residential rentals totaled \$30,818,270 and \$27,210,289 for 2011 and 2010, respectively.

For 2011 and 2010, gross revenues from commercial property rentals, including CAM (common area maintenance) income of \$3,963,551 and \$3,635,494 respectively, totaled \$17,137,525 and \$16,029,874, respectively. Commercial properties are leased to tenants under terms expiring at various dates through 2036. Lease terms often include renewal options.

## NOTE TO CONSOLIDATED FINIANCIAL STATEMENTS

Commercial space is rented under long-term agreements. Minimum future rentals on non-cancelable operating leases as of December 31, 2011 are as follows:

Years Ending December 31,	Amount
2012	\$15,619,665
2013	15,087,867
2014	14,782,728
2015	14,361,667
2016	11,471,997
Thereafter	77,596,287
<b>Total Payments</b>	<b>\$148,920,211</b>

### NOTE 14 - PROPERTY MANAGEMENT FEES

We have entered into various management agreements with unrelated management companies. The agreements provide for the payment of management fees based on a percentage of rental income (5%). During 2011 and 2010, we incurred property management fees of \$114,014 and \$150,806, respectively, to unrelated management companies.

During 2011 and 2010, we incurred management fees of 5% of rents to INREIT Management, LLC and GOLDMARK Property Management, both related parties (see Note 11).

### NOTE 15 - COMMITMENTS AND CONTINGENCIES

#### *Environmental Matters*

Federal law (and the laws of some states in which we may acquire properties) imposes liability on a landowner for the presence on the premises of hazardous substances or wastes (as defined by present and future federal and state laws and regulations). This liability is without regard to fault or knowledge of the presence of such substances and may be imposed jointly and severally upon all succeeding landowners. If such hazardous substance is discovered on a property acquired by us, we could incur liability for the removal of the substances and the cleanup of the property. There can be no assurance that we would have effective remedies against prior owners of the property. In addition, we may be liable to tenants and may find it difficult or impossible to sell the property either prior to or following such a cleanup.

#### *Risk of Uninsured Property Losses*

We maintain property damage, fire loss, and liability insurance. However, there are certain types of losses (generally of a catastrophic nature) which may be either uninsurable or not economically insurable. Such excluded risks may include war, earthquakes, tornadoes, certain environmental hazards, and floods. Should such events occur, (i) we might suffer a loss of capital invested, (ii) tenants may suffer losses and may be unable to pay rent for the spaces, and (iii) we may suffer a loss of profits which might be anticipated from one or more properties.

#### *Tenant in Common Ownership*

As a tenant in common, we own our respective share of the assets of tenant in common properties as well as being liable for its respective share of the debts. We owned the following properties as a tenant in common.

The operating partnership is the 100% owner of Grand Forks INREIT, LLC, which owns a 1/3 interest as a tenant in common of Grand Forks Marketplace Retail Center. The operating partnership is also the 50% owner of Marketplace Investors, LLC, which owns a 1/3 interest as a tenant in common of Grand Forks Marketplace Retail Center. Grand Forks Marketplace Retail Center has approximately 183,000 square feet of commercial space in Grand Forks, North Dakota. The property is encumbered by a non-recourse first mortgage with Key Bank Real Estate Capital with a balance at December 31, 2011 and 2010 of \$11,949,310 and \$12,222,900, respectively. We owed \$5,974,655 and \$6,111,450 for our respective share of the balance as of December 31, 2011 and 2010, respectively.

The operating partnership owns a 2/3 interest as a tenant in common of a commercial building with approximately 75,000 square feet of rental space in Fargo, North Dakota. The property is encumbered by a first mortgage with GE Commercial Finance Business Property Corporation with a balance at December 31, 2011 and 2010 of \$7,579,143 and \$7,682,846, respectively. We owed \$5,052,762 and \$5,121,897 for our respective share of the balance on December 31, 2011 and 2010, respectively.

#### *Share Rescission or Liquidation*

We could be subjected to claims by shareholders that prior securities sales were not proper. However, we presently believe few, if any, of our shareholders will request rescission due to several factors, including our strong operating performance over the last three years, earnings covering dividends, increased dividends, and, we believe, the current value of our common shares, currently set at \$14.00 per share, would exceed the

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

amount a shareholder would receive pursuant to a rescission offer. In fact, based on limited utilization of our repurchase plan (whereby less than 3.5% of the shares sold have been requested to be repurchased under this new plan since January 1, 2011) and known demand for our common shares at \$14.00 per share, we believe such claims will not exceed \$1.0 million and most likely would not exceed our cash and cash equivalents of approximately \$3.2 million at December 31, 2011. Additionally, as of December 31, 2011, we had approximately \$6.9 million in unused lines of credit. The amount and validity of any such claims, if asserted, however, is speculative at this time and the potential claims could approximate \$33 million. If claims are greater than anticipated and such claims are found to be meritorious, our liquidity could be negatively affected and we could be required to sell additional securities or borrow additional funds. We believe we have ready access to any additional capital that might be required, but there is no assurance such funds will be available or, if available, on terms acceptable to us.

### *Investment in Unconsolidated Affiliate*

The operating partnership owns a 40.26% interest in Highland Meadows, LLLP, a 144 unit multi-tenant apartment complex in Bismarck, North Dakota. The property is encumbered by a first mortgage with NorthMarq Capital LLC with a balance at December 31, 2011 of \$2,495,298. We owed \$1,004,607 of our respective share of the balance as of December 31, 2011. The property was purchased in July 2011.

## NOTE 16 – DISCONTINUED OPERATIONS

We report in discontinued operations the results of operations for properties that have either been sold or are classified as held for sale. We also report any gains or losses from the sale of properties in discontinued operations.

### 2011

- During the first quarter of 2011, there were no dispositions.
- During the second quarter of 2011, we sold an assisted living facility in Williston, North Dakota for \$1.45 million and recognized a gain of \$366,990.
- During the third quarter of 2011, we sold a retail property in Norfolk, Nebraska for \$1,375,000 and recognized a loss of \$66,921.
- During the fourth quarter of 2011, there were no dispositions.

### 2010

- During the first quarter of 2010, we sold an apartment complex in Carrington, North Dakota for \$710,000 and recognized a gain of \$189,374.
- During the second quarter of 2010, there were no dispositions.
- During the third quarter of 2010, we sold an apartment complex in Fargo, North Dakota for \$1,550,000 and recognized a gain of \$574,644.
- During the fourth quarter of 2010, we sold an assisted living facility in Minot, North Dakota for \$7,830,595 and recognized a gain of \$1,228,798.

## NOTE TO CONSOLIDATED FINIANCIAL STATEMENTS

The following table shows the effect on net income and the gains or losses from the sale of properties classified as discontinued operations for 2011 and 2010:

	Discontinued Operations Twelve Months Ended December 31,	
	2011	2010
INCOME FROM RENTAL OPERATIONS	\$ 145,732	\$ 1,106,022
EXPENSES		
Expenses from rental operations		
Interest	66,041	384,195
Depreciation and amortization	52,608	229,629
Real estate taxes	33,367	147,806
Property management fees	6,375	29,241
Utilities	10,716	29,396
Repairs and maintenance	5,340	38,045
Insurance	8,813	9,000
Administrative	15,020	61,946
	198,280	929,259
Administration of REIT		
Administrative expenses	150	280
Acquisition and disposition expenses	123,500	302,718
Legal and accounting	7,426	13,015
	131,076	316,013
Total expenses	329,356	1,245,272
OTHER INCOME		
Interest income	-	784
	-	784
INCOME FROM DISCONTINUED OPERATIONS BEFORE GAIN (LOSS) ON SALE	(183,624)	(138,465)
GAIN ON SALE OF DISCONTINUED OPERATIONS	300,069	1,992,816
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	\$ 116,445	\$ 1,854,351



## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 17 - BUSINESS COMBINATIONS

We continue to implement our strategy of acquiring properties in desired markets. It is impractical for us to obtain historical financial information on acquired properties and accordingly, proforma statements have not been presented.

We account for our property acquisitions by allocating the purchase price of a property to the property's assets based on management's estimates of their fair value. Techniques used to estimate fair value include an appraisal of the property by a certified independent appraiser at the time of acquisition. Significant factors included in the independent appraisal include items such as current rent schedules, occupancy levels, and discount factors. Property valuations are completed primarily using the income capitalization approach, in which anticipated benefits are converted to an indication of current value.

The total value allocable to intangible assets acquired, which consists of unamortized lease origination costs, in-place leases and tenant relationships, is allocated based on management's evaluation of the specific characteristics of each tenant's lease and our overall relationship with that respective tenant. Characteristics considered by management in allocating these values include the nature and extent of the existing business relationships with the tenant, growth prospects for developing new business with the tenant, the remaining term of the lease and the tenant's credit quality, among other factors.

The value allocable to above or below market component of an acquired in-place lease is determined based upon the present value (using a market discount rate) of the difference between (i) the contractual rents to be paid pursuant to the lease over its remaining term, and (ii) management's estimate of rents that would be paid using fair market rates over the remaining term of the lease. The amounts allocated to above or below market leases are included in lease intangibles, net in the accompanying balance sheets and are amortized on a straight-line basis as an increase or reduction of rental income over the remaining non-cancelable term of the respective leases.

We estimate the in-place lease value for each lease acquired. This fair value estimate is calculated using factors available in third party appraisals or cash flow

estimates of the property prepared by our internal analysis. These estimates are based upon cash flow projections for the property, existing leases, and the current economic climate.

Our analysis results in three discrete financial items: assets for above market leases, liabilities for below market leases, and assets for the in-place lease value. The calculation of each of these components is performed in tandem to provide a complete intangible asset value.

Key factors considered in the calculation of fair value of both real property and intangible assets include the current market rent values, dark periods, direct costs estimated with obtaining a new tenant, discount rates, escalation factors, standard lease terms, and tenant improvement costs.

#### 2011 Purchases

In January 2011, the operating partnership purchased a 4,997 square foot restaurant in Apple Valley, Minnesota for approximately \$2.5 million. The purchase was financed through the issuance of limited partnership units valued at approximately \$1.7 million and cash.

In January 2011, the operating partnership purchased the remaining 65.44% interest in Sierra Ridge, a 136 unit apartment complex in Bismarck, North Dakota for approximately \$6.5 million. The purchase was financed with approximately \$2.2 million in cash and the assumption of \$4.3 million in debt. The debt assumption was finalized on April 1, 2011.

In May 2011, the operating partnership purchased a 40 unit apartment complex and a 24 unit apartment complex in Fargo, North Dakota for approximately \$2.5 million. The purchase was financed through the assumption of approximately \$0.8 million in debt and the issuance of limited partnership units valued at approximately \$1.7 million. The properties were purchased from entities affiliated with Kenneth Regan and James Wieland, related parties who each received limited partnership units valued at approximately \$419,000.

In May 2011, the operating partnership purchased a 2,712 square foot restaurant and a 3,510 square foot office building in Moorhead, Minnesota for approximately \$2.2 million. The purchase was financed with a combination of a new \$575,000 loan and the issuance of limited partnership units valued at approximately \$1.6 million.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

In June 2011, the operating partnership purchased a 13,390 square foot retail store and 36,432 square feet of adjacent land in Denver, Colorado for approximately \$5.9 million. The purchase was financed with a combination of a \$4.6 million loan and approximately \$1.3 million in cash.

In July 2011, the operating partnership purchased a 24 unit apartment complex in Fargo, North Dakota for approximately \$1.0 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$503,000, the assumption of an approximately \$531,000 loan, and cash.

In July 2011, the operating partnership purchased a 40.26% interest in a 144 unit apartment building in Bismarck, North Dakota. The sales price was approximately \$2.3 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$1.2 million, the assumption of approximately \$1.0 million in mortgage debt and \$125,000. The remaining ownership consists of Mr. Regan and Mr. Wieland, related parties. The investment is recorded under the equity method of accounting.

In August 2011, the operating partnership purchased an 18 unit apartment building in Grand Forks, North Dakota for approximately \$640,000. The purchase was financed with the issuance of limited partnership units valued at approximately \$382,000, new loan of \$249,000 and cash.

In September 2011, the operating partnership purchased a single tenant 8,000 square foot office building in Norfolk, Nebraska for \$600,000. The purchase was financed with cash.

In October 2011, the operating partnership purchased a 42,000 square foot implement dealership in Marshall, Minnesota for approximately \$5.0 million. The purchase was financed with the issuance of limited partnership units valued at approximately \$2.6 million, an approximately \$2.4 million loan and cash. The purchase price allocation is not yet complete.

In December 2011, the operating partnership purchased a 414 unit apartment complex in Eagan, Minnesota for approximately \$26.2 million. The purchase was financed with the assumption of an existing \$16.7 million mortgage, an \$8.0 million advance from the Wells Fargo line of credit and cash.

Total consideration given for acquisitions in 2011 was primarily given in the form of cash, which totaled approximately \$13,284,000. Acquisitions with total consideration of approximately \$9,664,000 were completed through issuing limited partnership units in the operating partnership, valued at \$14.00 per unit. Units issued in exchange for property are determined through a value established annually by our Board of Trustees, and reflects the fair value at the time of issuance.

The following table summarizes the fair value of the assets acquired and liabilities assumed during 2011:

	Property and Equipment	In Place Leases	Favorable Lease Terms	Unfavorable Lease Terms	Mortgages Assumed	Consideration Given
Applebee's, Apple Valley, MN	\$1,795,299	\$322,866	\$404,635	\$ -	\$ -	\$2,522,800
Sierra Ridge Apartments, Bismarck, ND	6,458,761	-	-	-	(4,264,480)	2,194,281
Country Side Apartments, Fargo, ND	936,320	-	-	-	(286,083)	650,237
Country Club Apartments, Fargo, ND	1,527,680	-	-	-	(466,766)	1,060,914
Bank of the West, Moorhead, MN	922,187	77,813	-	-	(263,925)	736,075
Dairy Queen, Moorhead, MN	1,027,324	151,810	1,866	-	(311,075)	869,925
Walgreen's, Denver, CO	4,706,332	449,949	53,719	-	(4,062,030)	1,147,970
Taco Bell Land, Denver, CO	669,224	20,122	654	-	(537,970)	152,030
Islander Apartments, Fargo, ND	1,044,000	-	-	-	(530,928)	513,072
Southview III, Grand Forks, ND	639,511	-	-	-	(249,000)	390,511
Premiere Marketing, Norfolk, NE	495,296	111,051	-	(6,347)	-	600,000
Titan Machinery, Marshall, MN	5,000,000	-	-	-	(2,445,391)	2,554,609
Glen Pond Apartments, Eagan, MN	26,250,000	-	-	-	(16,694,344)	9,555,656
	<u>\$51,471,934</u>	<u>\$1,133,611</u>	<u>\$460,874</u>	<u>(\$6,347)</u>	<u>(\$30,111,992)</u>	<u>\$22,948,080</u>

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

For one acquisition completed during 2011, the fair value of the identifiable assets acquired and liabilities assumed exceeded the fair value of the purchase price of the business. Consequently, we reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. As a result, we recognized a gain of \$100,000 associated with this acquisition. The gain is included in the line item "Other income" in the Consolidated Statement of Operations.

### 2010 Purchases

In January 2010, the operating partnership purchased a 14 unit apartment building in Hawley, Minnesota. The approximate purchase price was \$425,000. The purchase was financed with limited partnership units valued at approximately \$213,000 and cash.

In March 2010, the operating partnership purchased a 5,043 square foot restaurant in Bloomington, Minnesota. The approximate purchase price was \$2.2 million, paid in cash.

In March 2010, the operating partnership purchased a 5,576 square foot restaurant in Coon Rapids, Minnesota. The approximate purchase price was \$2.4 million. The purchase was financed with limited partnership units valued at approximately \$2.1 million and cash.

In March 2010, the operating partnership purchased a 4,936 square foot restaurant in Savage, Minnesota. The approximate purchase price was \$1.6 million, paid in cash.

In July 2010, the operating partnership purchased a 14,830 square foot retail store in Laurel, Mississippi. The approximate purchase price was \$3.9 million. The purchase was financed with new mortgage financing of approximately \$2.5 million and cash.

In July 2010, the operating partnership purchased a 7,296 square foot restaurant in Austin, Texas. The approximate purchase price was \$2.5 million. The purchase was financed with limited partnership units valued at approximately \$1.7 million and cash.

In August 2010, the operating partnership purchased an 81.25% partnership interest in a 144 unit apartment building in West Fargo, North Dakota. The approximate purchase price was \$6.6 million. The purchase was financed with new mortgage financing of approximately \$6.6 million.

In November 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota. The purchase price was \$844,000. The purchase was financed with limited partnership units valued at \$844,000.

In December 2010, the operating partnership purchased an additional 1.34% interest in a 172 unit apartment building in Bismarck, North Dakota. The approximate purchase price was \$121,000. The operating partnership had previously held a 1/3 interest in the property.

In December 2010, the operating partnership purchased a 9,100 square foot commercial property in Mandan, North Dakota. The approximate purchase price was \$1.5 million, paid in cash.

In December 2010, the operating partnership purchased a 24 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland, a related party. The approximate purchase price was \$820,000. The purchase was financed with limited partnership units valued at \$506,000 and cash.

In December 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$665,000. The purchase was financed with limited partnership units valued at \$665,000.

In December 2010, the operating partnership purchased an 18 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland and Kenneth Regan, related parties. The approximate purchase price was \$665,000. The purchase was financed with limited partnership units valued at \$665,000.

In December 2010, the operating partnership purchased a 16 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland, a related party. The approximate purchase price was \$620,000. The purchase was financed with limited partnership units valued at \$530,000 and cash.

In December 2010, the operating partnership purchased a 20 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$780,000. The purchase was financed with limited partnership units valued at \$360,000 and cash.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2010, the operating partnership purchased a 20 unit apartment building in Fargo, North Dakota, from an entity affiliated with Kenneth Regan, a related party. The approximate purchase price was \$780,000. The purchase was financed with limited partnership units valued at \$780,000.

In December 2010, the operating partnership purchased a 24 unit apartment building in Fargo, North Dakota, from an entity affiliated with James Wieland and Kenneth Regan, related parties. The approximate purchase price was \$1,300,000. The purchase was financed with limited partnership units valued at \$855,000 and cash.

Total consideration given for acquisitions in 2010 was primarily given in the form of cash, which totaled approximately \$17,421,000. Acquisitions with total consideration of approximately \$7,830,000 were completed through issuing limited partnership units in the operating partnership, valued at \$14.00 per unit. Units issued in exchange for property are determined through a value established annually by our Board of Trustees, and reflects the fair value at the time of issuance.

The following table summarizes fair value of the assets acquired and liabilities assumed during 2010:

	Property and Equipment	In Place Leases	Favorable Lease Terms	Unfavorable Lease Terms	Mortgages Assumed	Consideration Given
Westside Apartments, Hawley, MN	\$425,000	\$ -	\$ -	\$ -	\$ -	\$425,000
Applebee's, Bloomington, MN	1,426,868	322,368	400,764	-	-	2,150,000
Applebee's, Coon Rapids, MN	1,617,328	326,155	482,517	-	-	2,426,000
Applebee's, Savage, MN	1,165,240	253,324	150,436	-	-	1,569,000
Buffalo Wild Wings, Austin, TX	2,238,329	376,657	-	(67,110)	-	2,547,876
Walgreens, Laurel, MS	3,623,441	335,865	-	(57,806)	(2,477,849)	1,423,651
Eagle Run, West Fargo, ND	6,624,000	-	-	-	-	6,624,000
Sierra Ridge, Bismarck, ND	121,239	-	-	-	-	121,239
Galleria III, Fargo, ND	844,000	-	-	-	-	844,000
Mandan Commercial, Mandan, ND	1,370,884	142,701	37,655	(61,240)	-	1,490,000
Maplewood Bend I, Fargo, ND	820,000	-	-	-	-	820,000
Maplewood Bend III, Fargo, ND	665,000	-	-	-	-	665,000
Maplewood Bend IV, Fargo, ND	665,000	-	-	-	-	665,000
Maplewood Bend VI, Fargo, ND	620,000	-	-	-	-	620,000
Maplewood Bend VII, Fargo, ND	780,000	-	-	-	-	780,000
Maplewood Bend VIII, Fargo, ND	780,000	-	-	-	-	780,000
Maplewood Bend Royal, Fargo, ND	1,300,000	-	-	-	-	1,300,000
	<u>\$25,086,329</u>	<u>\$1,757,070</u>	<u>\$1,071,372</u>	<u>\$(186,156)</u>	<u>\$(2,477,849)</u>	<u>\$25,250,766</u>

For one acquisition completed during 2010, the fair value of the identifiable assets acquired and liabilities assumed exceeded the fair value of the purchase price of the business. Consequently, we reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. As a result, we recognized a gain of \$608,500 associated with this acquisition. The gain is included in the line item "Other income" in the Consolidated Statement of Operations.

The Board of Trustees has determined an estimate of fair value for the limited partnership units issued in 2011 and 2010. In determining this value, the board relied upon their experience with, and knowledge about our real estate portfolio and debt obligations. The board also relied on valuation methodologies that are commonly used in the real estate industry, including, among others a discounted cash flow analysis, which projects a range of estimated future streams of cash flows reasonably likely to be generated by our portfolio of properties, and discounts the projected future cash flows reasonably likely to be generated by our portfolio of properties, and discounts the projected future cash flows to a present value.

## NOTE TO CONSOLIDATED FINANCIAL STATEMENTS

The Board also took into account the estimated value of our other assets and liabilities including a reasonable estimate of our debt obligations. Based on the results of the methodologies, the Board determined the fair value of the limited partnership units to be \$14.00 per unit.

As with any valuation methodology, the methodologies utilized by the Board in reaching an estimate of the value of the limited partnership units are based upon a number of estimates, assumptions, judgments or opinions that may, or may not, prove to be correct. The use of different estimates, assumptions, judgments, or opinions would likely have resulted in significantly different estimates of the value of the limited partnership units. In addition, the Board's estimate of limited partnership unit value

is not based on the fair values of our real estate, as determined by GAAP, as our book value for most real estate is based on the amortized cost of the property, subject to certain adjustments.

Furthermore, in reaching an estimate of the value of the limited partnership units, the Board did not include a liquidity discount, in order to reflect the fact that the limited partnership units are not currently traded on a national securities exchange; a discount for debt that may include a prepayment obligation or a provision precluding assumption of the debt by a third party; or the costs that are likely to be incurred in connection with an appropriate exit strategy, whether that strategy might be a listing of the limited partnership units or INREIT common shares on a national securities exchange or a merger or sale of our portfolio.

### NOTE 18 - OTHER COMPREHENSIVE Income

The details related to other comprehensive income are as follows:

	<u>2011</u>	<u>2010</u>
Net income	<u>\$ 6,617,950</u>	<u>\$ 7,612,575</u>
Other comprehensive income (loss)		
Increase (decrease) in fair value of interest rate swap	<u>(258,087)</u>	<u>(26,167)</u>
Total other comprehensive income (loss)	<u>(258,087)</u>	<u>(26,167)</u>
Comprehensive income	<u>6,359,863</u>	<u>7,586,408</u>
Comprehensive income attributable to the noncontrolling interest	<u>4,699,638</u>	<u>5,720,577</u>
Comprehensive income attributable to INREIT Real Estate Investment Trust	<u>\$ 1,660,225</u>	<u>\$ 1,865,831</u>

### NOTE 19 - SUBSEQUENT EVENTS

In January 2012, the operating partnership purchased a 2,811 square foot restaurant in Dickinson, North Dakota for approximately \$1,330,000. The purchase was financed primarily with limited partnership units valued at approximately \$1.3 million and cash.

In February 2012, the operating partnership sold a 4,500 square foot retail property in Norfolk, Nebraska for approximately \$335,000 and recognized a loss of approximately \$88,000.

In February 2012, the operating partnership received full payment in the amount of \$1,509,000 on the Minot Land note that was outstanding as of December 31, 2011.

Pending acquisitions are subject to numerous conditions and contingencies and there are no assurances that the transactions will be completed.

We have evaluated subsequent events through the date of this filing. We are not aware of any other subsequent events which would require recognition or disclosure in the consolidated financial statements.



## Investor Relations

You can contact INREIT Investor Relations at any time to order financial documents such as annual reports and Form 10-Ks free of charge.

Call us toll-free at (877) 269-1031, or e-mail us at [information@inreit.com](mailto:information@inreit.com). We can be contacted between the hours of 9:00 a.m. and 5:00 p.m. Central Time to answer investment oriented questions about INREIT Real Estate Investment Trust. For additional financial information, visit our website online at [www.inreit.com](http://www.inreit.com).

Our mailing address is:

INREIT Real Estate Investment Trust  
Investor Relations  
216 South Broadway  
Suite 202  
Minot, North Dakota 58701

We also electronically file our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy and information statements and all amendments to these filings with the Securities and Exchange Commission ("SEC"). The SEC maintains an Internet site at [www.sec.gov](http://www.sec.gov) containing our reports, proxy statements and other information we file electronically.

You may also read and copy any materials filed by us with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the operation of 10:00 am to 3:00 pm. You can obtain information on the operation of the Public Reference Room by calling the SEC at (800)-SEC-0330.

## Registered Shareholder Services

In 2012, INREIT Real Estate Investment Trust will retain Registrar and Transfer Company ("RTCO") as our transfer agent. Beginning on June 15, 2012, RTCO and our Investor Relations team will be able to help you with a variety of shareholder related services including:

- Change of address
- Transfer of stock to another person
- Transfers of stock on death
- Other administrative services

RTCO will also administer our dividend reinvestment plan for the Trust. To find out more about these services you may contact RTCO, after June 15, 2012, directly at (800) 368-5948 or visit RTCO online at [www.rtcocom/inv/](http://www.rtcocom/inv/).

You can send mail to the Transfer Agent at:

INREIT Real Estate Investment Trust  
Investor Relations  
C/O Registrar and Transfer Company  
10 Commerce Drive  
Cranford, NJ 07016

Shareholders of record who receive more than one copy of this annual report can contact our transfer agent and arrange to have their accounts consolidated.

Shareholders can also sign up for electronic alerts to access the 2012 annual report and proxy statement online. The service provides you the information you need faster and also allows the convenience of online proxy voting. To sign up for this free service, visit our website at [www.inreit.com](http://www.inreit.com) or call us at (877) 269-1031.



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