MELCOR | REIT

2014 ANNUAL REPORT

# Tradition. Growth. Results.

MELCOR | REIT 2014 ANNUAL REPORT

## Tradition. Growth. **Results.**

Melcor REIT is an unincorporated, open-ended real estate investment trust. We own, acquire, manage and lease quality retail, office and industrial income-generating properties. Our portfolio is currently made up of interests in 38 properties representing approximately 2.74 million square feet of gross leasable area located in and around Edmonton, Calgary, Lethbridge, and Red Deer, Alberta; Regina, Saskatchewan; and Kelowna, British Columbia. Backed by Melcor Development's 90+ year history, Melcor REIT was born out of a proud tradition of real estate excellence in western Canada. Our growth potential is a true competitive advantage, with the right to acquire Melcor's pipeline of newly constructed, high quality retail, industrial and office projects. Melcor has over 6 million sf in current and future projects to be built over the next 5 to 10 years. For more information, please visit www.MelcorREIT.ca

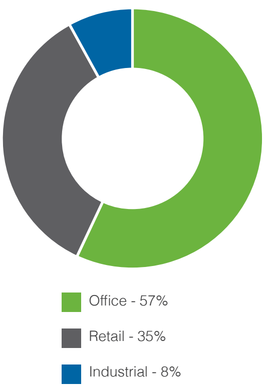
# Facts & Data

**38** Assets
(29 – 2013)

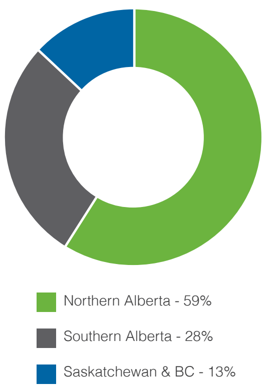
**$44.5M** Revenue
($39.3M – 2013)

**$658M** Asset Fair Value
($455M – 2013)

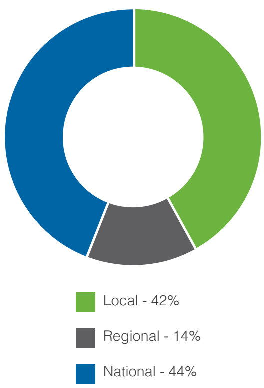
### GLA By Property Type



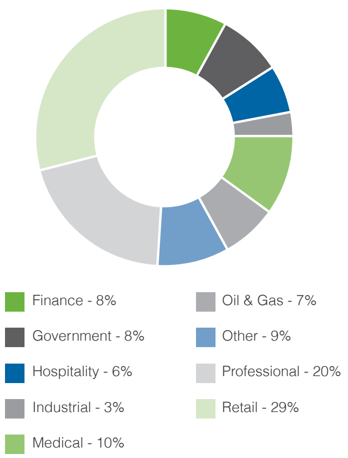

### GLA By Region



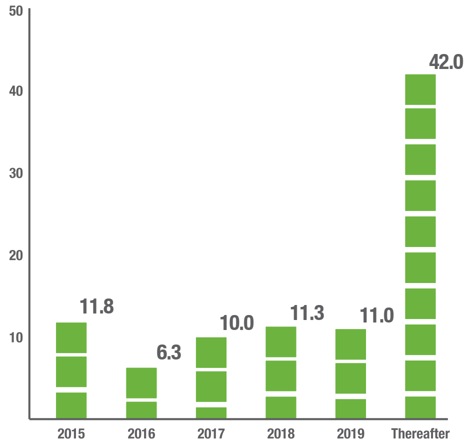

### Retail GLA By Tenant Profile



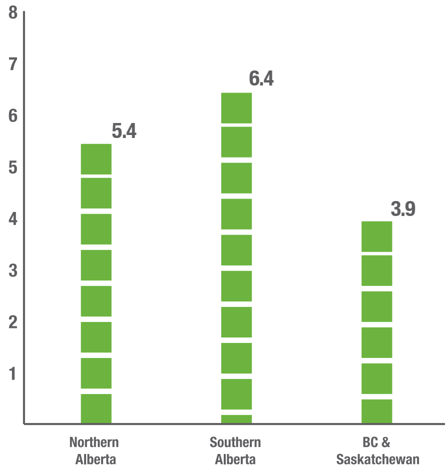

### GLA By Tenant Industry




### GLA EXPIRING (%)

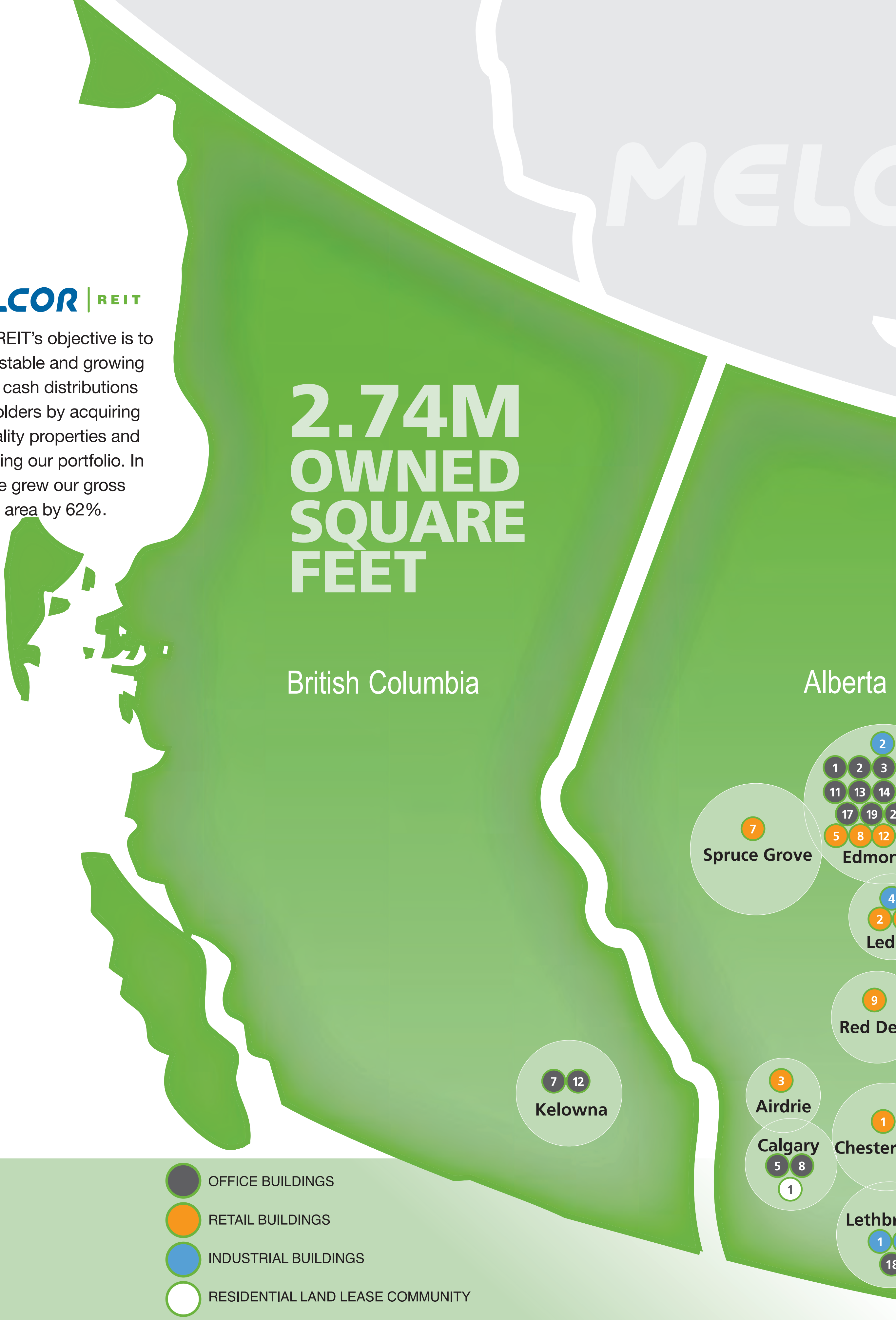



### WEIGHTED AVERAGE LEASE TERM (years)



**MELCOR** | REIT

Melcor REIT's objective is to provide stable and growing monthly cash distributions to unitholders by acquiring high quality properties and diversifying our portfolio. In 2014, we grew our gross leasable area by 62%.

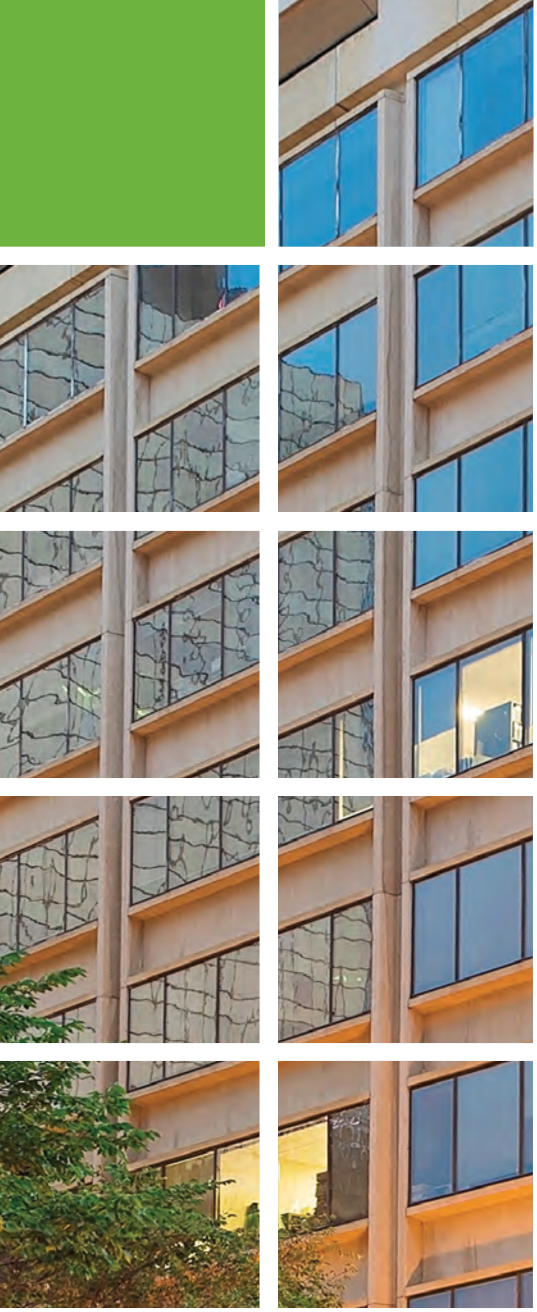


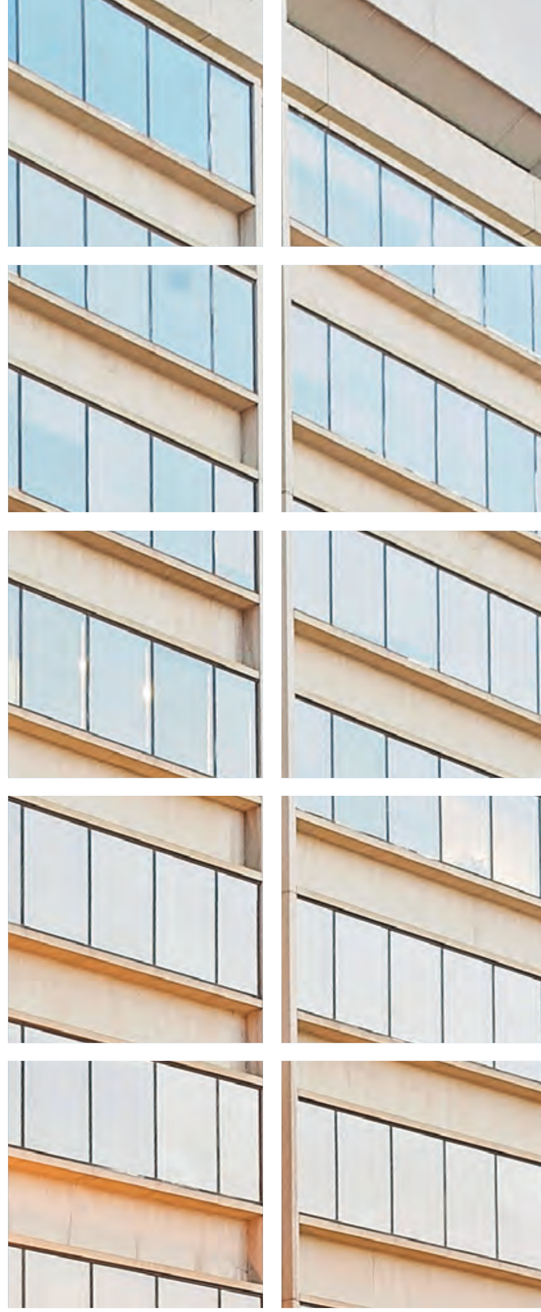

| | OFFICE BUILDINGS | LOCATION | GLA | OCC % |
|---|---|---|---|---|
| 1 | 100 Street Place | Edmonton | 44,295 | 68 |
| 2 | Trail Business Centre | Edmonton | 77,296 | 74 |
| 3 | Birks Building | Edmonton | 35,104 | 85 |
| 4 | Capilano Centre | Edmonton | 45,487 | 99 |
| 5 | Crowfoot Business Centre | Calgary | 67,630 | 100 |
| 6 | Executive Terrace | Regina | 42,843 | 77 |
| 7 | Kelowna Business Centre | Kelowna | 72,076 | 83 |
| 8 | Kensington Road Building | Calgary | 24,050 | 68 |
| 9 | Melton Building | Edmonton | 114,612 | 94 |
| 10 | Parliament Place | Regina | 24,411 | 97 |
| 11 | Princeton Place | Edmonton | 59,081 | 80 |
| 12 | Richter Street | Kelowna | 28,978 | 77 |
| 13 | Royal Bank Building | Edmonton | 132,377 | 90 |
| 14 | Stanley Building | Edmonton | 34,976 | 99 |
| 15 | Sterling Business Centre | Edmonton | 67.899 | 96 |
| 16 | Westcor Building | Edmonton | 72,810 | 88 |
| 17 | Westgate Business Centre | Edmonton | 75,141 | 100 |
| 18 | Lethbridge Centre | Lethbridge | 446,272 | 90 |
| 19 | Select Building | Edmonton | 23,432 | 100 |
| 20 | The Village at Blackmud Creek | Edmonton | 48,335 | 99 |
| 21 | White Oaks Square | Edmonton | 30,495 | 88 |
| | **TOTAL** | | **1,567,600** | **89** |

| | RETAIL BUILDINGS | LOCATION | GLA | OCC % |
|---|---|---|---|---|
| 1 | Chestermere Station | Chestermere | 48,729 | 96 |
| 2 | Corinthia Plaza | Leduc | 23,179 | 100 |
| 3 | Kingsview Market | Airdrie | 47,558 | 100 |
| 4 | Leduc Common | Leduc | 284,932 | 95 |
| 5 | Miller Crossing | Edmonton | 27,340 | 93 |
| 6 | Towers Mall | Regina | 114,331 | 97 |
| 7 | Westgrove Common | Spruce Grove | 21,810 | 99 |
| 8 | Coast Home Centre | Edmonton | 59,725 | 92 |
| 9 | Liberty Crossing | Red Deer | 63,317 | 100 |
| 10 | Market Mall | Regina | 42,586 | 100 |
| 11 | University Park Mall | Regina | 41,238 | 97 |
| 12 | The Village at Blackmud Creek | Edmonton | 9,029 | 87 |
| 13 | West Henday Promenade | Edmonton | 34,987 | 96 |
| 14 | White Oaks Square | Edmonton | 127,824 | 100 |
| | **TOTAL** | | **946,585** | **97** |

| | INDUSTRIAL BUILDINGS | LOCATION | GLA | OCC % |
|---|---|---|---|---|
| 1 | Lethbridge Industrial | Lethbridge | 49,005 | 100 |
| 2 | TKE Building | Edmonton | 15,968 | 100 |
| 3 | LC Industrial | Lethbridge | 67,610 | 93 |
| 4 | Telford Industrial | Leduc | 88,699 | 100 |
| | **TOTAL** | | **221,282** | **98** |

| | LAND LEASE COMMUNITY | LOCATION | GLA | OCC % |
|---|---|---|---|---|
| 1 | Watergrove | Calgary | NA | 100 |





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# Letter from the Chairman

Dear unitholders,

I am pleased to report to you on a successful 2014 – the first full year of operations for the REIT.

The REIT team continues to deliver on the promise of executing on our growth strategy, diversifying our portfolio through acquisitions – realizing the great potential afforded by the Melcor pipeline – and delivering a great experience to our clients. You will hear more about how we executed on our strategy throughout this report and in the CEO's message to unitholders.

Four groups have been pivotal to our success in 2014: our trustees; our management team; Melcor Developments as our asset manager, largest unitholder and growth pipeline; and you, our investors.

We are grateful to our board of trustees for their support and guidance. Your trustees worked diligently through all of our transactions to ensure that unitholders' best interests were represented. They encouraged us as we executed on our strategy throughout 2014, and they continue to encourage us to stay the course as we face the challenges of an uncertain market in 2015.

As a group, your trustees increased their unitholdings by 30% throughout the year, even though we spent a large part of the year in blackout due to in-progress transactions and scheduled financial releases.

We are also grateful to our management team for their hard work and dedication to executing our strategy. We completed the acquisition of nine new properties and additional phases at two existing properties and we raised equity and unsecured debt to complete the acquisitions from Melcor. Our management team worked countless hours to ensure these transactions went smoothly. Today, management continues to demonstrate the same enthusiasm as they roll up their sleeves to meet the challenge of protecting unitholder interests. Our team, including Melcor Developments staff, also continue to deliver exceptional customer service to our tenants.

With an Alberta-centric portfolio, we operate in a cyclical economy where oil and gas prices can fluctuate rapidly. Our 90+ years in business have taught us how to weather these cycles. Through each cycle, we not only learned, we made our business stronger by recognizing and taking advantage of opportunities and balancing our risk and exposure.

The fundamentals of our business remain strong. We remain uniquely positioned through our relationship with Melcor and the pipeline that creates a systemic growth engine for the REIT. We have a long pedigree of conservative management and a strong balance sheet that puts us in good position against headwinds. We will continue to look at new and unique strategies to take advantage of acquisition opportunities.

I would like to personally thank our investors, both those who have been with us from the beginning and those who joined us recently. Our goal is to reward your confidence in us with stable and growing cash distributions.

2015 will be a challenging year, but we are ready. We will continue to perform.

**Andrew Melton**

## Letter from the CEO

Dear fellow unitholders,

It is my privilege to report to you on our progress in 2014 and our plans for the future. 2014 was a year where we continued to execute on our growth strategy, achieving significant wins in all aspects of our plan. I am proud of our team and what we accomplished.

From our beginning, our maxim has been to deliver on what we promise, and we have consistently done this. To illustrate how, let's take a look at our growth strategy and how our actions throughout 2014 stack up against it:

### GROW PORTFOLIO THROUGH THIRD PARTY ACQUISITIONS

**WHAT WE DID**

We completed three third party acquisitions in 2014, adding:

- LC Industrial - 67,610 sf industrial (Lethbridge)
- Select Building - 23,432 sf office (Edmonton)
- White Oaks Square - 158,319 sf retail mixed-use (Edmonton)

This equates to a $42.83 million investment in portfolio growth.

**RESULTS**

- Grew portfolio GLA by 14.7%
- Diversified property mix by increasing retail and industrial components.

## We acquired $194.6M of commercial property in 2014.

# Our portfolio grew by 62%.

## GROW PORTFOLIO THROUGH MELCOR ACQUISITIONS

✓

**WHAT WE DID**

We completed two acquisitions via our exclusive Melcor pipeline in 2014, adding 6 new properties to the portfolio:

- Market Mall – 42,586 sf retail (Regina)
- Lethbridge Centre – 446,276 sf office (Lethbridge)
- Telford Industrial – 88,699 sf industrial (Leduc)
- The Village at Blackmud Creek – 57,364 sf office mixed-use (Edmonton)
- University Park – 41,238 sf retail (Regina)
- West Henday Promenade – 34,987 sf retail (Edmonton)

We also acquired additional phases in some of our existing properties:

- Kingsview Market phase 3 – 11,555 sf retail (Airdrie)
- Leduc Common phase 4 – 71,240 sf retail (Leduc)

This equates to a $151.75 million investment in portfolio growth.

**RESULTS**

- Grew portfolio GLA by 46.9%
- Diversified property mix by increasing retail and industrial components
- Completed first two acquisitions from our exclusive Melcor pipeline and established a model for serving the interests of unitholders as we undertake future transactions

## ACHIEVE GROWTH OBJECTIVES BY ACCESSING CAPITAL MARKETS

✓

**WHAT WE DID**

To fund acquisitions, we completed the following transactions:

- A bought deal issuance (including exercise of over-allotment option) of 2,145,000 units for gross proceeds of $22.84 million
- A bought deal issuance of 5.50% convertible debentures (including exercise of over-allotment option) for gross proceeds of $34.50 million

**RESULTS**

- Enabled the completion of the acquisitions noted above

# Our primary objective is to provide stable and growing monthly cash distributions to unitholders.

# REDEVELOP

**WHAT WE DID**

We invested $4.44 million in our capital expenditure program in 2014. The focus of this program is to maintain asset value through routine care and improve efficiency through upgrades and to enhance properties for improved comfort and aesthetics.

**RESULTS**

- Completed roof replacements at two office properties
- Completed common area and washroom upgrades at 4 office properties
- Upgraded landscaping at one office property

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**WHAT WE DID**

We achieved BOMA BESt certification at two additional properties:

- Westcor Building received Level 2 certification in January 2014.
- Princeton Place received Level 2 certification in January 2015.

BOMA BESt is the leading environmental certification program for existing buildings in Canada.

**RESULTS**

Collectively, our four BOMA BESt buildings have decreased consumption of electricity by 28% and natural gas by 22% since 2011.

We continue to review our buildings against BOMA BESt standards and apply for certification when applicable.

## Over 6M square feet in development projects in Melcor's pipeline.

## PROPERTY MANAGEMENT

**WHAT WE DID**

✓ We continued to improve our property management practices and grew our property management team to ensure our focus on customer relationships remains strong as our portfolio grows.

We rolled out our signature care program to all tenants, including industrial and retail properties.

**RESULTS**

Our property management team received an average mark of 92% for availability & responsiveness, competency, professionalism and communication on surveys completed in 2014.

We achieved a 97% on time response rate on service calls while at the same time handling 10% more calls.

## LEASING

**WHAT WE DID**

✓ We continued to improve our proactive leasing strategy, which includes tenant targeting to achieve the right tenant mix and creative leasing in collaboration with our tenants to meet their current and future needs.

**RESULTS**

We retained 82.7% of tenants on leases expiring in 2014, which represented 17.6% of our portfolio at the beginning of the year.

We positioned the REIT to take advantage when opportunities arose, and we did so in our characteristic manner - quickly and efficiently. I'm pleased with the quality of the properties acquired and look forward to seeing the full impact of their contribution to our results in 2015. We improved our best-in-class customer care program and we continue to build strong relationships with our clients.

A conservative approach to growth drives our strategy. Looking into an uncertain environment in our major market of Alberta, we will maintain our tradition of exercising discipline and sticking to the fundamentals of real estate. We will continue to look for and take advantage of opportunities to build and strengthen our portfolio.

## In 2015, we will continue to execute.

We continue to focus on the details, stress testing our portfolio and ensuring that we have the right mix of properties and clients.

In 2015, we will continue to execute. We will continue to improve on all elements of our business, including client service and our signature care program. We will continue to streamline processes to improve our operating efficiency. We will continue to look at opportunities to create new value by densifying on our current properties. We will continue to explore opportunities to diversify our portfolio within and outside of Alberta and across multiple asset classes. We will continue with our strategic and proactive leasing programs to maintain stable occupancy levels.

With a strong, diversified portfolio, focus on property management and client relationships, strong balance sheet and a solid pipeline of over 6 million square feet (sf) of high quality assets being developed over the next 5-10 years, we remain well positioned for the future.

We are sticking to the same philosophies that got us to this point and that will drive us forward.

**Darin Rayburn**

Building Environmental Standards BOMA BESt

**Our BOMA BESt properties reduced electricity consumption by 28% since 2011.**

**Andrew Melton**
**Calgary, Alberta, Canada**
**Chairman, Melcor REIT**

**RELATED**
Trustee Since: 2013
Attendance: 100%
Trustee Compensation[1]: $nil
REIT Unitholdings: 68,800
Committees: Investment

**Brian Hunt**
**Calgary, Alberta, Canada**
**President & Director, Taviston Inc.**

**INDEPENDENT**
Trustee Since: 2013
Attendance: 100%
Trustee Compensation: $54,500
REIT Unitholdings: 40,000
Committees: Audit, Investment

**Larry Pollock**
**Edmonton, Alberta, Canada**
**Corporate Director**

**INDEPENDENT**
Trustee Since: 2013
Attendance: 100%
Trustee Compensation: $49,000
REIT Unitholdings: 50,000
Committees: Audit, Investment, Special Committee Chair

# Board of Trustees & Corporate Governance Practices

We are committed to effective corporate governance practices as a core component of our operating philosophy.

Strong governance practices lay the foundation for a sustainable company and long-term value creation for our unitholders.

As governance practices evolve, we periodically review, evaluate and enhance our governance program. Here are a few highlights of our program.

### Independence

The majority of our trustees are independent. Committees are comprised by a majority of independent trustees. The audit committee is 100% independent. The independent trustees meet *in camera* (without management and related trustees) for a portion of each board and committee meeting held. As our executive chairman is related to Melcor, we have appointed a lead trustee, Don Lowry, who is independent. Mr. Lowry chairs the *in camera* sessions of the board and ensures that the board conducts itself in accordance with good governance practices. Each of the arrangements with Melcor (Asset Management, Property Management, and Development and Opportunities Agreements) require the agreement of the majority of independent trustees, providing independent oversight on all transactions to represent the interests of minority unitholders.

### Integrity: the Heart of our Business

The highest standard of ethical conduct has always been at the heart of Melcor's operating philosophy. Trustees and officers follow our Code of Business Conduct and Ethics, which governs the work environment, regulatory compliance and the protection of our assets and reputation. The Code can be found on our website at www.MelcorREIT.ca. Melcor employees who manage our properties follow the Melcor Code of Business Conduct and Ethics, which is largely the same.

### Ralph Young
**Edmonton, Alberta, Canada**
**Chancellor, University of Alberta**

RELATED
Trustee Since: 2013
Attendance: 86%
Trustee Compensation[2]: $25,000
REIT Unitholdings: 19,800
Committees: Compensation & Governance

### Brian Baker
**Edmonton, Alberta, Canada**
**CEO, Melcor Developments Ltd.**

RELATED
Trustee Since: 2013
Attendance: 100%
Trustee Compensation[1]: $nil
REIT Unitholdings: 5,000
Committees: none

### Donald Lowry
**Edmonton, Alberta, Canada**
**Corporate Director**

INDEPENDENT
Trustee Since: 2013
Attendance: 100%
Trustee Compensation: $49,500
REIT Unitholdings: 34,600
Committees: Audit, Compensation & Governance

### Patrick Kirby
**Edmonton, Alberta, Canada**
**Counsel, Felesky Flynn LLP**

INDEPENDENT
Trustee Since: 2013
Attendance: 100%
Trustee Compensation: $38,500
REIT Unitholdings: 11,600
Committees: Compensation & Governance

# Board of Trustees & Corporate Governance Practices (continued)

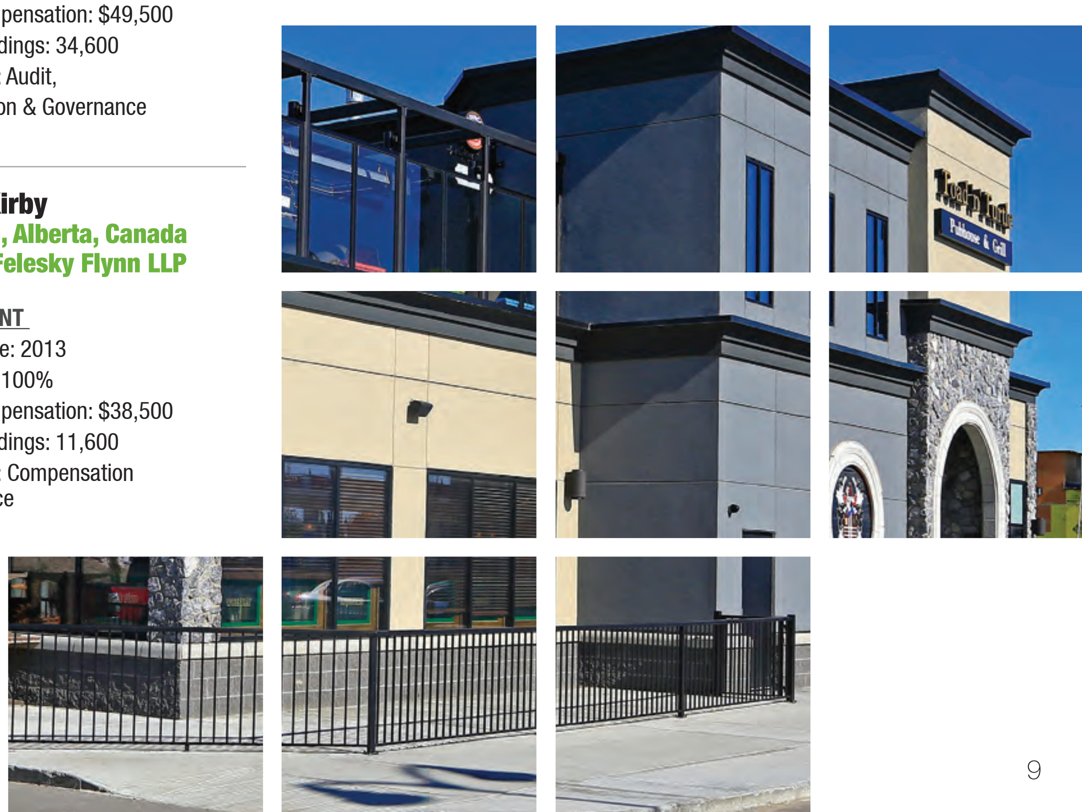
**Strategic Planning Process**

The board ensures that we establish a solid strategy designed to optimize unitholder value. This process includes active consultation with management on the issues, business environment, assumptions, goals and financial budgets that underpin the strategy and ensures that risk levels are appropriate. To keep the board fully informed and engaged in the strategic issues and critical risks of our business, one meeting each year is dedicated to the review and approval of our strategic plan to manage risk, protect unitholder value and build a sustainable business.

**Alignment with Unitholder Interests**

All trustees and officers took part in the REIT initial public offering and own, on average, over 31,000 units. This ensures alignment with unitholder interests and a focus on long-term value creation. Additional information on our governance practices can be found in our 2014 Information Circular.

*1 Melcor employees do not receive trustee compensation.*
*2 Ralph Young is Melcor Developments Ltd. nominee to the Melcor REIT board. He is paid for trustee duties by Melcor Developments.*



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## March 2, 2015

The following Management's Discussion and Analysis (MD&A) of Melcor Real Estate Investment Trust's (the REIT) results should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2014. The discussion outlines strategies and provides analysis of our financial performance for the fourth quarter and the full year.

The underlying financial statements in this MD&A, including 2013 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted.

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on March 2, 2015. Disclosure contained in this MD&A is current to March 2, 2015, unless otherwise indicated.

All dollar amounts included in this MD&A are Canadian dollars unless otherwise specified.

### Non-standard Measures

We refer to terms and measures which are not specifically defined in the CPA Canada Handbook and do not have any standardized meaning prescribed by IFRS. These measures include funds from operations (FFO), adjusted funds from operations (AFFO) and net operating income (NOI), which are key measures of performance used by real estate businesses. We believe that these measures are important in evaluating the REIT's operating performance, financial risk, economic performance, and cash flows. These non-standard measures may not be comparable to similar measures presented by other companies and real estate investment trusts and should not be used as a substitute for performance measures prepared in accordance with IFRS.

Non-standard measures included in this MD&A are defined on page 33: "Non-standard Measures."

### Financial Reporting

As Melcor Developments Ltd. (Melcor) retained control over the REIT, the May 1, 2013 initial public offering (IPO) and acquisition of the Initial Properties was accounted for as a reorganization and recapitalization using the continuity of interests method. Financial information for the pre-acquisition period is presented based on historical combined financial information for the Initial Properties as previously reported by Melcor.

Throughout this MD&A we make reference to the terms we, our and management. These terms are used to describe the activities of the REIT through the eyes of management, as provided by Melcor under the asset management and property management agreements entered into as part of the Offering and acquisition of the Initial Properties.

### Formation of the REIT

The REIT is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust dated January 25, 2013, which was subsequently amended and restated May 1, 2013.

We began operations on May 1, 2013 when our trust units were issued for cash pursuant to the IPO. Units of the REIT trade on the Toronto Stock Exchange under the symbol MR.UN. The REIT is externally managed, administered and operated by Melcor pursuant to the property management and asset management agreements entered into in conjunction with the IPO.

As of March 2, 2015, Melcor holds an approximate 56.5% effective interest in the REIT through ownership of all Class B LP units of the partnership through an affiliate and a corresponding number of special voting units of the REIT. The Class B LP units are economically equivalent to, and are exchangeable for, trust units. Melcor is the ultimate controlling party.

### Declaration of Trust

The investment guidelines and operating policies of the REIT are outlined in the Amended and Restated Declaration of Trust (DOT) dated May 1, 2013. A copy of the DOT is filed on SEDAR at www.sedar.com and is available on request to all unitholders. At March 2, 2015, the REIT was in compliance with all investment guidelines and operating policies stipulated in the DOT.

**Regulatory Filings**

***Additional information about the REIT, including our annual information form, management information circular and quarterly reports, is available on our website at melcorREIT.ca and on SEDAR at sedar.com.***

# 2014 At-a-Glance

***Growth through acquisition:***

- Completed two acquisitions via our proprietary Melcor pipeline, adding six new properties and additional phases at two existing properties: 793,941 sf for $151.75 million
- Completed third party acquisitions of three properties: 249,361 sf for $42.83 million
- Completed a bought deal issuance of 2,145,000 units (including exercise of over-allotment option) for gross proceeds of $22.84 million
- Completed a bought deal issuance of 5.50% convertible debentures (including exercise of an over-allotment option) for gross proceeds of $34.50 million
- Increased GLA by 62%
- Improved portfolio diversification by increasing industrial and retail components

***Improving assets:***

- Improved asset and portfolio quality through capital expenditures and improvements program
- Increased occupancy to 92.4% in 2014
- Achieved tenant retention of 82.7% on expiring GLA (17.6% of portfolio) as a result of proactive leasing programs
- Achieved BOMA BESt level 2 at Westcor and Princeton Place (subsequent to year end)
- Extended our signature customer service program to retail and industrial properties
- Achieved 97% on-time response rate to customer service requests and responded to 10% more requests

**GLA By Property Type**


**GLA By Region**


**Retail GLA By Tenant Profile**


**GLA By Tenant Industry**


## Caution Regarding Forward-looking Statements

In order to provide our investors with an understanding of our current results and future prospects, our public communications often include written or verbal forward-looking statements.

Forward-looking statements are disclosures regarding possible events, conditions, or results of operations that are based on assumptions about future economic conditions, courses of action and include future-oriented financial information.

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent the REIT's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Forward-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2015 and beyond, future leasing, acquisition and financing plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

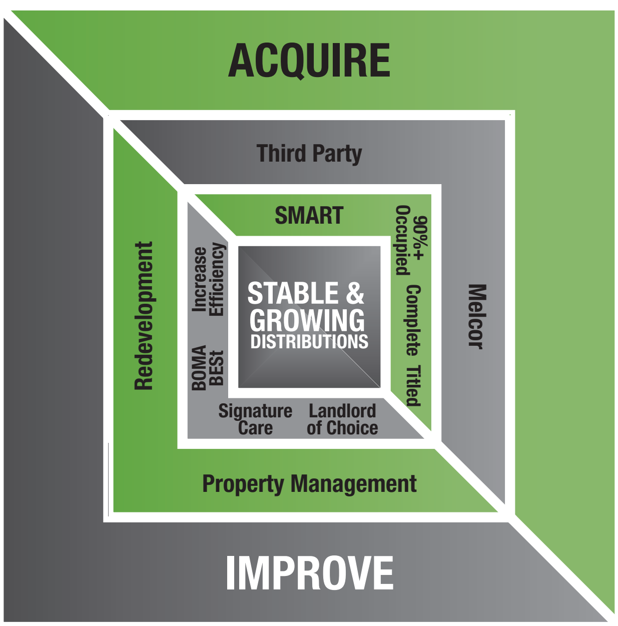
By their nature, forward-looking statements require assumptions and involve risks and uncertainties related to the business and general economic environment, many beyond our control. There is significant risk that the predictions, forecasts, valuations, conclusions or projections we make will not prove to be accurate and that our actual results will be materially different from targets, expectations, estimates or intentions expressed in forward-looking statements. We caution readers of this document not to place undue reliance on forward-looking statements. Assumptions about the performance of the western Canadian economy and how this performance will affect the REIT's business are material factors we consider in determining our forward-looking statements. For additional information regarding material risks and assumptions, please see the discussion under Business Environment and Risks.

Readers should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Except as may be required by law, we do not undertake to update any forward-looking statement, whether written or oral, made by the REIT or on its behalf.

# Our Business
## Vision, Goals & Strategy

Melcor REIT (the REIT) has an established and diversified portfolio focused on Western Canada. We own 38 income-producing office, retail and industrial properties representing 2.74 million sf (square feet) in gross leasable area (GLA) at December 31, 2014. These high-quality properties feature stable occupancy and a diversified mix of tenants, some of whom have been in place for over 20 years. The REIT is externally managed, administered and operated by Melcor Developments Ltd. pursuant to the asset management and property management agreements entered into in conjunction with the IPO.

Melcor, a real estate company founded in 1923, has a rich history of growth and performance prior to the formation of the REIT. Our objective is to continue that tradition by expanding our portfolio of income-producing properties across Western Canada to provide stable and growing monthly cash distributions to unitholders. Our growth strategy is simple: acquire and improve. Together with Melcor, we have a proven track record of doing both.




## Acquire

Our acquisition growth strategy is focused on:

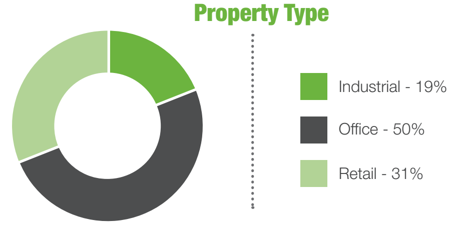
- Increasing penetration in existing geographic markets to exploit existing competitive advantage
- Diversifying our property portfolio, and
- Expanding to adjacent geographic markets.

We focus on two channels to support our acquisition growth strategy:

***Acquiring properties via our proprietary pipeline:*** As Melcor completes development and leasing of commercial properties, the REIT has a first right to purchase each asset for its portfolio. This organic asset pipeline is unique to the REIT. Based on projects currently being developed or planned to begin in the near-term, we expect this current acquisition pipeline to yield over 6 million sf of GLA over the next 5-10 years. Under the Development and Opportunities Agreement entered into in conjunction with the IPO, the REIT also has the opportunity to participate in investment opportunities, joint ventures and mezzanine financing on Melcor projects.

In 2014, we acquired 793,941 sf of GLA from Melcor, including six new properties and additional phases at two existing properties. These high quality properties include both innovative mixed-use new developments and redeveloped properties and were acquired for an aggregate purchase price of $151.75 million. Melcor currently has an additional 237,000 sf of GLA under development.

**Melcor GLA Under Development by Property Type**

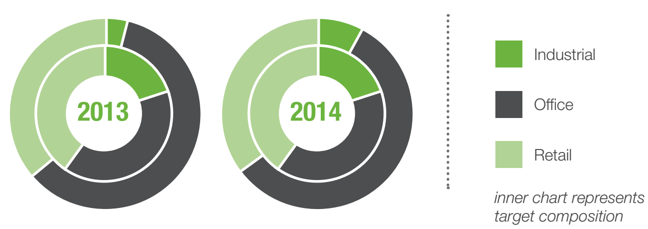



***Acquiring accretive income-producing properties:*** We actively seek strategic property acquisitions that fit our SMART investment criteria: properties that have a good Strategic fit, are in the right Market, Accretive to AFFO per unit, at the Right price and in our Targeted areas. Target acquisitions include properties with potential to increase value through expansion, redevelopment or improved property management.

In 2014, we also acquired three properties with 249,361 sf of GLA from third parties for an aggregate purchase price of $42.83 million, demonstrating the advantage of local market knowledge, reputation and our ability to find and quickly close unmarketed opportunities.

These acquisitions helped to diversify our portfolio and brought us closer to our target portfolio mix of 40% office, 40% retail and 20% industrial.

**REIT Portfolio by Property Type**




*The section titled Our Business: Vision, Goals & Strategy above and on the following pages contains forward-looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the Caution Regarding Forward-looking Statements on page 11.*

## SMART ACQUISITION STRATEGY

| | |
|---|---|
| **S**trategic<br>**M**arket<br>**A**ccretive<br>**R**ight Price<br>**T**argeted | **Acquisition Targets**<br>▪ Stable, accretive properties<br>▪ Penetrate existing geographic markets<br>▪ Expand into adjacent markets<br>▪ Properties with redevelopment and repositioning potential<br>**Acquisition & Integration Strengths**<br>▪ Proven due diligence process<br>▪ Agility to quickly execute on decisions<br>▪ Ability to close within 30 days (preferred access to unmarketed opportunities)<br>▪ Clustering of properties for efficient management & strong market knowledge |

Each acquisition undertaken in 2014 was consistent with our acquisition growth strategy and helped to further diversify our portfolio.

# Improve

There are two key components to improving our existing assets – property management and asset enhancement. The goals of our property management and asset enhancement programs are to:

- Maximize occupancy
- Maximize tenant retention
- Increase rental income

### Property Management

To ensure that our occupancy rates remain high and that our space is leased at attractive rates, we are committed to being the Landlord of Choice by providing consistent, high quality service and our signature customer care program to our clients.

Efficient property management optimizes operating costs, occupancy and rental rates. Our hands-on, on-site building management identifies issues early on for prompt resolution, and with continuous logging and monitoring of all maintenance activity, we can make capital investment decisions at the right time to sustain operating margins.

Our property management practices are designed to improve operating efficiency and reduce cost while at the same time increasing client satisfaction and thus retention rates. We enjoy strong, long-term relationships with our clients, some of whom have been with Melcor for over 20 years.

Our signature customer care program is focused on responsiveness. We are proud of our track record of responding to over 97% of service requests within 30 minutes during business hours. Our signature customer care program was enhanced with online customer care options in December 2013.

As 2014 was a year with higher than average lease expiries (297,298 sf or 17.6% of the portfolio at the beginning of the year), we developed an early renewal strategy for larger tenants. As a result of this program, 82.7% of expiring GLA was renewed.

322,473 sf of GLA or 11.8% of our portfolio expires in 2015. We continue to be proactive in our leasing strategy to maintain occupancy at or above our target.

### Asset Enhancement

We continually improve our assets with value-adding investments that enhance property quality, which leads to higher occupancy and rental rates. These upgrades typically focus on increasing operating efficiency, property attractiveness, functionality and desirability. We use our intimate knowledge of the buildings we operate to support capital investment decisions, optimize operating efficiency and continuously improve our buildings for enhanced client satisfaction. Each building undergoes an annual assessment to identify preventative maintenance and capital investment requirements, and we continuously monitor and log all equipment and maintenance activity.

## CAPITAL EXPENDITURES STRATEGY

| | |
|---|---|
| PRESERVE | ▪ Inner works (boilers, roofs, maintenance)<br>▪ Maintain asset value through routine care<br>▪ Improve efficiencies through upgrades (lower building operating costs)<br>▪ Driven by annual building & equipment condition assessments |
| ENHANCE | ▪ Visible improvements such as common area upgrades, landscaping and aesthetics, as well as improved comfort<br>▪ Upgrades that help lease buildings and retain tenants<br>▪ Driven by lease expiries/vacancies and need |

Melcor invested over $17 million in asset preservation and enhancement prior to the IPO and the REIT expects to continue to invest a further $12 million over the coming 10 years based on third party building condition assessment reports.

Many of our continuous improvement initiatives focus on sustainability and energy reduction strategies to ensure our buildings are green. As we upgrade and replace equipment, we do so with technology that promotes energy efficiency. We also engage specialists to monitor and analyze our energy usage to identify ways it can be improved.

We are dedicated to achieving and maintaining BOMA BESt standards. BOMA BESt is the leading environmental certification program for existing buildings in Canada. We had three BOMA BESt certified Green & Responsible buildings at the end of December 2014 and we were pleased to receive BOMA BESt certification on a fourth building in January 2015. Together, our BOMA BESt certified buildings have reduced electricity consumption by 28% and natural gas consumption by 22% since 2011. We continue to assess our buildings against the BOMA BESt standards and will apply for certification on additional properties once they meet the criteria as a result of our capital expenditures and improvements program.

Another component of asset enhancement that we consider is creating additional value out of existing properties through densification (adding GLA to existing properties). In 2014, we built a 7,456 sf commercial retail unit (CRU) at Chestermere (this CRU was not included in GLA for 2014). We expect tenants to take occupancy in early 2015. We continue to look for densification opportunities across our portfolio.

### Key Metrics

| Metric | Target | 2014 |
|---|---|---|
| Debt/gross book value | 50-55% | **50%** |
| Debt/gross book value including debenture | max 65% | **56%** |
| Tenant retention | 75% | **82.7%** |
| Occupancy | 90%+ | **92.4%** |
| **Portfolio diversification** | | |
| Retail | 40% | **34.6%** |
| Office | 40% | **57.3%** |
| Industrial | 20% | **8.1%** |
| **Weighted average base rent** | | |
| Retail | $18.50+ | **$18.40** |
| Office | $14.00+ | **$14.15** |
| Industrial | $8.00+ | **$8.63** |
| Customer Care On-time Response | 95%+ | **97%** |

# 2014 Highlights
## & Key Performance Indicators

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2014 | 2013 | Change |
| **Non-Standard KPIs** | | | |
| Net operating income (NOI) | **28,581** | 25,295 | 13% |
| Funds from operations (FFO) | **17,907** | 15,903 | 13% |
| Adjusted funds from operations (AFFO) | **15,613** | 13,916 | 12% |
| Rental revenue | **44,509** | 39,325 | 13% |
| Income before fair value adjustments and taxes | **8,375** | 9,317 | (10)% |
| Fair value adjustment on investment properties | **93** | 16,953 | (99)% |
| Distributions to unitholders | **7,128** | 4,109 | 73% |
| Cash flows from operations | **9,252** | 10,502 | (12)% |
| **Per Unit Metrics [1]** | | | |
| Income - diluted | **$0.75** | $1.25 | (40)% |
| FFO | **$0.87** | $0.85 | 2% |
| AFFO | **$0.76** | $0.75 | 1% |
| Distributions | **$0.68** | $0.45 | 50% |
| **IFRS Measures** | | | |
| Total assets ($000s) | **657,765** | 454,743 | 45% |
| Equity ($000s)[2] | **261,853** | 186,608 | 40% |
| Debt ($000s)[3] | **344,694** | 215,601 | 60% |
| Weighted average interest rate on debt | **3.98%** | 3.98% | —% |
| Debt to GBV ratio[4] | **56%** | 51% | 10% |
| Finance costs coverage ratio[5] | **2.94** | 2.96 | (1)% |
| Debt service coverage ratio[6] | **2.75** | 2.83 | (3)% |
| **Operational Highlights** | | | |
| Number of properties | **38** | 29 | 31% |
| Gross leasable area (GLA) sf | **2,735,467** | 1,691,920 | 62% |
| Occupancy % (weighted by GLA) | **92.4%** | 90.6% | 2% |
| Retention % (weighted by GLA) | **82.7%** | 75.5% | 10% |
| Weighted average remaining lease term (years) | **5.49** | 4.75 | 16% |
| Weighted average base rent (per sf) | **$15.25** | $16.63 | (8)% |

1. 2013 figures are calculated as if the trust units and Class B LP Units issued in 2013 were outstanding during the entire comparative period, except for income - diluted which is calculated for the post formation period May 1, 2013 to December 31, 2013.
2. Calculated as the sum of trust units and Class B LP Units at their book value. Class B LP Units are presented as a financial liability in the consolidated financial statements.
3. Calculated as the sum of total amount drawn on revolving credit facility, mortgages payable, Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units and convertible debenture, excluding unamortized discount and transaction costs.
4. Excluding convertible debentures, Debt to GBV ratio is 50%
5. Calculated as the sum of FFO and finance costs; divided by finance costs, excluding distributions on Class B LP Units.
6. Calculated as FFO divided by sum of contractual principal repayments on mortgages payable and distributions of Class C LP Units, excluding amortization of fair value adjustment on Class C LP Units.

### *Growth & Diversification of Portfolio*

Throughout 2014, we continued to execute on growth through our acquisition strategy. Through a combination of Melcor and third party acquisitions, we increased our portfolio GLA by 62% while at the same time diversifying our portfolio mix by increasing industrial and retail GLA.

Acquisitions completed in 2014 are outlined below:

| Property | Date Acquired | Purchase Price | Acquired From | Property Type | GLA | Occupancy % |
|---|---|---|---|---|---|---|
| LC Industrial | January 2014 | $5,900,000 | 3rd Party | Industrial | 67,610 | 100% |
| **May 2014 Melcor Acquisition** | May 2014 | $13,500,000 | Melcor | | | |
| Kingview Market Phase 3 | | | | Retail | 11,555 | 100% |
| Market Mall | | | | Retail | 42,586 | 100% |
| Select Building (107 Avenue Building) | May 2014 | $5,550,000 | 3rd Party | Office | 23,432 | 100% |
| White Oaks Square | December 2014 | $31,380,000 | 3rd Party | Retail | 158,319 | 98% |
| **December 2014 Melcor Acquisition** | December 2014 | $138,250,000 | Melcor | | | |
| Lethbridge Centre | | | | Office | 446,272 | 90% |
| Telford Industrial | | | | Industrial | 88,699 | 100% |
| Leduc Common Phase 4 | | | | Retail | 71,240 | 100% |
| The Village at Blackmud Creek | | | | Office | 48,335 | 100% |
| The Village at Blackmud Creek | | | | Retail | 9,029 | 87% |
| University Park Mall | | | | Retail | 41,238 | 97% |
| West Henday Promenade | | | | Retail | 34,987 | 96% |
| **Total** | | **$194,580,000** | | | **1,043,302** | **95%** |

The acquisitions completed in December had minimal impact on our 2014 financial results and will be accretive in 2015.

We also continued to execute on our strategy of improving existing assets through exceptional property management and asset enhancement programs designed to maximize occupancy, maximize tenant retention, increase rental income and optimize operating costs. These programs achieved the following results in 2014.

- Leveraged strategic leasing programs to increase occupancy to 92% in 2014 in spite of 17.6% of total GLA expiring in the year. The addition of fully occupied properties also contributed to this increase. Tenant retention was 82.7% of expiring GLA.
- Achieved BOMA BESt Level 2 certification at Westcor Building and Princeton Place (subsequent to year end). BOMA BESt is the leading environmental certification program for existing buildings in Canada. Our four BOMA BESt certified Green & Responsible buildings have reduced electricity consumption by 28% and natural gas consumption by 22% since 2011.
- Extended our signature customer service program to our retail and industrial properties and achieved a 97% on-time response rate on customer service requests (responding to requests within 30 minutes). Our call volume also increased by 10% over 2013.

The successful execution of these strategies contributed to:

- 13% growth in both Revenue and NOI over 2013
- FFO growth of 13% and AFFO growth of 12% over 2013

Other financial highlights include:

- 45% increase in total asset value
- Distributions of $0.05625 per trust unit per month were paid. 70% of distributions to unitholders were classified as return of capital.

## Consolidated Revenue & Net Operating Income

| ($000s unless noted) | Year Ended December 31 2014 | 2013 | Change |
|---|---|---|---|
| Base rent | **28,487** | 25,196 | 13% |
| Recoveries | **16,740** | 14,457 | 16% |
| Other | **1,214** | 1,572 | (23)% |
| Amortization of tenant incentives | **(2,539)** | (2,297) | 11% |
| Straight-line rent adjustments | **607** | 397 | 53% |
| Rental revenue | **44,509** | 39,325 | 13% |
| Operating expenses | **8,801** | 8,009 | 10% |
| Utilities and property taxes | **9,059** | 7,921 | 14% |
| Direct operating expenses | **17,860** | 15,930 | 12% |
| Net rental income | **26,649** | 23,395 | 14% |
| NOI | **28,581** | 25,295 | 13% |
| Same-asset NOI | **22,839** | 22,954 | (1)% |
| Operating margin | **60%** | 59% | 2% |

### Revenue

Rental revenue for the year ended December 31, 2014 increased $5.18 million or 13% over 2013. Higher revenue was driven by portfolio growth, with nine properties and additional phases at two existing properties acquired during 2014 increasing our GLA by 62% or 1,043,547 sf compared to December 31, 2013. Rental revenue generated by newly acquired properties was $5.19 million in 2014 (2013 - $0.59 million). Same-asset rental revenue grew by $0.58 million or 2% over 2013 driven by recoveries on higher direct operating expenses incurred during the year.

Weighted average base rent was $15.25 per sf at December 31, 2014, a decrease of 8% compared to 2013. Rate compression was driven by the increase in our industrial GLA, which typically have lower average rents, and certain anchor tenants which have lower base rents. On a same-asset basis average base rents were steady over 2013 with escalations on in-place rents in conjunction with a modest increase in average base rents on renewed leases driving the increase.

Occupancy improved to 92.4% as a result of higher average occupancy on newly acquired properties. On a same-asset basis occupancy improved moderately as a result of leasing activity on new and renewed deals during the year. We achieved a retention rate of 82.7% on the GLA expiring in 2014.

The following table summarizes the REIT's average base rent, GLA, occupancy and retention:

| | Year Ended December 31 2014 | 2013 | Change |
|---|---|---|---|
| Average base rent (per sf) | **$15.25** | $16.63 | (8)% |
| Weighted average remaining lease term | **5.49** | 4.75 | 16% |
| GLA | **2,735,467** | 1,691,920 | 62% |
| Occupancy % | **92.4%** | 90.6% | 2% |
| Retention % | **82.7%** | 75.5% | 10% |

Recoveries are amounts recovered from tenants for direct operating expenses incurred during the year and include a nominal administrative charge. During the year ended December 31, 2014, recoveries revenue increased by $2.28 million or 16% and correlates with the increase in direct operating expenses which were 12% or $1.93 million higher than 2013. Recovery revenue from newly acquired properties contributed $1.37 million in 2014 (2013 - $0.11 million). During 2014 we reclassified costs related to tenant recoveries from operating expenses to general & administrative expense, resulting in growth in recovery revenue exceeding increases in direct operating expenses during the year.

Other revenue is comprised of parking revenue and other miscellaneous revenue. These revenues can fluctuate from period to period.

Net non-cash adjustments related to amortization of tenant incentives and straight-line rent adjustments were steady over the comparative period. Amortization of tenant incentives increased over 2013 as a result of higher lease rollover during 2014, contributing to increased tenant incentives on new and renewed leases. Straight-line rent adjustments relate to new leases entered into during the period which have escalating rent rates and/or rent-free periods. Straight-line rent adjustments fluctuate from period to period due to the timing of leases signed.

### Direct operating expenses

Direct operating expenses increased by $1.93 million or 12% over 2013. Excluding the impact of newly acquired properties, direct operating expenses increased by $0.70 million over 2013. On a same-asset basis operating expenses were $0.22 million or 3% higher than 2013 and reflect inflationary growth in the cost of goods and services, offset by lower snow removal costs and certain non-recoverable costs. Property taxes and utilities increased by $0.47 million or 6% on a same-asset basis compared to 2013 and reflect higher property taxes on specific assets due to rising appraised values. These increases were partially offset by cost savings on utility contracts.

### NOI and Same-asset NOI

Net operating income (NOI) and same-asset NOI are non-standard metrics used in the real estate industry to measure the performance of investment properties. The IFRS measurement most directly comparable to NOI and same-asset NOI is net income.

Property acquisitions completed in 2014 and the last half of 2013 contributed to the increase in NOI, which grew 13% over 2013. On a same-asset basis, NOI was steady over 2013. The calculation of same-asset NOI is as follows (refer to non-standard measures for calculation of NOI and reconciliation to net income):

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Same-asset NOI | **22,839** | 22,954 | (1)% |
| Acquisitions | **3,810** | 441 | |
| NOI before adjustments | **26,649** | 23,395 | 14% |
| Amortization of tenant incentives | **2,539** | 2,297 | |
| Straight-line rent adjustments | **(607)** | (397) | |
| NOI | **28,581** | 25,295 | 13% |

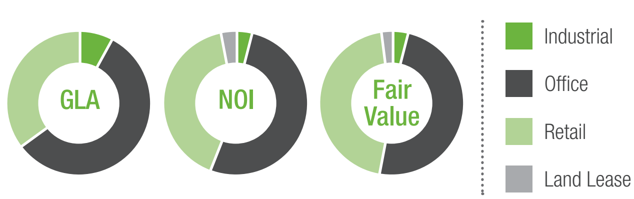
## Property Analysis

At December 31, 2014 our portfolio includes interests in 38 retail, office and industrial income-producing properties located in Western Canada for a total of 2,735,467 sf of GLA, and a land lease community.

During 2014 we acquired nine properties and additional phases at two existing properties, adding 1,043,302 sf to our portfolio. Since our IPO on May 1, 2013 our portfolio GLA has increased 74%, adding depth and diversification to our portfolio.

The following table summarizes the composition of our properties at December 31, 2014 by property type:

| | Number of Properties | GLA (sf) / Lots | % of Portfolio (GLA) | Fair value ($000s) | NOI ($000s) |
|---|---|---|---|---|---|
| Retail | 13 | 946,585 | 34.6% | 286,821 | 11,656 |
| Office | 20 | 1,567,600 | 57.3% | 314,317 | 14,988 |
| Industrial | 4 | 221,282 | 8.1% | 28,300 | 994 |
| Land Lease Community | 1 | 308 lots | n/a | 14,850 | 943 |
| | 38 | 2,735,467 | 100.0% | 644,288 | 28,581 |




The following table details key financial and operational metrics for each of property type for the year ended December 31, 2014:

| | Retail | | Office | | Industrial | | Land Lease Community | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Year ended December 31 ($000s) | | | | | | | | |
| Rental revenue | 15,843 | 12,279 | 26,134 | 25,166 | 1,274 | 652 | 1,258 | 1,228 |
| NOI | 11,656 | 9,126 | 14,988 | 14,896 | 994 | 419 | 943 | 854 |
| As at December 31 | | | | | | | | |
| Average base rent (per sf) | $18.40 | $19.12 | $14.15 | $15.55 | $8.63 | $6.67 | n/a | n/a |
| Occupancy | 96.8% | 93.2% | 89.0% | 88.4% | 97.9% | 100% | 100% | 100% |

***Retail*** - our 13 retail properties include 5 multi-building retail power centres and 8 neighborhood shopping centres. Retail GLA increased by 56% or 338,351 sf over 2013 through acquisitions. Rental revenue grew 29% over 2013. The increase is a result of two property acquisitions and additional phases at two power centres in 2014 (2013 - two property additions), contributing revenues of $4.04 million (2013 - $0.59 million). On a same-asset basis, rental revenue was consistent with 2013.

***Office*** - our 20 office properties include low and medium-rise buildings located in strategic urban and suburban centres. Office GLA increased by 54% or 548,887 sf over 2013 through acquisitions. Rental revenue increased by 4% over 2013. Property acquisitions resulted in GLA growth of 548,887 sf and generated $0.53 million of revenues in 2014 (2013 - $nil). Weighted average base rent decreased by $1.40 per sf as a result of an anchor tenant with lower base rents in one of the newly acquired properties. Normalizing for the anchor tenant, weighted average base rent on office properties was $15.50 at December 31, 2014.

***Industrial*** - our 4 industrial properties include single and multi-tenant buildings. Industrial GLA increased by 241% or 156,309 sf over 2013 through acquisitions. Rental revenue increased 95% compared to 2013 as a result of the acquisition of two industrial properties in Alberta during the year, which generated $0.62 million in 2014 revenues (2013 - $nil).

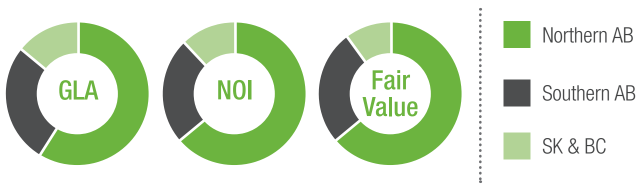
***Land Lease Community*** – we have one land lease community in Calgary, AB consisting of 308 pad lots. It was 100% occupied at December 31, 2014 (December 31, 2013 – 100%). Rental revenue was steady over 2013; improved NOI was due to lower property taxes during the year.

During 2014, same-asset NOI was steady across our portfolio.

## Regional Analysis

The following table summarizes the composition of our properties at December 31, 2014 by geographic region:

| | Number of Properties | GLA (sf) | % of Portfolio (GLA) | Fair value ($000s) | NOI ($000s) |
|---|---|---|---|---|---|
| Northern Alberta | 24 | 1,618,150 | 59.2% | 412,430 | 18,366 |
| Southern Alberta | 7 | 750,854 | 27.4% | 167,158 | 6,788 |
| Saskatchewan & British Columbia | 7 | 366,463 | 13.4% | 64,700 | 3,427 |
| | 38 | 2,735,467 | 100.0% | 644,288 | 28,581 |




The following table details key financial and operational metrics for each of our geographic regions for the year ended December 31, 2014:

| | Northern AB 2014 | Northern AB 2013 | Southern AB 2014 | Southern AB 2013 | SK & BC 2014 | SK & BC 2013 |
|---|---|---|---|---|---|---|
| Year ended December 31 ($000s) | | | | | | |
| Rental revenue | 29,220 | 25,531 | 9,329 | 8,246 | 5,960 | 5,548 |
| NOI | 18,366 | 16,441 | 6,788 | 5,737 | 3,427 | 3,117 |
| As at December 31 | | | | | | |
| Average base rent (per sf) | $16.22 | $17.19 | $14.00 | $23.22 | $13.39 | $12.88 |
| Occupancy | 93.1% | 90.0% | 91.9% | 98.4% | 90.5% | 86.8% |

**Northern Alberta** - our Northern Alberta assets are located throughout the greater Edmonton area, including Leduc and Spruce Grove, and Red Deer. Rental revenue grew 14% over 2013. The increase is a result of six property acquisitions and the acquisition of an additional phase in an existing property in 2014 (2013 - two property additions), contributing revenues of $3.32 million (2013 - $0.59 million). On a same-asset basis, rental revenue growth was driven by recoveries for higher direct operating expenses.

**Southern Alberta** - our Southern Alberta assets are located throughout the greater Calgary area, including Chestermere, and Lethbridge. Rental revenue increased by 13% over 2013. Property acquisitions completed in the region resulted in GLA growth of 468,212 sf and generated $1.23 million of revenues in 2014 (2013 - $nil). Weighted average base rent decreased by $9.22 per sf as a result of new property additions in the region. Rate compression was driven by the increase in our industrial GLA through the acquisition of LC Industrial, which typically have lower average rents, and an anchor tenant at Lethbridge Centre which has lower base rents. Excluding the anchor tenant, weighted average base rent was $17.14.

**Saskatchewan and British Columbia** - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue increased 7% compared to 2013 as a result of the acquisition of two retail properties in Saskatchewan during the year, which generated $0.64 million in 2014 revenues (2013 - $nil).

During 2014, same-asset NOI was steady across our Northern and Southern Alberta portfolio. Saskatchewan and BC decreased due to higher average vacancy.

## General & Administrative Expense

| ($000s) | Year Ended December 31 2014 | 2013 | Change |
|---|---|---|---|
| Asset management fee | **1,123** | 676 | 66% |
| Salaries and benefits | **—** | 315 | (100%) |
| Professional fees | **441** | 232 | 90% |
| Public company costs | **216** | 172 | 26% |
| Other | **354** | 333 | 6% |
| | **2,134** | 1,728 | 23% |

The analysis of general & administrative components year over year is not meaningful due to the formation of the REIT and resulting change in cost structure in 2013. Professional fees and public company costs increased over 2013 and reflect the higher costs associated with the REIT being a stand-alone publicly traded entity for a full twelve month period. Increased professional fees were also driven by additional administrative infrastructure required to support the growth of the portfolio and continued capital market activity. Property acquisitions completed over the past twelve months drove the increase in asset management fee, which is charged at an annual rate of 0.25% of gross book value. Refer to note 22 of the consolidated financial statements for additional discussion on the management fee structure. Other expenses fluctuate from period to period due to the timing of costs incurred. During 2014 we reclassified costs related to tenant recoveries from operating expenses to general & administrative expense. We expect general & administrative expense to increase with portfolio growth and correlate with rental revenue at an approximate rate of 5%.

## Finance Costs

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Interest on mortgages payable and revolving credit facility | **5,264** | 5,586 | (6%) |
| Interest on Class C LP Units | **3,971** | 2,721 | 46% |
| Amortization of fair value adjustment on Class C LP Units | **(440)** | (293) | 50% |
| Interest on convertible debenture | **151** | — | 100% |
| Non-cash finance costs | **273** | 108 | 153% |
| **Finance costs before distributions** | **9,219** | 8,122 | 14% |
| Distributions on Class B LP Units | **6,993** | 4,289 | 63% |
| **Finance costs** | **16,212** | 12,411 | 31% |

Finance costs for the year ended December 31, 2014 were $3.80 million or 31% higher compared to 2013. Financing of newly acquired properties during the year and higher leverage contributed to the increase in finance costs. Analysis of the components of finance costs is not meaningful due to the formation of the REIT and resulting conversion of certain mortgages into Class C LP Units. On December 3, 2014, we issued a convertible debenture for gross proceeds of $34.50 million, which pays a coupon of 5.50% annually.

Distributions made on Class B LP Units increased by $2.70 million or 63% as a result of the issuance of 5,085,080 Class B LP Units as part of the acquisitions from Melcor completed during 2014. The increase also reflects that distributions were paid in twelve months in 2014 compared to eight months in 2013.

Lower weighted average interest rates on Class C LP Units, the revolving credit facility and on new and renewed mortgages partially offset the increase in indebtedness during the year. As at December 31, 2014, the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debenture was 3.98% based on period end balances (December 31, 2013 – 3.98%).

## Income Taxes

As at December 31, 2014, the REIT qualifies as a mutual fund trust within the meaning of the Income Tax Act (Canada) and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through (SIFT) rules; accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT.

In 2013 we recorded a deferred income tax recovery of $40.59 million related to the de-recognition of a deferred income tax liability as a result of qualifying for the REIT Exception at the IPO.

## Funds from Operations & Adjusted Funds from Operations

Funds From Operations (FFO) and Adjusted Funds From Operations (AFFO) are non-standard measures used in the real estate industry as a measure of operating performance of investment properties. We believe that AFFO is an important measure of economic performance and is indicative of the REIT's ability to pay distributions, while FFO is an important measure of operating performance and the performance of real estate properties.

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s, except per unit amounts) | 2014 | 2013 | Change |
| Net income for the year | **18,348** | 62,719 | |
| Add / (deduct) | | | |
| Fair value adjustment on investment properties | **(93)** | (16,953) | |
| Fair value adjustment on Class B LP Units | **(9,880)** | 3,812 | |
| Amortization of tenant incentives | **2,539** | 2,297 | |
| Distributions on Class B LP Units | **6,993** | 4,289 | |
| Deferred income tax recovery | **—** | (40,261) | |
| **Funds From Operations (FFO)** | **17,907** | 15,903 | 13% |
| Add / (deduct) | | | |
| Straight-line rent adjustments | **(607)** | (397) | |
| Non-cash finance costs | **273** | 168 | |
| Net impact of amortization of fair value adjustment and interest subsidy [1] | **547** | 432 | |
| Normalized capital expenditures [2] | **(835)** | (729) | |
| Normalized tenant incentives and leasing commissions [2] | **(1,672)** | (1,461) | |
| **Adjusted Funds from Operations (AFFO)** | **15,613** | 13,916 | 12% |
| **FFO/Unit** | **$0.87** | $0.85 | 2% |
| **AFFO/Unit** | **$0.76** | $0.75 | 1% |

1. Adjustment includes the following: amortization of the fair value adjustment recognized on the Class C LP Unit liability; and usage of the interest rate subsidy provided by Melcor as part of the transfer of the Initial Properties.
2. Represents 3% and 6% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively. Amounts are net of usage of the capital expenditure subsidy provided by Melcor as part of the transfer of Initial Properties. Amounts presented in the comparative pre-acquisition period is based upon the respective percentage of annual NOI for comparative purposes.

Our convertible debenture can be converted into trust units at the holder's option and are considered a dilutive instrument. The following table calculates diluted FFO and diluted FFO/Unit:

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s, except per unit amounts) | 2014 | 2013 | Change |
| **Funds From Operations (FFO)** | **17,907** | 15,903 | 13% |
| Interest on convertible debenture | **151** | — | |
| Non-cash finance costs | **38** | — | |
| **Funds From Operations - Diluted (FFO - Diluted)** | **18,096** | 15,903 | 14% |
| **FFO - Diluted/Unit** | **$0.87** | $0.85 | 2% |

## Distributions

In order to continue to qualify for the 'REIT Exception', as provided under the SIFT rules, we must allocate substantially all taxable income. As such, we allocate monthly distributions to unitholders as determined and approved by the Board of Trustees. We made monthly distributions to unitholders at a rate of $0.05625 per unit, representing $0.675 per unit on an annualized basis. Distributions to unitholders during the year were $7.13 million (2013 - $4.11 million).

Distributions made during the year ended December 31, 2014 represent a payout ratio of approximately 89% of AFFO (2013 - 90% on an annualized basis, including pre-REIT formation). AFFO/Unit was negatively affected during the year by the time lag between capital raises and the deployment of funds on asset purchases. We generate sufficient cash flows from operations in order to sustain our current distribution rate for the foreseeable future. We use AFFO in evaluating our ability to continue to make distributions through operating activities. The most similar GAAP measure is cash flow from operations. Cash flow from operations for 2014 was $9.25 million, exceeding distributions by $2.12 million (2013 - May 1, 2013 to December 31, 2013 - $7.14 million, exceeding distributions by $3.03 million).

A reconciliation of cash flow from operations to AFFO is as follows:

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| **Cash flows from operations** | **9,252** | 10,502 | (12)% |
| Distributions on Class B LP Units | **6,993** | 4,289 | |
| Changes in operating assets and liabilities (note 3o) | **888** | 590 | |
| Interest subsidy | **987** | 725 | |
| Normalized capital expenditures | **(835)** | (729) | |
| Normalized tenant incentives and leasing commissions | **(1,672)** | (1,461) | |
| **Adjusted Funds from Operations (AFFO)** | **15,613** | 13,916 | 12% |

## Fair Value of Investment Properties

We carry our investment properties at fair value in accordance with IFRS 13, Fair value measurement. The following table summarizes key metrics of our investment properties and components of the fair value calculation:

| | At December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Number of properties | **38** | 29 |
| Total GLA (sf) | **2,829,885** | 1,786,447 |
| GLA (REIT owned %) (sf) | **2,735,467** | 1,691,920 |
| Fair value of portfolio ($000s) | **644,288** | 440,349 |
| Value per square foot | **$236** | $260 |
| NOI ($000s) | **28,581** | 25,295 |
| Weighted average capitalization rate | **6.49%** | 6.41% |
| Weighted average discount rate | **6.77%** | 7.57% |
| Weighted average terminal cap rate | **7.69%** | 6.69% |

Investment properties were valued by qualified independent external valuation professionals as at December 31, 2014 and 2013, resulting in fair value gains of $0.09 million (2013 - $16.95 million) on investment properties recorded to income during the year. Refer to note 27 to the consolidated financial statements for additional information on the calculation of fair value adjustments.

A breakdown of our fair value adjustment on investment properties by geographic region are as follows:

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Northern Alberta | **(3,787)** | 7,969 | (148)% |
| Southern Alberta | **2,955** | 6,178 | (52)% |
| Saskatchewan & British Columbia | **925** | 2,806 | (67)% |
| | **93** | 16,953 | (99)% |

Fair value losses in Northern Alberta were primarily due to an increase in capitalization rates on three Edmonton office properties. Fair value gains in Southern Alberta and Saskatchewan & British Columbia were primarily driven by newly acquired properties where appraised fair value exceeded purchase price. Decreased fair value adjustments compared to 2013 reflects increased stability in the portfolio.

Fair values are most sensitive to changes in capitalization rates.

| (%) | December 31, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | **Min** | **Max** | **Weighted Average** | Min | Max | Weighted Average |
| Capitalization rate | **5.50** | **9.00** | **6.49** | 5.50 | 9.00 | 6.41 |
| Terminal capitalization rate | **5.75** | **9.25** | **6.77** | 5.75 | 9.25 | 6.69 |
| Discount rate | **6.50** | **10.00** | **7.69** | 6.50 | 10.00 | 7.57 |

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by $43.83 million (2013 - $31.88 million) while a 50 basis points decrease (-0.5%) would increase it by $51.15 million (2013 - $37.28 million).

# Liquidity & Capital Resources

We employ a range of strategies to fund operations and facilitate growth. Our principal liquidity needs are to:

- Fund recurring expenses
- Meet debt service requirements
- Make distribution payments
- Fund capital projects, and
- Purchase investment properties.

## Cash Flows

The following table summarizes cash flows from operating, investing and financing activities:

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Cash from operating activities | **9,252** | 10,502 | (1,250) |
| Cash used in investing activities | **(56,995)** | (34,867) | (22,128) |
| Cash from financing activities | **48,523** | 29,608 | 18,915 |
| Increase in cash and cash equivalents | **780** | 5,243 | (4,463) |
| Cash and cash equivalents, beginning of year | **5,932** | 689 | 5,243 |
| Cash and cash equivalents, end of year | **6,712** | 5,932 | 780 |

### *Operating activities*

Cash from operating activities was $1.25 million lower than 2013. This decrease is primarily due to distributions on Class B LP Units, which were $6.99 million during the year, compared to $4.29 million in 2013, and are included in finance costs.

### *Investing activities*

In 2014 we invested $49.61 million in acquisitions of nine properties and additional phases of two exiting properties (2013 - $25.85 million on two property acquisitions).

We continue to invest in targeted and strategic value enhancing capital projects to improve the appeal of our investment properties to prospective and existing tenants.

Our capital asset enhancement program invested $4.44 million in strategic value-adding building improvement and asset enhancement projects in 2014 (2013 - $3.82 million). Capital spending in 2014 includes $0.64 million in development costs incurred on the construction of a commercial retail unit (CRU) on vacant land at one of our power centres (owned with joint arrangement partners). The majority of building improvement expenditures are recoverable from the tenants over 5-25 years. Normalized capital expenditures are calculated on a ten year horizon and account for annual fluctuations due to timing of capital programs.

Leasing activity on both new and renewed leases was strong during the year, driving $1.06 million in leasing fees paid under the Property Management Agreement (2013 - $0.79 million). Payments of tenant incentives correlates with lease activity, increasing $2.93 million over 2013. We used $2.04 million of restricted cash to partially fund 2014 investment activities. Timing of lease expiries impacts the level of spending on tenant incentives and leasing costs. Higher expenditures during the period reflects 17.6% of our portfolio GLA expiring in 2014, with 82.7% renewed during the year. In addition, we completed 116,524 sf in new leasing during the year.

### *Financing activities*

On May 7, 2014 we received $18.75 million from the issuance of 1,900,000 trust units, net of transaction costs. On May 16, 2014, an additional 245,000 trust units were issued under the over-allotment option for net proceeds of $2.50 million. Proceeds were used to fund acquisitions and to reduce the amount outstanding under our revolving credit facility.

On December 3, 2014 we received $31.93 million from the issuance of a 5.50% convertible debenture, net of transaction costs. Funds were used to complete property acquisitions.

In the comparative period we issued 9,130,000 of trust units as part of the IPO, for proceeds of $74.41 million, net of transaction costs.

During 2014 we obtained mortgage financing on four recently acquired and previously unencumbered properties for proceeds of $19.01 million. Partial proceeds were used to repay the remaining amounts drawn under the revolving credit facility. In addition, we refinanced three mortgages on two properties for gross proceeds (including one held with joint arrangement partners) of $29.40 million. Proceeds were used to repay the outstanding principal balance of $21.83 million and for general trust purposes. Comparatively, in 2013, we recognized $55.00 million in proceeds on the renewal and refinancing of five properties and extinguished mortgages on four properties totaling a repayment of $13.95 million.

Cash flows from equity financings completed during the year and new mortgage financing allowed us to reduce our indebtedness under our revolving credit facility by $19.00 million (2013 - draw of $24.00 million to fund the acquisition of two properties).

We continued our monthly distribution of $0.05625 per unit for total annual distributions declared of $7.13 million to unitholders (2013 - $4.11 million).

During the comparative period, we recognized net distributions to Melcor of $7.45 million. Net distributions to Melcor represent the net financing received by Melcor prior to the formation of the REIT to fund operating and investing activities.

We are able to meet our capital needs through a number of sources, including cash generated from operations, short-term borrowings under our revolving credit facility, mortgage financings, and the issuance of trust units to purchase investment properties.

We believe that internally generated cash flows, supplemented by borrowings through our revolving credit facility and mortgage financings, where required, will be sufficient to cover our normal operating, debt service, distribution and capital expenditure requirements. We regularly review our credit facility limits and manage our capital requirements accordingly.

As at December 31, 2014 we had $6.71 million in cash, $2.95 million in restricted cash and additional available funds under our revolving credit facility. Available funds will enable us to capitalize on future acquisition opportunities as well as meet ongoing capital needs.

## Capital Structure

We define capital as the total of trust units, Class B LP Units, Class C LP Units, mortgages payable, convertible debenture and amounts drawn under our revolving credit facility.

Pursuant to the DOT, the REIT may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, the total indebtedness of the REIT would be more than 60% (65% including any convertible debentures) of Gross Book Value (GBV) (Degree of Leverage Ratio). Throughout the year, we were in compliance with the Degree of Leverage Ratio and had a ratio of 56% as at December 31, 2014 (50% excluding convertible debenture).

As at December 31, 2014, the REIT's total capitalization was $603.17 million and is comprised as follows:

| ($000s) | December 31, 2014 |
|---|---|
| Revolving credit facility [1] | 5,000 |
| Mortgages payable [1] | 215,675 |
| Class C LP Units [2] | 89,519 |
| **Indebtedness, excluding convertible debenture** | **310,194** |
| Convertible debenture [3] | 34,500 |
| **Indebtedness** | **344,694** |
| Class B LP Units [4] | 147,708 |
| Trust units | 114,145 |
| **Equity** | **261,853** |
| **Total capitalization** | **606,547** |
| **Gross book value (GBV) [5]** | **619,987** |
| Debt to GBV, excluding convertible debenture (maximum threshold - 60%) | 50% |
| Debt to GBV (maximum threshold - 65%) | 56% |

1. Debts are presented excluding unamortized transaction costs, discount on bankers acceptance, and fair value adjustment on mortgage.
2. Class C LP Units excluding unamortized fair value adjustment on Class C LP Units.
3. Convertible debenture is presented at face value, excluding unamortized transaction costs and amounts allocated to conversion feature.
4. Class B LP Units are classified as equity for purposes of this calculation and are included at their book value.
5. GBV is calculated as the cost of the total assets acquired in the Initial Properties and subsequent asset purchases.

We are also subject to financial covenants on our $25.00 million revolving credit facility. The covenants include a maximum debt to total capital ratio of 60%, a minimum interest coverage ratio of 1.50, and a minimum net book value of unitholders' equity of $140.00 million. As at December 31, 2014, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 56%, interest coverage ratio of 1.67, and a net book value of unitholders equity of $288.27 million. We also have financial covenants on certain mortgages for investment properties. At December 31, 2014, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and ability to meet our financial covenants.

### *Indebtedness*

*Debt Repayment Schedule* – the following table summarizes our contractual obligations and illustrates certain liquidity and capital resource requirements:

| ($000s) | Revolving Credit Facility | Mortgages Payable | Class C LP Units | Convertible Debenture | Total | % of Portfolio |
|---|---|---|---|---|---|---|
| **Total** | **5,000** | **215,675** | **89,519** | **34,500** | **344,694** | **100%** |
| 2015 | 5,000 | 20,957 | 25,825 | — | 51,782 | 15% |
| 2016 | — | 31,874 | 11,180 | — | 43,054 | 12% |
| 2017 | — | 5,011 | 4,584 | — | 9,595 | 3% |
| 2018 | — | 37,783 | 13,108 | — | 50,891 | 15% |
| 2019 | — | 69,860 | 8,064 | 34,500 | 112,424 | 33% |
| Thereafter | — | 50,190 | 26,758 | — | 76,948 | 22% |

We ladder the renewal and maturity dates on our borrowings as part of our capital management strategy. This mitigates the concentration of interest rate and financing risk associated with refinancing in any particular period. In addition, we try to match the maturity of our debt portfolio with the weighted average remaining lease term on our properties.

*Debt Analysis* – our mortgages payable, Class C LP Units and convertible debentures bear interest at fixed rates; our revolving credit facility bears interest at variable rates. The following table summarizes the interest rates and terms to maturity:

| ($000s) | Revolving Credit Facility | Mortgages Payable | Class C LP Units | Convertible Debenture | Total |
|---|---|---|---|---|---|
| **Total** | **5,000** | **215,675** | **89,519** | **34,500** | **344,694** |
| Fixed | — | 215,675 | 89,519 | 34,500 | 339,694 |
| Variable | 5,000 | — | — | — | 5,000 |
| Weighted average interest rate | 3.52% | 3.80% | 3.84% | 5.50% | 3.98% |
| Weighted average term to maturity | 0.33 | 5.22 | 3.90 | 5.00 | 4.78 |

The weighted average interest rate on our debts has remained steady since December 31, 2013. During 2014 we obtained mortgage financing on four recently acquired and previously unencumbered properties for $19.01 million at a weighted average interest rate of 3.45%. In addition, we refinanced three mortgages on two properties for gross proceeds (including one held within a jointly owned property) of $29.40 million at a weighted average interest rate of 3.53%. Proceeds were used to repay the outstanding principal balance of $21.83 million and for general trust purposes. We also assumed mortgages of $93.51 million as part of the Melcor acquisition and the purchase of White Oaks at a combined weighted average interest rate of 3.70%

During 2013 we refinanced six mortgages totaling $60.00 million and obtained financing of $7.00 million on a previously unencumbered property.

*Debt Service Coverage Ratio and Finance Costs Coverage Ratio* – we calculate debt service coverage ratio as FFO for the period divided by principal repayments on mortgages payable and Class C LP Units made during the year. We calculate interest coverage as FFO plus finance costs for the period divided by finance costs expensed during the period, less distributions on Class B LP Units. We consider these measures to be useful in evaluating our ability to service our debts. These metrics are not calculated for purposes of covenant compliance on any of our debt facilities.

| ($000s) | 2014 | 2013 |
|---|---|---|
| FFO | **17,907** | 15,903 |
| Principal repayments on Mortgages payable | **3,441** | 3,653 |
| Principle repayments on Class C LP Units | **3,059** | 1,966 |
| **Debt service coverage ratio** | **2.75** | 2.83 |
| FFO plus finance costs [1] | **27,126** | 24,025 |
| Finance costs [1] | **9,219** | 8,122 |
| **Finance costs coverage ratio** | **2.94** | 2.96 |

1. Finance costs excluding finance expense recognized on Class B LP Unit distributions.

### *Equity*

The REIT is authorized to issue an unlimited number of trust units and an unlimited number of special voting units. Each trust unit represents a holder's proportionate undivided beneficial ownership interest in the REIT and will confer the right to one vote at any meeting of the unitholders and to receive any distributions by the REIT. Special voting units have no economic entitlement in the REIT but entitle the holder to one vote per special voting unit. Special voting units may only be issued in connection with securities exchangeable into trust units (including Class B LP Units).

Class B LP Units of the Partnership are economically equivalent to, and exchangeable into, trust units at the option of the holder, and therefore, are considered a dilutive instrument. The Class B LP Units are classified as financial liabilities in accordance with IAS 32, Financial Instruments – presentation, due to their puttable feature.

On May 7, 2014 the REIT completed the issuance of 1,900,000 trust units at a price of $10.65 per unit to a syndicate of underwriters, on a bought deal basis, for gross proceeds of $20.24 million. Subsequently, the underwriters exercised their over-allotment option to purchase an additional 245,000 trust units at a price of $10.65 for gross proceeds of $2.61 million. The issuance was qualified under a short form prospectus dated April 30, 2014.

On May 9, 2014 the REIT issued 694,836 Class B LP Units at a price of $10.65 per unit, or $7.40 million, to Melcor as partial consideration for the May 2014 Melcor Acquisition.

On December 3, 2014, we issued a 5.50% extendible convertible unsecured subordinated debenture (the Debentures) to the public for gross proceeds of $34,500, including $4,500 issued pursuant to the exercise of an over-allotment option. The Debentures can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion rate of 79.0514 trust units per one thousand principal amount of Debentures (the Conversion Price).

On December 18, 2014 the REIT issued 4,390,244 Class B LP Units at $10.25 per unit to Melcor as partial consideration for properties acquired from Melcor.

The following table summarizes the change in units during the year and the fully diluted number of units outstanding:

| Issued and fully paid units ($000s) | December 31, 2014 Units | December 31, 2014 $ Amount | December 31, 2013 Units | December 31, 2013 $ Amount |
|---|---|---|---|---|
| Balance, beginning of year | 9,130,000 | 91,300 | — | — |
| Issuance of units - IPO | — | — | 8,300,000 | 83,000 |
| Issuance of units - over-allotment option | — | — | 830,000 | 8,300 |
| Issuance of units | 2,145,000 | 22,844 | — | — |
| **Balance, end of year** | 11,275,000 | 114,144 | 9,130,000 | 91,300 |
| Dilutive securities | | | | |
| Class B LP Units | 14,615,878 | 147,708 | 9,530,798 | 95,308 |
| Convertible debenture | 2,727,273 | 34,500 | — | — |
| **Diluted balance, end of year** | 28,618,151 | 296,352 | 18,660,798 | 186,608 |

## Off Balance Sheet Arrangements

As at December 31, 2014, we had no off-balance-sheet arrangements.

# Quarterly Results

| 2014 ($000s except per unit amounts) | Q4 | Q3 | Q2 | Q1 |
|---|---|---|---|---|
| Revenue ($000s) | 11,669 | 11,074 | 11,119 | 10,647 |
| Net income ($000s) | 9,481 | 2,693 | 5,296 | 878 |
| Basic earnings per unit [1] | $0.88 | $0.24 | $0.52 | $0.10 |
| Annualized distribution rate | $0.675 | $0.675 | $0.675 | $0.675 |
| Period-end closing unit price | $9.46 | $9.70 | $10.29 | $10.55 |
| Annualized distribution yield on closing unit price (%) [2] | 7.14% | 6.96% | 6.56% | 6.40% |

| 2013 ($000s except per unit amounts) | Q4 | Q3 | Q2 | Q1 |
|---|---|---|---|---|
| Revenue ($000s) | 10,070 | 9,794 | 9,773 | 9,688 |
| Net income ($000s) | 7,466 | 5,945 | 44,492 | 4,816 |
| Basic earnings per unit [1] | $0.51 | $0.65 | $2.38 | $0.26 |
| Annualized distribution rate | $0.675 | $0.675 | $0.675 | n/a |
| Period-end closing unit price | $10.40 | $10.00 | $10.10 | n/a |
| Annualized distribution yield on closing unit price (%) [2] | 6.49% | 6.75% | 6.68% | n/a |

1. Calculated as if the trust units were outstanding during the entire comparative period.
2. Annualized distribution yield is calculated as the annualized distribution rate divided by the period-end closing unit price.

# Fourth Quarter Results

## Consolidated Revenue & Net Operating Income

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Base rent | **7,567** | 6,434 | 18% |
| Recoveries | **4,426** | 3,582 | 24% |
| Other | **315** | 589 | (47)% |
| Amortization of tenant incentives | **(780)** | (616) | 27% |
| Straight-line rent adjustments | **141** | 81 | 74% |
| **Rental revenue** | **11,669** | 10,070 | 16% |
| | | | |
| Operating expenses | **2,359** | 2,392 | (1)% |
| Utilities and property taxes | **2,469** | 1,982 | 25% |
| **Direct operating expenses** | **4,828** | 4,374 | 10% |
| | | | |
| **Net rental income** | **6,841** | 5,696 | 20% |
| **NOI** | **7,480** | 6,231 | 20% |
| **Same-asset NOI** | **5,613** | 5,319 | 6% |
| **Operating margin** | **59%** | 57% | 4% |

Rental revenue for the fourth quarter was $11.67 million, an increase of $1.60 million over Q4-2013. Portfolio growth was the primary driver, contributing $1.81 million to revenues in Q4-2014 (Q4-2013 - $0.51 million). Recoveries were 24% higher than 2013, correlating with an increase in direct operating expenses. Recoveries are trued up to actual expenses in the fourth quarter each year, which can result in greater variance in the quarter.

## General & Administrative Expense

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Asset management fee | **299** | 257 | 16% |
| Professional fees | **125** | 27 | 363% |
| Public company costs | **71** | 76 | (7)% |
| Other | **157** | 99 | 59% |
| | **652** | 459 | 42% |

Increased professional fees were driven by additional administrative infrastructure required to support the growth of the portfolio and continued capital market activity. Property acquisitions completed in 2014 drove the increase in asset management fee which is charged at an annual rate of 0.25% of gross book value. Other expenses fluctuate from period to period due to the timing of costs incurred. During 2014 we reclassified costs related to tenant recoveries from operating expenses to general & administrative expense.

## Finance Costs

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Interest on mortgages payable and revolving credit facility | **1,431** | 1,169 | 22% |
| Interest on Class C LP Units | **980** | 1,014 | (3)% |
| Amortization of fair value adjustment on Class C LP Units | **(110)** | (110) | —% |
| Interest on convertible debenture | **151** | — | 100% |
| Non-cash finance costs | **113** | 72 | 57% |
| **Finance costs before distributions** | **2,565** | 2,145 | 20% |
| Distributions on Class B LP Units | **1,973** | 1,608 | 23% |
| **Finance costs** | **4,538** | 3,753 | 21% |

Finance costs for the fourth quarter were $4.54 million or 21% higher than Q4-2013. Increased interest on mortgages and our revolving credit facility comprised $0.26 million of the increase. This was driven by financing of new property acquisitions, offset by lower interest rates on new and renewed mortgages. On December 3, 2014, we issued a convertible debenture which pays a coupon of 5.50% annually. Distributions on Class B LP Units increased by $0.37 million or 23% as a result of issuance of 5,085,080 Class B LP Units as part of the acquisitions completed during 2014.

## Funds from Operations & Adjusted Funds from Operations

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s, except per unit amounts) | 2014 | 2013 | Change |
| Net income for the period | **9,481** | 7,466 | |
| Add / (deduct) | | | |
| Fair value adjustment on investment properties | **(3,196)** | (9,488) | |
| Fair value adjustment on Class B LP Units | **(4,616)** | 3,521 | |
| Amortization of tenant incentives | **780** | 616 | |
| Distributions on Class B LP Units | **1,973** | 1,608 | |
| **Funds From Operations (FFO)** | **4,422** | 3,723 | 19% |
| Straight-line rent adjustments | **(141)** | (81) | |
| Non-cash finance costs | **113** | 92 | |
| Net impact of amortization of fair value adjustment and interest subsidy [1] | **123** | 157 | |
| Normalized capital expenditures [2] | **(223)** | (182) | |
| Normalized tenant incentives and leasing commissions [2] | **(448)** | (360) | |
| **Adjusted Funds from Operations (AFFO)** | **3,846** | 3,349 | 15% |
| **FFO/Unit** | **0.20** | 0.20 | —% |
| **AFFO/Unit** | **0.17** | 0.18 | (6)% |

1. Adjustment includes the following: amortization of the fair value adjustment recognized on the Class C LP Unit liability; and usage of the interest rate subsidy provided by Melcor as part of the transfer of the Initial Properties.
2. Represents 3% and 6% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively, net of the capital expenditure subsidy provided by Melcor.

Funds from operations (FFO) and Adjusted funds from operations (AFFO) for the fourth quarter were 19% and 15% higher than the comparative period. The increase was primarily driven by property acquisitions completed during 2014.

Distributions to unitholders for the fourth quarter were $1.90 million (2013 - $1.54 million).

A reconciliation of cash flow from operations to AFFO is as follows:

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s, except per unit amounts) | 2014 | 2013 | Change |
| Cash flows from operations | **2,541** | 1,595 | 59% |
| Distributions on Class B LP Units | **1,973** | 1,608 | |
| Changes in operating assets and liabilities (note 3o) | **(230)** | 421 | |
| Interest subsidy | **233** | 267 | |
| Normalized capital expenditures | **(223)** | (182) | |
| Normalized tenant incentives and leasing commissions | **(448)** | (360) | |
| **Adjusted Funds from Operations (AFFO)** | **3,846** | 3,349 | 15% |

*The section titled Outlook contains forward-looking statements. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. Please refer to the Caution Regarding Forward-looking Statements on page 11.*

# Outlook

We own a high quality portfolio of income-producing assets. Alberta, our main market, has undergone dramatic changes in economic outlook over the past few months as a result of lower oil prices. Despite this, we continue to see good leasing activity and have not seen a slow down in interest or in our near-term ability to renew and sign new leases. We will continue to seek out suitable acquisitions to expand our asset base as conditions allow.

We will also continue to improve existing assets through asset enhancement programs and efficient and effective property management. Our disciplined approach helps to ensure that our assets remain profitable over the long term while at the same time achieving our objective of providing stable and growing monthly cash distributions to unitholders.

With new downtown office inventory coming online in the next few years in Edmonton and Calgary, we are continuing to proactively renew leases and seek out new tenants for existing vacancies. We also continue to focus on our signature care program to ensure we remain the landlord of choice for our tenants.

With a strong, diversified portfolio, focus on property management and client relationships, and a solid pipeline of over 6 million sf of high quality assets being developed over the next 5-10 years, we remain well positioned for the future.

Occupancy at year end was 92.4% compared to 90.6% at the end of the 2013. Our tenants include a diversified mix of national, regional and local businesses operating in a variety of industries. This diversified tenant base helps mitigate our exposure to negative trends occurring in any one sector.

Over the next 12 months, five mortgages on four properties (two of which are held with joint arrangement partners) are up for renewal. These mortgages have an outstanding principal balance of $14.90 million (at REIT % interest) and a weighted average interest rate of 4.86% as at December 31, 2014. We expect to be able to refinance these mortgages at lower interest rates based on comparable recent refinancings.

In addition, we have two properties encumbered by Class C LP Units where the underlying mortgages held by Melcor are up for renewal in the next twelve months. At maturity the value of the Class C LP Units will be $23.05 million, representing 2,304,469 Class C LP Units, with a weighted average interest rate of 4.00%. Subsequent to year-end we obtained mortgage financing on one property for $3.11 million at a fixed rate of 2.48%. We expect to be able to obtain new mortgage financing on the remaining property, proceeds of which will be used to redeem the Class C LP Unit liability to Melcor.

Our revolving credit facility matures May 1, 2015. Under the terms of the agreement we may request a one year extension to be granted at the discretion of the lenders. We expect to be able to renew or extend the facility.

# Business Environment & Risks

We are exposed to various risks and uncertainties, many of which are beyond our control. The following risk factors could materially impact our financial condition, results of operations, cash flows and the value of our trust units. We take steps to mitigate these risks; however, there is no assurance that the steps taken will avoid future loss.

## General Risks

We are subject to market conditions in the geographic areas where we own and manage properties. Where strong market conditions prevail, we are able to achieve higher occupancy rates. Market conditions are influenced by outside factors such as general inflation and interest rate fluctuations, population growth and migration, financing and economic environments, job creation and employment patterns, consumer confidence, government policies, regulations and taxation, and availability of credit and financing.

## Real Estate Risk

Real estate investments are subject to varying levels of risk. These risks include changes to general economic conditions, government and environmental regulations, local supply/demand, and competition from other real estate companies. Real estate assets are relatively illiquid in down markets. As a result, the REIT may not be able to rebalance its portfolio in response to changing economic or investment conditions.

Other real property risks include:

- The value of the property and any improvements made to it
- Rollover of leases and the ability to rent unleased suites
- Financial stability of tenants and their ability to pay rent and fulfill their lease obligations and
- Geographic concentration.

Cash available for distribution will be adversely affected if a significant number of tenants are unable to meet their obligations under their leases or if a significant amount of available space in the properties becomes vacant and cannot be leased on economically favourable lease terms.

## Concentration of Properties and Tenants

Of the total GLA, 86.60% is located in Alberta. Consequently, the market value of the REIT's properties, the income generated by the REIT and the REIT's performance are particularly sensitive to changes the real estate markets in Alberta and economic conditions in Alberta generally. The factors impacting on the real estate markets in Alberta and the Alberta economy in general may differ from those affecting other regions of Canada.

Adverse changes in the economic conditions in Alberta may have a material adverse effect on the REIT's business, cash flows, financial condition and results of operations and ability to make distributions to holders of units. The Alberta economy is sensitive to the price of oil and gas. To mitigate against this risk, the REIT endeavors to achieve a diverse mix of tenants representing a variety of industries, as well as a mix of regional, local and national tenants.

## Competitive Conditions

The real estate market is highly competitive, with a large number of well-financed companies operating in the same markets as the REIT. We may compete for real property acquisitions with individuals, corporations, institutions and other entities, which may increase the purchase price and reduce the yield of an acquired property. The REIT's rights under the Development and Opportunities Agreement entered into with Melcor helps to mitigate competition risk.

We also compete with other developers, managers and property owners in attracting tenants. Some of our competitors are better capitalized or financially stronger, and would be in a better position to withstand an economic downturn. The existence of competition for tenants could have an adverse effect on our ability to lease space in our properties and on the rents charged or concessions granted, and could materially and adversely affect our cash flows, operating results and financial condition. The REIT focuses on providing exceptional customer care and building solid relationships with our clients to increase the likelihood that they will renew leases.

## Fixed Costs

The failure to rent unleased space on a timely basis or at all would likely have an adverse effect on the REIT's financial condition and results of operation and decrease the amount of cash available for distribution. Certain significant expenditures, including property taxes, ground rent, maintenance costs, mortgage payments (including those associated with the Retained Debt), insurance costs and related charges must be made throughout the period of ownership of real property regardless of whether a property is producing any income. If the REIT is unable to meet mortgage payments on any property (including those associated with the Retained Debt), losses could be sustained as a result of the mortgagee's exercise of its rights of foreclosure or sale or the landlord's exercise of remedies. Costs may also be incurred in making improvements or repairs to property required by a new tenant and income may be lost as a result of any prolonged delay in attracting suitable tenants to the vacant space.

The timing and amount of capital expenditures by the REIT will indirectly affect the amount of cash available for distribution to unitholders. Distributions may be reduced, or even eliminated, at times when the REIT deems it necessary to make significant capital or other expenditures.

## Financing

We require access to capital to maintain our properties and fund our growth strategy. There is no assurance that capital will be available when needed or on favourable terms. Our access to third-party financing will be subject to a number of factors, including general market conditions, the market's perception of our growth potential, our current and expected future earnings, our cash flow and cash distributions, and cash interest payments and the market price of our units.

We use debt and other forms of leverage in the ordinary course of business to execute on our strategy.

We are subject to general risks associated with debt financing. The following risks may adversely affect our financial condition and results of operations:

- Cash flow may be insufficient to meet required payments of principal and interest
- Payments of principal and interest on borrowings may leave us with insufficient cash resources to pay operating expenses
- We may not be able to refinance indebtedness on our assets at maturity due to company and market factors
- The fair market value of our assets
- Liquidity in the debt markets
- A high level of debt will reduce the amount of funds available for the payment of distributions to unitholders and interest payments on our debentures
- Financial, competitive, business and other factors, including factors beyond our control and
- Refinancing terms that are not as favourable as the original terms of the related financing.

We attempt to mitigate these risks through the use of long-term debt and diversifying terms and maturity dates.

The terms of various credit agreements and other financing documents require that we comply with a number of financial and other covenants, such as maintaining debt service coverage and leverage ratios, and minimum insurance coverage. These covenants may limit our flexibility in our operations, and breaches of these covenants could result in defaults under the instruments governing the applicable indebtedness even if we had satisfied our payment obligations.

If we are unable to refinance assets/indebtedness on acceptable terms, or at all, we may need to use available liquidity, which would reduce our ability to pursue new investment opportunities. Alternately we may be required to dispose of one or more of our assets on disadvantageous terms. In addition, unfavourable interest rates or other factors at the time of refinancing could increase interest expense.

A large proportion of our capital is invested in physical, long-lived assets, which can be difficult to liquidate, especially if local market conditions are poor. This circumstance could limit our ability to diversify our portfolio of assets promptly in response to changing economic or investment conditions.

The liabilities of the REIT have fixed and floating interest rate components resulting in an exposure to interest rate fluctuations. These fluctuations in interest rates will have an impact on the earnings of the REIT. As a result of increased interest rates, the REIT's financial results and condition or operating results could be materially adversely affected.

The REIT may implement hedging programs in order to offset the risk of revenue losses and to provide more certainty regarding the payment of distributions to unitholders should current variable interest rates increase. However, to the extent that the REIT fails to adequately manage these risks, its financial results, and its ability to pay distributions to unitholders and interest payments on debt and future financings may be adversely affected. Increases in interest rates generally cause a decrease in demand for properties. Higher interest rates and more stringent borrowing requirements, whether mandated by law or required by banks, could have a material adverse effect on the REIT's ability to sell any of its properties.

We may enter into financing commitments in the normal course of business and, as a result, may be required to fund these, particularly through joint arrangements. If we are unable to fulfill any of these commitments, damages could be pursued against the REIT.

### Lease Maturity Risk

We are subject to lease maturity risk as there is no assurance that we will be able to renew or replace expiring leases at similar terms. We manage our lease maturity risk by pro-actively engaging tenants whose leases are expiring for early identification of potential vacancy risk. In addition, where possible we ladder maturity dates to minimize exposure in any particular period and to maintain a diversified portfolio.

The following table illustrates the number of leases maturing over the next five years and beyond.

| Year of Maturity | Number of Leases | Renewal GLA (sf) | % of GLA | Average Base Rent Expiring Per Annum |
|---|---|---|---|---|
| 2015 | 104 | 322,473 | 11.8% | $12.49 |
| 2016 | 75 | 172,161 | 6.3% | $14.52 |
| 2017 | 92 | 274,705 | 10.0% | $16.78 |
| 2018 | 58 | 309,053 | 11.3% | $15.33 |
| 2019 | 66 | 300,155 | 11.0% | $14.85 |
| Thereafter | 175 | 1,149,859 | 42.0% | $15.88 |
| Vacant Space | — | 207,061 | 7.6% | — |
| | **570** | **2,735,467** | | **$15.25** |

The following table illustrates the 2015 maturities by portfolio type and geographic area:

| (sf) | Northern AB | Southern AB | BC & SK | Total |
|---|---|---|---|---|
| Retail | 61,808 | 1,593 | 4,083 | 67,484 |
| Office | 125,764 | 31,960 | 48,260 | 205,984 |
| Industrial | — | 49,005 | — | 49,005 |
| | 187,572 | 82,558 | 52,343 | 322,473 |

## Credit Risk

We are subject to credit risk as our tenants may not be able to fulfill their financial obligations on current balances and contracted future rents. We manage our credit risk through careful selection of tenants and look to obtain national tenants or tenants in businesses with a long standing history, or perform financial background checks including business plan review for smaller tenants. We manage our concentration risk by renting to an expansive tenant base, with no dependency on rents from any one specific tenant.

The following table illustrates the ten largest tenants for the portfolio, as measured by their percentage contribution to the total contracted future minimum lease payment for 2015 and corresponding areas leased by each tenant.

| Rank | Tenant (Operating Name) | % of Total Minimum Rent | Lease GLA (sf) | % of Total GLA | Remaining Term (yrs) | Locations | Credit Rating (S&P/Moody's/DBRS) |
|---|---|---|---|---|---|---|---|
| 1 | Alberta Health Services | 4.9% | 144,723 | 5.3% | 7 | 4 | --- |
| 2 | Government of Alberta | 4.7% | 109,652 | 4.0% | 6 | 5 | AAA /Aaa/ AAA |
| 3 | Royal Bank of Canada | 3.8% | 60,515 | 2.2% | 5 | 5 | AA-/Aa3/ AA |
| 4 | Melcor Developments Ltd. | 3.4% | 71,821 | 2.6% | 2 | 11 | --- |
| 5 | Shoppers Drug Mart | 3.0% | 44,228 | 1.6% | 12 | 3 | BBB+/-/ BBB |
| 6 | BasinTek LLC | 2.4% | 88,699 | 3.2% | 9 | 1 | --- |
| 7 | Fountain Tire Ltd. | 2.3% | 30,514 | 1.1% | 14 | 1 | --- |
| 8 | TD Bank | 1.7% | 25,675 | 0.9% | 7 | 4 | AA-/Aa1/ AA |
| 9 | The Brick Warehouse LP | 1.2% | 33,664 | 1.2% | 3 | 1 | --- |
| 10 | Select Engineering Consultants Ltd. | 1.1% | 23,432 | 0.9% | 12 | 1 | --- |

## Significant Ownership by Melcor

Melcor holds a 56.5% effective interest in the REIT, where each Class B LP Unit is attached to a Special Voting Unit of the REIT. Melcor also holds all of the Class C LP Units of the Partnership.

The Class C LP Units have been designed to provide Melcor with an interest in the Partnership that entitles Melcor to distributions, in priority to distributions to holders of the Class A LP Units and Class B LP Units in an amount, if paid, that is expected to be sufficient (without any additional amounts) to permit Melcor to satisfy amounts payable under the Retained Debt.

In addition, the DOT grants Melcor the right to nominate certain Trustees of the REIT based on Melcor's direct and indirect ownership interest in the REIT. For so long as Melcor maintains a significant effective interest in the REIT, Melcor will have the ability to exercise certain influence with respect to the affairs of the REIT and significantly affect the outcome of Unitholder votes, and may have the ability to prevent certain fundamental transactions. As a result, Melcor has the ability to influence many matters affecting the REIT.

Accordingly, the units may be less liquid and trade at a relative discount compared to such units in circumstances where Melcor did not have the ability to influence or determine matters affecting the REIT. Additionally, Melcor's significant effective interest in the REIT may discourage transactions involving a change of control of the REIT, including transactions in which an investor, as a holder of the units, might otherwise receive a premium for its units over the then-current market price.

Pursuant to the Exchange Agreement, each Class B LP Unit is exchangeable at the option of the holder for one Unit of the REIT (subject to customary anti-dilution adjustments). If Melcor exchanges some or all of its Class B LP Units for units and subsequently sells such units in the public market, the market price of the units may decrease. Moreover, the perception in the public market that these sales will occur could also produce such an effect.

## Dependence on Melcor

The REIT is dependent on Melcor for management, administrative and operations services relating to the REIT's business. The Asset Management Agreement has a term of 5 years, with automatic 5 year renewals, and may at times in the future not reflect current market terms for duties and responsibilities of Melcor. There is a risk that, because of the term and termination provisions of the Asset Management Agreement, termination of the Asset Management Agreement may be uneconomical for the REIT and accordingly not in the best interest of the REIT.

Should Melcor terminate the Asset Management Agreement or the Property Management Agreement, the REIT may be required to engage the services of an external asset manager and/or property manager. The REIT may be unable to engage an asset manager and/or property manager on acceptable terms, in which case the REIT's operations and cash available for distribution may be materially adversely affected. Alternatively, it may be able to engage an asset manager and/or property manager on acceptable terms or it may elect to internalize its external management structure, but the process undertaken to engage such manager(s) or to internalize management could be costly and time-consuming and may divert the attention of management and key personnel away from the REIT's business operations, which could materially adversely affect its financial condition.

Additionally, the Development and Opportunities Agreement provides that, subject to certain exceptions, the REIT will not engage a party other than Melcor or its affiliates to perform any of the services to be performed by Melcor pursuant to the Asset Management Agreement.

While the Trustees have oversight responsibility with respect to the services provided by Melcor pursuant to the Asset Management Agreement and the Property Management Agreement, the services provided by Melcor under such agreements will not be performed by employees of the REIT or the Partnership, but by Melcor directly, and through entities to which it may subcontract its duties. Further, the foregoing arrangements are subject to limited termination rights in favour of the REIT. As a result, Melcor directly, and indirectly through entities to which it may subcontract, has the ability to influence many matters affecting the REIT and the performance of its properties now and in the foreseeable future.

While the Melcor name and trade-mark and related marks and designs will be licensed to the REIT by Melcor under a non-exclusive, royalty-free trademark license agreement, such license will not be on a perpetual basis and may be terminated by Melcor at any time on 30 days' notice following the date of termination of the Asset Management Agreement. Termination of the license would require the REIT to rebrand its business, which could be costly and time-consuming and may divert attention of management and key personnel from the REIT's business operations, which could materially adversely affect its financial condition.

### Potential Conflicts of Interest with Melcor

Melcor's continuing businesses may lead to conflicts of interest between Melcor and the REIT. The REIT may not be able to resolve any such conflicts, and, even if it does, the resolution may be less favourable to the REIT than if it were dealing with a party that was not a holder of a significant interest in the REIT. The agreements that the REIT entered into with Melcor on Closing may be amended upon agreement between the parties, subject to applicable law and approval of the Independent Trustees. As a result of Melcor's significant holdings in the REIT, the REIT may not have the leverage to negotiate any required amendments to these agreements on terms as favourable to the REIT as those the REIT could secure with a party that was not a significant holder of units.

### Taxation Matters

Although we currently meet the requirements of the REIT Exception, there can be no assurance that the REIT will be able to qualify for the REIT Exception to not to be subject to the tax imposed by the SIFT Rules in future years.

The SIFT Rules may have an adverse impact on the REIT and the unitholders, on the value of the units and on the ability of the REIT to undertake financings and acquisitions and if the SIFT Rules were to apply, the distributable cash of the REIT may be materially reduced. The effect of the SIFT Rules on the market for the units is uncertain.

If certain tax proposals released on September 16, 2004 are enacted as proposed (the "September 16th Tax Proposals"), the REIT would cease to qualify as a "mutual fund trust" for purposes of the Tax Act if, at any time after 2004, the fair market value of all units held by non-residents, partnerships that are not Canadian partnerships or any combination of the foregoing is more than 50% of the fair market value of all issued and outstanding units unless not more than 10% (based on fair market value) of the REIT's property is at any time "taxable Canadian property" within the meaning of the Tax Act and certain other types of specified property. Restrictions on the ownership of units are intended to limit the number of units held by non-residents, such that non-residents, partnerships that are not Canadian partnerships or any combination of the foregoing may not own units representing more than 50% of the fair market value of all units. The September 16th Tax Proposals were not included in budget implementation and technical amendment bills including Bill C-52 of the First Session of the Thirty-Ninth Parliament, which received Royal Assent on June 22, 2007, Bill C-45 and Bill C-48 of the First Session of the Forty-First Parliament, 60-61 Elizabeth II, 2011-2012.

### Environmental Risk

The REIT is subject to various requirements (including federal, provincial and municipal laws) relating to the protection of the environment.

Under these requirements, the REIT could be, or become, liable for environmental or other harm, damage or costs, including with respect to the release of hazardous, toxic or other regulated substances into the environment and/or affecting persons, and the removal or other remediation of hazardous, toxic or other regulated substances that may be present at or under its properties.

Such requirements often impose liability without regard to whether the owner or operator knew of, or was responsible for, the release or presence of such substances. Additional liability may be incurred by the REIT with respect to the release of such substances from the REIT's properties to properties owned by third parties, including properties adjacent to the REIT's properties or with respect to the exposure of persons to such substances. The failure to remove or otherwise address such substances may materially adversely affect the REIT's ability to sell such property, maximize the value of such property or borrow using such property as collateral security, and could potentially result in claims or other proceedings against the REIT.

It is the REIT's operating policy to obtain, or be entitled to rely on, a Phase I environmental site assessment prior to acquiring a property. Where a Phase I environmental site assessment warrants further investigation, it is the REIT's operating policy to conduct further environmental investigations. Although such environmental assessments provide the REIT with some level of assurance about the condition of the properties, the REIT may become subject to liability for undetected contamination or other environmental conditions of its properties against which it cannot insure, or against which the REIT may elect not to insure where insurance premium costs are considered to be disproportionate to the assessed risk, which could have a material adverse effect on the REIT's business, cash flows, financial condition and results of operations and ability to make distributions to holders of units.

Environmental laws and other requirements can change and the REIT may become subject to more stringent environmental laws or other requirements in the future. Compliance with more stringent environmental laws or requirements, the identification of currently unknown environmental issues or an increase in the costs required to address a currently known condition may have a material adverse effect on the REIT's business, cash flows, financial condition and results of operations and ability to make distributions to holders of units.

Subject to the obligations of Melcor described above, the REIT will bear the risk of assessment, remediation or removal of such contamination, hazardous substances or other residual pollution. The discovery of any such residual pollution on the sites and/or in the buildings, particularly in connection with the lease or sale of properties or borrowing using the real estate as security, could trigger claims for rent reductions or termination of leases for cause, for damages and other breach of warranty claims against the REIT. The remediation of any contamination and the related additional measures the REIT would have to undertake could have a materially adverse effect and could involve considerable additional costs that the REIT may have to bear. The REIT will also be exposed to the risk that recourse against the polluter or the previous owners or occupants of the properties might not be possible, for example, because they cannot be identified, no longer exist or have become insolvent. Moreover, the existence or even the mere suspicion of the existence of contamination, hazardous materials or other residual pollution can materially adversely affect the value of a property and our ability to lease or sell such a property.

The REIT employs a rigorous due diligence process, including obtaining a Phase I environmental site assessment, prior to acquiring property to mitigate its exposure to these potential issues.

### Joint Arrangements

Some of our properties are jointly owned. These joint arrangements may involve risks that would not otherwise be present if the third parties were not involved, including the possibility that the partners have different economic or business interests or goals. Also, within these arrangements, the REIT may not have sole control of major decisions relating to these assets, such as: decisions relating to the sale of the assets and businesses, timing and amount of distributions of cash from such entities to the REIT and its joint arrangement partners, and capital expenditures.

## Other Financial Information

### Joint Arrangements

We record only our share of the assets, liabilities, revenue and expenses of our joint arrangements. In 2014, we had three joint arrangements (2013 - three). Refer to note 22 to the consolidated financial statements for additional information. The following table illustrates selected financial data related to joint arrangements at 100% as well as the net portion relevant to the REIT:

| | Joint arrangement activity at JV% | | Joint arrangement activity at 100% | |
|---|---|---|---|---|
| ($000s) | 2014 | 2013 | 2014 | 2013 |
| Revenue | **3,867** | 3,741 | **7,734** | 7,482 |
| Earnings | **1,586** | 4,138 | **3,172** | 8,276 |
| Assets | **52,389** | 48,712 | **104,778** | 97,424 |
| Liabilities | **24,612** | 22,472 | **49,224** | 44,944 |

### Related Party Transactions

Please refer to note 22 to the consolidated financial statements for information pertaining to transactions with related parties.

### Subsequent Events

Please refer to note 28 to the consolidated financial statements for information pertaining to subsequent events.

### Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with IFRS. In applying IFRS, we make estimates and assumptions that affect the carrying amounts of assets and liabilities, disclosure of contingent liabilities and the reported amount of income for the period. Actual results could differ from estimates previously reported. We have discussed the development, selection and application of our key accounting policies, and the critical accounting estimates and assumptions they involve, with the Audit Committee and the Board of Trustees.

Our significant accounting policies and accounting estimates are contained in the consolidated financial statements. Please refer to note 3 to the consolidated financial statements for a description of our accounting policies and note 4 for a discussion of accounting estimates and judgments.

### Changes in Accounting Policies

Refer to note 5 to the consolidated financial statements for information pertaining to accounting pronouncements that will be effective in future years.

## Internal Control over Financial Reporting & Disclosure Controls

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant and material information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), in a timely manner. Under the supervision of the CEO and CFO, we carried out an evaluation of the effectiveness of our disclosure controls and procedures as defined in Canada by National Instrument 52-109 as of December 31, 2014. Based on this evaluation, our CEO and CFO concluded that the design and operation of our disclosure controls and procedures related to the REIT and its subsidiaries and joint arrangements were effective.

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Management designed these controls based on the criteria set out in Internal Control - Integrated Framework (COSO 2013 Framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The CEO and CFO have certified that the internal controls over financial reporting were properly designed and effective for the year ended December 31, 2014.

There has been no change in the REIT's disclosure controls and procedures of internal control over financial reporting during the year ended December 31, 2014, that materially affected, or is reasonably likely to materially affect, the REIT's internal control over financial reporting.

Notwithstanding the foregoing, no assurance can be made that the REIT's controls over disclosure and financial reporting and related procedures will detect or prevent all failures of people to disclose material information otherwise required to be set forth in the REIT's reports.

# Non-standard Measures

Throughout this MD&A, we refer to terms that are not specifically defined in the CPA Canada Handbook or in IFRS. These non-standard measures may not be comparable to similar measures presented by other companies.

We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results.

The non-standard terms that we refer to in this MD&A are defined below.

## Calculations

We use the following calculations in measuring our performance.

**Net operating income (NOI):** NOI is defined as rental revenue, adjusted for amortization of tenant improvements and straight-line rent adjustments, less direct operating expenses as presented in the statement of income and comprehensive income. A reconciliation of NOI to the most comparable IFRS measure, net income, is as follows:

| | Three Months Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Net income for the period | 9,481 | 7,466 | |
| Income tax (recovery) expense | — | — | |
| Net finance costs | 4,520 | 3,738 | |
| Fair value loss on Class B LP Units | (4,616) | 3,521 | |
| Fair value adjustment on investment properties | (3,196) | (9,488) | |
| General and administrative expenses | 652 | 459 | |
| Amortization of tenant incentives | 780 | 616 | |
| Straight-line rent adjustment | (141) | (81) | |
| NOI | 7,480 | 6,231 | 20% |

| | Year Ended December 31 | | |
|---|---|---|---|
| ($000s) | 2014 | 2013 | Change |
| Net income for the period | 18,348 | 62,719 | |
| Income tax (recovery) expense | — | (40,261) | |
| Net finance costs | 16,140 | 12,350 | |
| Fair value (gain) loss on Class B LP Units | (9,880) | 3,812 | |
| Fair value adjustment on investment properties | (93) | (16,953) | |
| General and administrative expenses | 2,134 | 1,728 | |
| Amortization of tenant incentives | 2,539 | 2,297 | |
| Straight-line rent adjustment | (607) | (397) | |
| NOI | 28,581 | 25,295 | 13% |

**Same-asset NOI:** this measure compares the NOI, less amortization on tenant incentives, plus straight-line rent adjustment, on assets that have been owned for the entire current and comparative period.

**Funds from operations (FFO):** FFO is defined as net income in accordance with IFRS, excluding: (i) fair value adjustments on investment properties; (ii) gains (or losses) from sales of investment properties; (iii) amortization of tenant incentives; (iv) fair value adjustments, interest expense and other effects of redeemable units classified as liabilities; (v) acquisition costs expensed as a result of the purchase of a property being accounted for as a business combination; and (vi) deferred income tax expense, after adjustments for equity accounted entities, joint ventures and non-controlling interests calculated to reflect FFO on the same basis as consolidated properties.

**Adjusted funds from operations (AFFO):** AFFO is defined as FFO subject to certain adjustments, including: (i) amortization of fair value mark-to-market adjustments on mortgages acquired; (ii) interest rate subsidy amounts received; (iii) non-cash finance costs; (iv) adjusting for any differences resulting from recognizing property revenues on a straight-line basis; (v) deducting a reserve for normalized maintenance capital expenditures, tenant inducements and leasing costs, as determined by us. Other adjustments may be made to AFFO as determined by the Board in its discretion.

**Operating margin:** is calculated as net rental income divided by rental revenue.

**Debt to Gross Book Value:** is calculated as the sum of total amount drawn on revolving credit facility, mortgages payable, Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units and convertible debenture, excluding unamortized discount and transaction costs divided by the total asset value assumed on acquisition of the Initial Properties plus total assets acquired from third parties subsequently.

**Finance costs coverage ratio:** is calculated as FFO plus finance costs for the period divided by finance costs expensed during the period, less distributions on Class B LP Units.

**Debt service coverage ratio:** is calculated as FFO for the period divided by principal repayments on mortgages payable and Class C LP Units made during the period.

**Payout ratio:** is calculated as per unit distributions divided by per unit AFFO.

## Management's Responsibility for Financial Reporting

The consolidated financial statements, Management's Discussion and Analysis (MD&A) and all financial information contained in the annual report are the responsibility of management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, have incorporated estimates based on the best judgment of management.

To discharge its responsibility for financial reporting, management is responsible for implementing and maintaining adequate internal controls to provide reasonable assurance that the Trust's assets are safeguarded, that transactions are properly authorized and that reliable financial information is relevant, accurate and available on a timely basis.

The consolidated financial statements have been examined by PricewaterhouseCoopers LLP, the Trust's external auditors. The external auditors are responsible for examining the consolidated financial statements and expressing their opinion on the fairness of the financial statements in accordance with International Financial Reporting Standards. The auditor's report outlines the scope of their audit examination and states their opinion.

The Board of Trustees, through the Audit Committee, is responsible for ensuring management fulfils its responsibilities for financial reporting and internal controls. The Audit Committee is comprised of three financially literate and independent directors. This committee meets regularly with management and the external auditors to review significant accounting, financial reporting and internal control matters. PricewaterhouseCoopers LLP have unrestricted access to the Audit Committee with and without the presence of management. The Audit Committee reviews the financial statements, the auditor's report, and MD&A and submits its report to the Board of Trustees for formal approval. The Audit Committee is also responsible for reviewing and recommending the annual appointment of external auditors and approving the external audit plan. These consolidated financial statements and Management's Discussion and Analysis have been approved by the Board of Trustees for inclusion in the annual report based on the review and recommendation of the Audit Committee.

**Darin Rayburn**
Chief Executive Officer

**Jonathan Chia, CA**
Chief Financial Officer

Edmonton, Alberta
March 2, 2015

## Auditors' Report to Unitholders

We have audited the accompanying consolidated financial statements of Melcor Real Estate Investment Trust and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013 and the consolidated statements of income and comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Melcor Real Estate Investment Trust and its subsidiaries as at December 31, 2014 and December 31, 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

**Chartered Accountants**
Edmonton, Alberta
March 2, 2015

# Consolidated Statements of Financial Position

| As at December 31 ($000s) | 2014 | 2013 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | **6,712** | 5,932 |
| Accounts receivable | **2,877** | 1,478 |
| Other assets (note 9) | **943** | 1,015 |
| | **10,532** | 8,425 |
| Non-Current Assets | | |
| Restricted cash | **2,945** | 5,969 |
| Investment properties (note 8 and 27) | **630,003** | 429,117 |
| Other assets (note 9) | **14,285** | 11,232 |
| | **647,233** | 446,318 |
| TOTAL ASSETS | **657,765** | 454,743 |
| LIABILITIES | | |
| Current Liabilities | | |
| Revolving credit facility (note 10) | **4,958** | 23,748 |
| Accounts payable | **1,297** | 1,989 |
| Distribution payable | **1,456** | 1,050 |
| Accrued liabilities and other payables (note 11) | **6,295** | 3,690 |
| Class C LP Units (note 13) | **25,825** | 3,059 |
| Mortgages payable (note 12) | **20,957** | 19,911 |
| | **60,788** | 53,447 |
| Non-Current Liabilities | | |
| Accrued liabilities and other payables (note 11) | **1,360** | 1,459 |
| Class B LP Units (note 15 and 27) | **138,266** | 99,120 |
| Class C LP Units (note 13) | **64,923** | 91,188 |
| Mortgages payable (note 14) | **194,002** | 78,911 |
| Convertible debenture (note 14) | **31,780** | — |
| Derivative financial liability (note 14) | **185** | — |
| TOTAL LIABILITIES | **491,304** | 324,125 |
| UNITHOLDERS' EQUITY | **166,461** | 130,618 |
| TOTAL LIABILITIES AND UNITHOLDERS' EQUITY | **657,765** | 454,743 |

*See accompanying notes to the consolidated financial statements*

On behalf of the REIT's Board of Trustees:

Audit Committee Chair

Andrew Melton
Chairman

# Consolidated Statements of Income & Comprehensive Income

| For the years ended December 31 ($000s) | 2014 | 2013 |
|---|---|---|
| Rental revenue (note 17 and 22) | **44,509** | 39,325 |
| Direct operating expenses (note 22) | **(17,860)** | (15,930) |
| Net rental income | **26,649** | 23,395 |
| General and administrative expenses (note 22) | **(2,134)** | (1,728) |
| Fair value adjustment on investment properties (note 8 and 27) | **93** | 16,953 |
| Fair value adjustment on Class B LP Units (note 15 and 27) | **9,880** | (3,812) |
| Income before finance costs and income taxes | **34,488** | 34,808 |
| Interest income | **72** | 61 |
| Finance costs (note 18 and 22) | **(16,212)** | (12,411) |
| Net finance costs | **(16,140)** | (12,350) |
| Net income before income taxes | **18,348** | 22,458 |
| Deferred income tax recovery (note 19) | **—** | 40,261 |
| Income tax recovery | **—** | 40,261 |
| Net income and comprehensive income | **18,348** | 62,719 |

*See note 21 for basic and diluted earnings per trust unit.*

*See accompanying notes to the consolidated financial statements*

# Consolidated Statements of Changes in Unitholders' Equity

| ($000s except unity amounts) | Number of Trust Units | Trust Units | Contributed Surplus | Divisional Surplus | Retained Earnings | Total Unitholders' Equity |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2012** | — | — | — | 168,331 | — | 168,331 |
| Net income for the period January 1, 2013 to April 30, 2013 (note 20) | — | — | — | 47,524 | — | 47,524 |
| Net distributions to Melcor Developments Ltd. | — | — | — | (7,447) | — | (7,447) |
| **Balance at April 30, 2013** | — | — | — | 208,408 | — | 208,408 |
| Reorganization and recapitalization (note 6 and 16) | 8,300,000 | 74,409 | 36,823 | (208,408) | — | (97,176) |
| Conversion of Class B LP Units (note 6 and 15) | 830,000 | 8,300 | — | — | — | 8,300 |
| Net income for the period May 1, 2013 to December 31, 2013 (note 20) | — | — | — | — | 15,195 | 15,195 |
| Distributions to unitholders | — | — | — | — | (4,109) | (4,109) |
| **Balance at December 31, 2013** | 9,130,000 | 82,709 | 36,823 | — | 11,086 | 130,618 |
| Issuance of units (note 16) | **2,145,000** | **21,250** | **—** | **—** | **—** | **21,250** |
| Property purchase from Melcor Developments Ltd. (note 7 and 15) | **—** | **—** | **125** | **—** | **—** | **125** |
| Property purchase from Melcor Developments Ltd. (note 7 and 15) | **—** | **—** | **3,248** | **—** | **—** | **3,248** |
| Net income for the year | **—** | **—** | **—** | **—** | **18,348** | **18,348** |
| Distributions to unitholders | **—** | **—** | **—** | **—** | **(7,128)** | **(7,128)** |
| **Balance at December 31, 2014** | **11,275,000** | **103,959** | **40,196** | **—** | **22,306** | **166,461** |

*See accompanying notes to the consolidated financial statements*

# Consolidated Statements of Cash Flows

| For the years ended December 31 ($000s) | 2014 | 2013 |
|---|---|---|
| **CASH FLOWS FROM (USED IN)** | | |
| **OPERATING ACTIVITIES** | | |
| Net income for the year | **18,348** | 62,719 |
| Non-cash items: | | |
| Amortization of tenant incentives (note 9 and 17) | **2,539** | 2,297 |
| Straight-line rent adjustments (note 17) | **(607)** | (397) |
| Fair value adjustment on investment properties (note 8 and 27) | **(93)** | (16,953) |
| Fair value adjustment on Class B LP Units (note 15 and 27) | **(9,880)** | 3,812 |
| Amortization of fair value adjustment on Class C LP Units (note 18) | **(440)** | (293) |
| Non-cash finance costs (note 18) | **273** | 108 |
| Deferred income tax recovery (note 19) | **—** | (40,261) |
| | **10,140** | 11,032 |
| Changes in operating assets and liabilities (note 3o) | **(888)** | (530) |
| | **9,252** | 10,502 |
| **INVESTING ACTIVITIES** | | |
| Additions to investment properties (note 7 and 8) | **(49,607)** | (25,851) |
| Payment of tenant incentives (note 9) | **(4,985)** | (2,052) |
| Investment property improvements, development and direct leasing costs (note 8) | **(4,440)** | (3,823) |
| Change in restricted cash | **2,037** | (3,141) |
| | **(56,995)** | (34,867) |
| **FINANCING ACTIVITIES** | | |
| Proceeds from issuing units, net of costs (note 16) | **21,250** | 74,409 |
| Proceeds from issuing convertible debenture, net of costs (note 14) | **31,927** | — |
| Acquisition of Initial Properties (note 6) | **—** | (66,016) |
| Change in revolving credit facility | **(19,000)** | 24,000 |
| Proceeds from mortgages payable | **48,405** | 67,000 |
| Repayment of mortgages payable | **(25,265)** | (53,435) |
| Repayment on Class C LP Units | **(3,059)** | (1,966) |
| Change in restricted cash | **987** | (2,828) |
| Net distribution to Melcor Developments Ltd. | **—** | (7,447) |
| Distributions to unitholders | **(6,722)** | (4,109) |
| | **48,523** | 29,608 |
| **INCREASE IN CASH & CASH EQUIVALENTS DURING THE YEAR** | **780** | 5,243 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR** | **5,932** | 689 |
| **CASH AND CASH EQUIVALENTS, END OF THE YEAR** | **6,712** | 5,932 |

*See accompanying notes to the consolidated financial statements*

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

## 1. DESCRIPTION OF THE TRUST

Melcor Real Estate Investment Trust (the "REIT" or "we") is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust ("DOT") dated January 25, 2013 and subsequently amended and restated May 1, 2013.

The REIT began operations on May 1, 2013 when its trust units were issued for cash pursuant to the initial public offering ("IPO").

The principal business of the REIT is to acquire, own and manage office, retail and industrial properties in select target markets in Western Canada. The REIT is externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the Property Management Agreement and Asset Management Agreement (see note 22).

As at March 2, 2015, Melcor, through an affiliate, holds an approximate 56.5% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

The REIT is governed under the laws of the Province of Alberta. The registered office of the REIT is located at Suite 900, 10310 Jasper Avenue Edmonton, Alberta, Canada. Our trust units are traded on the Toronto Stock Exchange under the symbol "MR.UN".

## 2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standard Board ("IASB").

As Melcor retained control over the REIT, the May 1, 2013 IPO and acquisition of the Initial Properties was accounted for as a reorganization and recapitalization using the continuity of interests method. Financial information for the pre-acquisition period as included in the comparative period is presented based on historical combined financial information for the Initial Properties as previously reported by Melcor.

These consolidated financial statements are presented in Canadian dollars, which is the presentation and functional currency of the REIT; and were authorized for issue by the Board of Trustees on March 2, 2015.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

### A. BASIS OF MEASUREMENT

These consolidated financial statements have been prepared under the historical cost convention, except for investment properties and Class B LP Units which are measured at fair value.

We prepare our consolidated financial statements in conformity with IFRS which requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Changes in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions change. We believe that the underlying assumptions are appropriate. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

### B. BASIS OF CONSOLIDATION

#### *I. SUBSIDIARIES*

Subsidiaries are entities controlled by the REIT. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. These consolidated financial statements include the accounts of the REIT and its subsidiaries, its controlled partnership Melcor REIT Limited Partnership (the "Partnership"), and its general partner, Melcor REIT GP Inc.

#### *II. JOINT ARRANGEMENTS*

These arrangements are undivided interests in the assets, liabilities, revenues and expenses under arrangement and we record our proportionate share in accordance with the agreements as joint operations. These consolidated financial statements include investments in three joint arrangements (2013 – three) with 50% interests. Refer to note 23 for additional details on our joint arrangements.

All intercompany transactions and balances are eliminated on consolidation.

### C. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired.

### D. RESTRICTED CASH

Restricted cash can only be used for specified purposes. The REIT's restricted cash represents subsidies funded by Melcor as part of the IPO to subsidize finance costs on assumed debt and Class C LP Units, and to fund capital expenditures, environmental expenditures, tenant incentives and lease costs.

### E. INVESTMENT PROPERTIES

Investment properties include commercial and industrial properties, and a manufactured home community held for the long term to earn rental income or for capital appreciation, or both. It also includes property under development for future use as investment properties.

Acquired investment properties are measured initially at cost, including transaction costs associated with the acquisition when the acquisition is accounted for as an asset purchase. Costs capitalized to properties under development include direct development and construction costs, borrowing costs, and property taxes.

After initial recognition, investment properties are recorded at their fair value, which is determined by either a direct capitalization or discounted projected future cash flows approach based on property specific capitalization rates. Valuations are performed as of the period end date by independent, external professional valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued. The fair value of investment property reflects, among other things, rental income from current leases and assumptions about rental income from future leases based on current market conditions. The value also reflects any cash outflows that could be expected in respect of the property. Changes in fair value are recognized in the consolidated statement of income.

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

Fair value measurement of an investment property under development is only applied if the fair value is considered to be reliably measurable. In rare circumstances, investment property under development is carried at cost until its fair value becomes reliably measurable. It may sometimes be difficult to determine reliably the fair value of an investment property under development. In order to evaluate whether the fair value of an investment property under development can be determined reliably, management considers the following factors, among others:

- the provisions of the construction contract;
- the stage of completion;
- whether the project or property is standard (typical for the market) or non-standard;
- the level of reliability of cash inflows after completion;
- the development risk specific to the property;
- past experience with similar construction; and
- status of construction permits.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to the REIT and the cost of the item can be measured reliably. All repairs and maintenance costs are expensed when incurred.

Initial direct leasing costs incurred in negotiating and arranging tenant leases are added to the carrying amount of investment properties. All direct leasing costs are external expenditures, including those charged under the Property Management Agreement with Melcor (note 22), and no amounts for internal allocations are capitalized with respect to the negotiation or arranging of tenant leases.

## F. OTHER ASSETS

Other assets include prepaid expenses, deposits, straight-line rent adjustments and tenant incentives incurred in respect of new or renewed leases. Tenant incentives are amortized on a straight-line basis over the lease term and are recorded as a reduction of revenue.

## G. PROVISION FOR DECOMMISSIONING OBLIGATION

Decommissioning obligations are measured at the present value of the expected cost to settle the obligation. A corresponding decommissioning cost is added to the carrying amount of the associated investment property. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows as well as any changes in the discount rate. Actual costs incurred upon settlement of the decommissioning obligation are recorded against the provision.

## H. CLASS B LP UNITS

The Class B LP Units are exchangeable into trust units at the option of the holder and, therefore, are considered a puttable instrument in accordance with International Accounting Standard ("IAS") 32, Financial instruments — presentation ("IAS 32"). The Class B LP Units, as puttable instruments, are required to be accounted for as financial liabilities. The Class B LP Units are designated as fair value through profit or loss financial liabilities and are remeasured to fair value at each period end date based on the trading price of the trust units at the period end date with any changes in fair value recognized in the consolidated statements of income and comprehensive income. Distributions declared on Class B LP Units are recorded as finance costs in the statement of income and comprehensive income.

## I. UNIT CAPITAL

The trust units are redeemable at the option of the holders and, therefore, are considered a puttable instrument in accordance with IAS 32. Puttable instruments are required to be accounted for as financial liabilities, except where certain conditions are met in accordance with IAS 32, in which case, the puttable instruments may be presented as equity. The trust units meet the conditions of IAS 32 and are, therefore, classified and accounted for as equity.

## J. DISTRIBUTIONS

Distributions to unitholders are recognized as a liability in the period in which the distributions are approved by the Board of Trustees and are recorded as a reduction of retained earnings.

## K. RECOGNITION OF REVENUE

Tenant leases are accounted for as operating leases given that we have retained substantially all of the risks and benefits of the ownership of our investment properties. Revenue from investment properties includes base rents, recoveries of operating expenses including property taxes, parking revenue and incidental income. Revenue recognition under a lease commences when the tenant has a right to use the leased asset. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease; a straight-line rent receivable, which is included in other assets, is recorded for the difference between the rental revenue recognized and the contractual amount received. When incentives are provided to our tenants, the cost of these incentives is recognized over the lease term, on a straight-line basis, as a reduction to rental revenue. Recoveries from tenants are recognized as revenues in the period in which the corresponding costs are incurred. Other revenues are recorded as earned.

## L. FINANCE COSTS

Finance costs are comprised of interest expense on mortgages, interest and other finance fees on our credit facility, interest on Class C LP Units, amortization of fair value adjustment on Class C LP Units, distributions on Class B LP Units, interest on convertible debenture, and non-cash financing costs. Borrowing costs are recognized in income using the effective interest rate method.

## M. INCOME TAXES

The REIT qualifies as a mutual fund trust within the meaning of the Income Tax Act (Canada) ("Tax Act") and as a real estate investment trust eligible for the 'REIT Exception', as defined in the rules applicable to Specified Investment Flow-Through ("SIFT") trusts and partnerships in the Tax Act. We expect to allocate all taxable income and to continue to qualify for the REIT Exception. Accordingly, no income tax expense or deferred income tax assets or liabilities have been recorded in these consolidated financial statements subsequent to the formation of the REIT.

## N. FINANCIAL INSTRUMENTS

At initial recognition, we classify our financial instruments in the following categories depending on the purpose for which the instruments were acquired:

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

***LOANS AND RECEIVABLES***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans to third parties and receivables are initially recognized at fair value plus transaction costs. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less a provision for impairment, if necessary. Loans and receivables are comprised of accounts receivable, cash and cash equivalents and restricted cash.

At each reporting date, we assess whether there is objective evidence that a financial asset is impaired, considering delinquencies in payments and financial difficulty of the debtor. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through use of an allowance account. The amount of any losses is recognized in income.

***FINANCIAL LIABILITIES***

We record our financial liabilities at fair value on initial recognition. Subsequently, "other liabilities" are measured at amortized cost using the effective interest rate method and financial liabilities designated as fair value through profit or loss ("FVTPL") are remeasured at fair value with changes in their fair value recorded through income. Other liabilities include the revolving credit facility, accounts payable, accrued liabilities and other payables, distributions payable, mortgages payable, and Class C LP Units. Class B LP Units are classified as FVTPL.

***COMPOUND FINANCIAL INSTRUMENT***

Our compound financial instrument is comprised of a convertible debenture that can be converted to trust units at the option of the holder, and the number of units to be issued does not vary with changes in their fair value. We also have the ability to redeem the debenture at a price equal to the principal amount thereof plus accrued and unpaid interest. We also have the ability to convert the debenture into trust units; however, the number of units to be issued at conversion varies with the market price of the units.

On initial recognition, the convertible debenture is separated into two financial liability components: the host instrument and the conversion feature. The conversion feature is required to be presented as a financial liability as the feature permits the holder to convert the debenture into trust units that, except for the available exemption under IAS 32, would normally be presented as a liability due to their redemption feature. Both components are measured based on their respective estimated fair values at the date of issuance. The host instrument financial liability is recognized initially at the fair value of a similar liability that does not have a conversion feature. The conversion feature is recognized at fair value. The fair value of the host instrument is recorded net of any related transaction costs.

Subsequent to initial recognition, the host instrument is measured at amortized cost using the effective interest method. The conversion feature derivative of the convertible debenture is classified as FVTPL and measured at fair value.

***FINANCIAL DERIVATIVES***

Our financial derivative is comprised of the conversion feature on our convertible debenture. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and subsequently remeasured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Derivative liabilities are recorded in the consolidated statement of financial position at their fair value. Changes in fair value of derivative liabilities that are not designated as hedges for accounting purposes are recognized in the income statement.

The REIT has not designated any derivatives as hedges for accounting purposes.

### O. STATEMENTS OF CASH FLOWS

Operating assets and liabilities is defined as the net change of accounts receivable, prepaid expense, and other, accounts payable, distribution payable and accrued liabilities and other payables. Investment property additions that are unpaid and included in accounts payable at year end are excluded from operating assets and liabilities.

## 4. SIGNIFICANT JUDGMENTS AND CRITICAL ACCOUNTING ESTIMATES

Estimates and judgments are continually evaluated and are based on historical experience and adjusted for current market conditions and other factors.

***SIGNIFICANT JUDGMENTS***

In the process of applying our accounting policies, we make various judgments, apart from those involving estimations, that can significantly impact the amounts recognized in the consolidated financial statements. These include:

### A. BUSINESS COMBINATIONS UNDER COMMON CONTROL

Business combinations under common control ("BCUCC") are business combinations involving entities or businesses under common control, in which all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination. BCUCC are not within the scope of IFRS 3, Business combinations.

As the REIT was a newly formed entity in 2013 and Melcor retained control over the REIT, the IPO and acquisition of the Initial Properties was accounted for as a reorganization and recapitalization using the continuity of interests method. Under this method, the REIT records the assets acquired and liabilities assumed at their carrying amounts on the closing date of the transaction. The difference between the consideration given and the aggregate value of the net assets acquired is recorded as an adjustment to unitholders' equity. Refer to note 6 for details of the accounting treatment for the acquisition of the Initial Properties. Financial information for the pre-acquisition period, as included in the comparative period is presented based on historical combined financial information for the Initial Properties as previously reported by Melcor. Refer to note 20 for statement of income and comprehensive income and statement of cash flows for the period disaggregated by the activities of the REIT, and its predecessor, Melcor.

### B. INVESTMENT PROPERTIES

Our accounting policies related to investment properties are described in note 3e. In applying this policy, judgment is required in determining whether certain costs are additions to the carrying amount of an investment property.

In determining the fair value of our investment property, judgment is required in assessing the 'highest and best use' as required under IFRS 13, Fair value measurement. We have determined that the current use of our investment properties is its 'highest and best use'.

### C. CLASSIFICATION OF TENANT INCENTIVES

Payments are often made to, or on behalf of, tenants of our commercial properties when new leases are signed. When the payments add future value to the space independent of the lease in place, such costs are capitalized to the investment property. If the costs incurred are specific to the lessee, and do not have stand-alone value, these costs are treated as tenant incentives and amortized on a straight-line basis to revenue over the lease term in accordance with SIC 15, Operating leases – incentives.

### D. COMPLIANCE WITH REIT EXEMPTION UNDER ITA

Under current tax legislation, a real estate investment trust is not liable for Canadian income taxes provided that its taxable income is fully allocated to unitholders during the year. In order to continue to be taxed as a mutual fund trust, we need to maintain our REIT status. At inception, we qualify as a REIT under the Specified Investment Flow-Through ("SIFT") rules in the Income Tax Act (Canada). The REIT's current and continuing qualification as a REIT depends on our ability to meet the various requirements imposed under the SIFT rules, which relate to matters such as our organizational structure and the nature of our assets and revenues. We apply judgment in determining whether it continues to qualify as a REIT under the SIFT rules. Should we cease to qualify, we would be subject to income tax on our earnings and would reflect current and deferred tax balances on our consolidated financial statements.

#### *CRITICAL ACCOUNTING ESTIMATES*

We make estimates and assumptions that affect the carrying amounts of assets and liabilities, disclosure of contingent liabilities and the reported amount of income for the period. Actual results could differ from estimates previously reported. The estimates and assumptions that are critical to the determination of the amounts reported in the consolidated financial statements relate to the following:

### VALUATION OF INVESTMENT PROPERTIES

Investment properties are valued using either a direct capitalization or discounted cash flow approach, as completed by qualified external professional valuators with key assumptions reviewed and updated quarterly. Key estimates and assumptions include expected occupancy rates and lease payments, expenditures for operating costs and capital expenditures as well as discount and capitalization rate. Refer to note 8 and 27 for further information about methods and assumptions used in determining fair value.

## 5. NEW STANDARDS

#### *NEW STANDARDS ADOPTED*

We have adopted the following new standard interpretation effective January 1, 2014.

**IFRIC 21, Levies** is an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets'. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.

The REIT is not subject to significant levies, other than with respect to property taxes. The adoption of IFRIC 21 did not result in a change in the recognition or timing of recognition of levies imposed on the REIT.

Other standards, amendments and interpretations that are effective for the year beginning January 1, 2014 are not material to the REIT.

#### *NEW STANDARDS NOT YET ADOPTED*

**IFRS 15, Revenue from Contracts with Customers** was issued in May 2014 by the IASB and supersedes IAS 18, 'Revenue', IAS 11, 'Construction Contracts' and other interpretive guidance associated with revenue recognition. IFRS 15 provides a single model to determine how and when an entity should recognize revenue, as well as requiring entities to provide more informative, relevant disclosures in respect of its revenue recognition criteria.

IFRS 15 is to be applied retrospectively or through the recognition of the cumulative effect to opening retained earnings and is effective for accounting periods beginning on or after January 1, 2017, with earlier application permitted, subject to Canadian adoption.

**IFRS 9, Financial instruments** was issued in its finalized version in July 2014 to replace IAS 39. The IASB has previously published versions of IFRS 9 that introduced a new classification and measurement model with only two classification categories, 'amortized cost' and 'fair value' (in 2009 and 2010), and a new hedge accounting model in 2013.

This final version introduces a third measurement category, 'fair value through other comprehensive income', for financial assets, as well as an expected loss impairment model that requires more timely recognition of expected credit losses. Additional disclosures on transition from IAS 39 to IFRS 9 will be required under IFRS 7, the application of which is effective on adoption of IFRS 9.

IFRS 9 is required to be applied for accounting periods beginning on or after January 1, 2018, with earlier adoption permitted.

**IFRS 8, Operating segments** was amended to require disclosure of the judgements made by management in aggregating operating segments. This includes a description of the segments which have been aggregated and the economic indicators which have been assessed in determining that the aggregated segments share similar economic characteristics. The standard was further amended to require a reconciliation of segment assets to the entity's assets when segment assets are reported.

This amendment is effective for years beginning on or after July 1, 2014.

**IAS 24, Related party transactions** was amended to include, as a related party, an entity that provides key management personnel services to the reporting entity or to the parent of the reporting entity ('the management entity').

This amendment is effective for years beginning on or after July 1, 2014.

We are currently assessing the impact of adopting these standards on our consolidated financial statements.

## 6. ACQUISITION OF INITIAL PROPERTIES

On May 1, 2013, the REIT completed the purchase of 27 income-producing properties located in Western Canada, comprised primarily of retail, office and industrial properties (the "Initial Properties") from Melcor Developments Ltd. ("Melcor") with a carrying value of $397,896. As part of the acquisition of the Initial Properties, the REIT also assumed mortgages on certain properties totaling $92,360 at April 30, 2013. Deferred financing fees of $97 were netted against the assumed mortgages. In addition, the working capital, which is comprised of cash balances,

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accounts receivable, prepaid expenses, accounts payable and accrued liabilities, and other liabilities were transferred on closing. The purchase price was satisfied with cash consideration of $66,016 and issuance of 10,360,798 Class B LP Units of the Partnership. Melcor retained the debt on certain properties (the "Retained Debt") with a fair value of $96,506 at April 30, 2013. In consideration of the Retained Debt, Melcor received Class C LP Units of the Partnership on which it will receive priority distributions.

The allocation of the purchase price to the assets acquired and liabilities assumed, based on their carrying values at the date of acquisition, is as follows:

| | |
|---|---|
| **Net assets acquired:** | |
| Real estate properties | 397,896 |
| Working capital, net | (2,680) |
| Assumed mortgages | (92,263) |
| | **302,953** |
| **Distributions to Melcor** | |
| Class C LP Units | 96,506 |
| Class B LP Units | 103,608 |
| Cash paid out by the REIT | 66,016 |
| | 266,130 |
| **Net contribution by Melcor** | **36,823** |

On May 10, 2013, the underwriters exercised, in full, their over-allotment option to purchase an additional 830,000 trust units from Melcor. The transaction resulted in an increase in unitholders' equity of $8,300 (underwriters' fee was paid by Melcor) and a decrease in Class B LP Units of $8,300.

Following closing of the over-allotment option, Melcor, through an affiliate, held an approximate 51.1% effective interest in the REIT through ownership of all remaining 9,530,798 Class B LP Units. As Melcor retained control over the REIT, the transaction constitutes a business combination under common control which is outside the scope of IFRS 3 – Business combinations. The IPO and acquisition of the Initial Properties by the REIT was accounted for as a reorganization and recapitalization using the continuity of interests method, where by the REIT recorded the assets acquired and liabilities assumed at their carrying amounts. The difference between the consideration given and the aggregate value of the net assets acquired was recorded as an adjustment to unitholders' equity.

Transaction costs directly related to the IPO and acquisition of the Initial Properties were $8,591 and were charged directly to unitholders' equity.

## 7. INVESTMENT PROPERTY ACQUISITIONS

### *ACQUIRED FROM MELCOR*

On May 9, 2014, we completed the purchase of two multi-tenant retail properties from Melcor (the "May 2014 Melcor Acquisition") for a purchase price of $13,500 (an additional $75 in transaction costs were capitalized to the properties). The REIT satisfied approximately $7,400 of the purchase price of the May 2014 Melcor Acquisition by issuing 694,836 Class B LP Units at $10.65 per unit (note 15). The remainder of the purchase price was funded through the REIT's line of credit and available cash.

On December 18, 2014, we completed the purchase of six properties located in Western Canada, comprised of retail, office and industrial investment property (the "Melcor Acquisition Properties") for a purchase price of $138,250 (an additional $169 in transaction costs were capitalized to the properties). As part of the purchase of the Melcor Acquisition Properties, the REIT also assumed mortgages on certain properties totaling $78,444. The REIT satisfied approximately $45,000 of the purchase price of the Melcor Acquisition Properties by issuing 4,390,244 Class B LP Units at $10.25 per unit (note 15). The remainder of the purchase price was funded through the REIT's line of credit and available cash.

As part of the purchase, Melcor undertook, at its expense, to complete certain construction, capital improvements, landlords work, and payment of tenant incentives and commissions related to the properties. In addition, on closing of the Melcor Acquisition Properties, the REIT and Melcor entered Head and Bridge Lease Agreements which provides rental income to the REIT over a period of time on certain vacant spaces (note 22).

The purchase price approximates fair market value and the acquisitions of the May 2014 Melcor Acquisition and Melcor Acquisition Properties have been accounted for as asset purchases.

### *ACQUIRED FROM UNRELATED THIRD PARTIES*

On January 10, 2014 we completed the acquisition of an industrial property, LC Industrial, located in Lethbridge, Alberta for $6,027 (including transaction costs).

On May 26, 2014 we completed the acquisition of an office building, 107 Avenue Building, located in Edmonton, Alberta for $5,669 (including transaction costs).

On December 8, 2014, the REIT acquired an office and retail complex, White Oaks, in Edmonton, Alberta for $31,829 (including transaction costs). As part of the purchase the REIT also assumed a mortgage on the property with a carrying value of $15,068. As a financial liability we recorded the assumed mortgage at its fair value on initial recognition. The fair value of the mortgage was calculated using a market interest rate for an equivalent mortgage and resulted in a fair value adjustment of $453 being recorded on the mortgage and the cost of the building.

The acquisitions were funded through the REIT's line of credit and available cash.

In accordance with our policy these acquisitions have been accounted for as asset purchases.

### *ACQUISITIONS COMPLETED IN THE COMPARATIVE YEAR*

On September 12, 2013, the REIT completed the purchase of Coast Home Centre ("Coast"), located in Edmonton, Alberta. We acquired 100% interest in the property for total consideration of $12,462 (including transaction costs).

On December 24, 2013, the REIT acquired Liberty Crossing ("Liberty"), located in Red Deer, Alberta. We acquired 100% interest in the property for total consideration of $13,389 (including transaction costs).

The acquisitions were funded through the REIT's line of credit and available cash.

In accordance with our policy these acquisitions were accounted for as asset purchases.

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## 8. INVESTMENT PROPERTIES

| | 2014 | 2013 |
|---|---|---|
| Balance - beginning of year | **429,117** | 382,381 |
| Additions | | |
| Direct acquisition (note 7) | **195,972** | 25,851 |
| Property improvements | **2,743** | 3,035 |
| Property development activities | **640** | — |
| Direct leasing costs (note 22) | **1,057** | 788 |
| Fair value adjustment on investment properties (note 27) | **93** | 16,953 |
| Change in decommissioning obligation (note 11) | **381** | 109 |
| Balance - end of year | **630,003** | 429,117 |

In accordance with our policy, as detailed in note 3e, we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized net operating income ("NOI"). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 27.

The cost of investment properties as at December 31, 2014 totalled $406,404 (December 31, 2013 - $205,992).

Presented separately from investment properties is $12,832 (December 31, 2013 - $10,386) in tenant incentives and $1,453 (December 31, 2013 - $846) in straight-line rent adjustments (note 9). The fair value of investment properties has been reduced by these amounts.

Our investment properties are leased to tenants primarily under long-term operating leases. Rentals are receivable from tenants monthly. Minimum lease payments under non-cancellable operating leases of investment properties are receivable as follows:

| | 2014 | 2013 |
|---|---|---|
| Within one year | **37,644** | 23,683 |
| Later than one year but not later than 5 years | **118,072** | 67,490 |
| Later than 5 years | **92,157** | 40,386 |
| | **247,873** | 131,559 |

## 9. OTHER ASSETS

| | 2014 | 2013 |
|---|---|---|
| **Current Assets** | | |
| Prepaid expense, and other | **943** | 1,015 |
| | | |
| **Non-Current Assets** | | |
| Straight-line rent adjustments | **1,453** | 846 |
| Tenant incentives | **12,832** | 10,386 |
| | **14,285** | 11,232 |

During the year we provided tenant incentives of $4,985 (December 31, 2013 - $2,052) and recorded $2,539 (December 31, 2013 - $2,297) of amortization expense respectively. In accordance with SIC 15, Operating leases - incentives, amortization of tenant incentives is recorded on a straight-line basis over the term of the lease against rental revenue.

## 10. REVOLVING CREDIT FACILITY

On April 20, 2013, we entered into a revolving term facility credit agreement with two major Canadian chartered banks. Under the terms of the agreement the REIT has an available credit limit based upon the carrying values of specific investment properties, as calculated quarterly, up to a maximum of $25,000 for general purposes, including a $3,000 swingline sub-facility. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. The facility matures on May 1, 2015, with a one year extension period at the discretion of the lenders. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.25% or bankers acceptance plus 2.25% stamping fee. Interest payments are due and payable based upon the form of the facility drawn upon, and principal is due and payable upon maturity. The agreement also bears a standby fee of 0.50% for the unused portion of the revolving facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the facility. During the year ended December 31, 2014 we amended our revolving credit facility agreement, pledging two additional recently acquired and unencumbered properties as collateral for the facility.

As at December 31, 2014, the carrying value of pledged properties was $80,500 (December 31, 2013 - $66,700). We initially capitalized $252 in transaction costs associated with the facility, of which $39 was unamortized at December 31, 2014 and is presented net of the outstanding balance (December 31, 2013 - $170).

As at December 31, 2014 we had $5,000 (December 31, 2013 - $24,000) drawn from the facility; and posted letters of credit of $nil (December 31, 2013 - $nil). The weighted average effective interest rate on borrowings, based on period end balances, is 3.52% (December 31, 2013 - 3.72%). The following table summarizes the components of the balance:

| | 2014 | 2013 |
|---|---|---|
| Amount drawn on facility | **5,000** | 24,000 |
| Unamortized transaction fees | **(39)** | (170) |
| Unamortized discount on bankers acceptance | **(3)** | (82) |
| | **4,958** | 23,748 |

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## 11. ACCRUED LIABILITIES AND OTHER PAYABLES

| | 2014 | 2013 |
|---|---|---|
| **Current Liabilities** | | |
| Accrued liabilities and other payables | **6,245** | 3,508 |
| Decommissioning obligation | **50** | 182 |
| | **6,295** | 3,690 |
| **Non-Current Liabilities** | | |
| Decommissioning obligation | **1,360** | 1,459 |

The REIT's decommissioning obligation relates to one of our commercial properties. The total decommissioning obligation is estimated based on the future obligation and timing of these expenditures to be incurred. We estimate the net present value of the obligation based on an undiscounted total future provision of $2,064 (December 31, 2013 - $2,298). At December 31, 2014, a discount rate of 4.00% (December 31, 2013 - 4.00%) and an inflation rate of 2.00% (December 31, 2013 - 2.00%) were used to calculate the net present value of the obligation. Due to uncertainty surrounding the nature and timing of this obligation amounts are subject to change.

## 12. MORTGAGES PAYABLE

| | 2014 | 2013 |
|---|---|---|
| Mortgages amortized over 15-25 years at fixed interest rates | **215,675** | 99,023 |
| Unamortized fair value adjustment | **432** | — |
| Unamortized deferred financing fees | **(1,148)** | (201) |
| | **214,959** | 98,822 |
| Current portion of mortgages payable | **(20,957)** | (19,911) |
| | **194,002** | 78,911 |
| Interest rate ranges | **(3.01%-5.70%)** | (3.01%-5.86%) |

Specific investment properties with a carrying value of $403,330 (December 31, 2013 - $197,866) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above mortgages. The weighted average effective interest rate for the above mortgages, based on period end balances, is 3.80% (December 31, 2013 – 4.20%).

The minimum contractual principal payments due within each of the next five years and thereafter are as follows:

| | Principal Instalment Repayments | Balance Maturing | Total |
|---|---|---|---|
| 2015 | 6,059 | 14,898 | **20,957** |
| 2016 | 5,430 | 26,444 | **31,874** |
| 2017 | 5,011 | — | **5,011** |
| 2018 | 5,191 | 32,592 | **37,783** |
| 2019 | 4,032 | 65,828 | **69,860** |
| Thereafter | 8,854 | 41,336 | **50,190** |
| | 34,577 | 181,098 | **215,675** |

## 13. CLASS C LP UNITS

On closing of the IPO, Melcor retained the debt on certain Initial Properties (the "Retained Debt"), with an outstanding principal balance of $94,544 at April 30, 2013. The Class C LP Units were initially recognized at their fair value of $96,506. The fair value of the Class C LP Units was determined based upon future payments at market interest rates. In consideration of the Retained Debt, Melcor received 9,454,411 Class C LP Units of Melcor REIT Limited Partnership (the "Partnership"), a subsidiary of the REIT, on which priority distributions are made to permit Melcor to satisfy required principal and interest payments. The Class C LP Units are classified as debt and a portion of the distributions are recognized as interest expense.

As at December 31, 2014 the carrying value of the Class C LP Units, included in the consolidated statement of financial position, were as follows:

| | 2014 | 2013 |
|---|---|---|
| Class C LP Units amortized over 2-6 years at fixed interest rates | **89,519** | 92,578 |
| Unamortized fair value adjustment | **1,229** | 1,669 |
| | **90,748** | 94,247 |
| Current portion of Class C LP Units | **(25,825)** | (3,059) |
| | **64,923** | 91,188 |
| Effective interest rate | **3.84%** | 3.84% |

| | Principal Instalment Repayments | Balance Maturing | Total |
|---|---|---|---|
| 2015 | 2,780 | 23,045 | **25,825** |
| 2016 | 2,150 | 9,030 | **11,180** |
| 2017 | 2,006 | 2,578 | **4,584** |
| 2018 | 1,687 | 11,421 | **13,108** |
| 2019 | 1,488 | 6,576 | **8,064** |
| Thereafter | 2,725 | 24,033 | **26,758** |
| | 12,836 | 76,683 | **89,519** |

During the year $3,531 (2013 - $2,428) was recognized in finance costs (note 18) and $3,499 (2013 - $2,259) was recognized as a reduction in the Class C LP Units liability related to these distributions.

## 14. CONVERTIBLE DEBENTURE

On December 3, 2014, we issued a 5.50% extendible convertible unsecured subordinated debenture (the "convertible debenture") to the public for gross proceeds of $34,500, including $4,500 issued pursuant to the exercise of an over-allotment option. The convertible debenture bears interest at an annual rate of 5.50% payable semi-annually in arrears on June 30 and December 31 each year, commencing June 30, 2015. Upon completion of the Melcor Acquisition Properties (note 7), the maturity date of the convertible debenture was extended to December 31, 2019. The convertible debenture can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion rate of 79.0514 trust units per one thousand principal amount of convertible debenture (the "Conversion Price"). On and from December 31, 2017, and prior to December 31, 2018, the convertible debenture may be redeemed by the REIT, in whole at any time, or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume weighted-average trading price of the trust units for a specified period (the "Current Market Price") preceding the date on which notice of redemption is given is not less than 125% of the Conversion Price. On and from December 31, 2018, and prior to the maturity date, the convertible debenture may be redeemed by the REIT, in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest. Subject to regulatory approval and other conditions, the REIT may, at its option, elect to satisfy its obligation to pay the principal amount of the convertible debenture on redemption or at maturity, in whole or in part, by delivering that number of freely tradeable trust units obtained by dividing the principal amount of the convertible debenture being repaid by 95% of the Current Market Price on the date of redemption or maturity.

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As a compound financial instrument, the fair value of the host instrument component was calculated using a market interest rate for an equivalent non-convertible, non-extendible bond. The conversion feature component is recognized at its fair value and presented as a liability.

A reconciliation of the convertible debenture is as follows:

| | Host Instrument | Conversion Feature | Total |
|---|---|---|---|
| Convertible debenture issued | **34,315** | **185** | **34,500** |
| Transaction costs | **(2,573)** | **—** | **(2,573)** |
| | **31,742** | **185** | **31,927** |
| Amortization of discount and transaction costs | **38** | **—** | **38** |
| Balance, end of year | **31,780** | **185** | **31,965** |

During the year ended December 31, 2014, we recognized $151 of interest expense which is included in finance costs (note 18).

At December 31, 2014 we remeasured the conversion feature to fair value resulting in a fair value adjustment of $nil for the year. Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 27.

## 15. CLASS B LP UNITS

On closing of the IPO, Melcor received 10,360,798 Class B LP Units of the Partnership as partial consideration for the Initial Properties. The Class B LP Units are exchangeable at the option of the holder for one trust unit of the REIT and accompanied by one special voting unit (note 16b). Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units. On May 10, 2013, Melcor exchanged 830,000 Class B LP Units for an equal number of trust units, which were then used to fulfill the over-allotment option held by the underwriters pursuant to the IPO.

On May 9, 2014 the REIT issued 694,836 Class B LP Units at $10.65 per unit to Melcor as partial consideration for the May 2014 Melcor Acquisition (note 7). As at the adjustment date the fair value of the units issued was $10.47 per unit, or $7,275; the $125 difference between book value and fair value was recorded to contributed surplus.

On December 18, 2014 the REIT issued 4,390,244 Class B LP Units at $10.25 per unit to Melcor as partial consideration for the Melcor Acquisition Properties (note 7). As at the adjustment date the fair value of the units issued was $9.51 per unit, or $41,752; the $3,248 difference between book value and fair value was recorded to contributed surplus.

Distributions on Class B LP Units for the year were $6,993 (2013 - $4,289), and are included in finance costs (note 18).

In accordance with our policy, as detailed in note 3h, we record Class B LP Units at fair value. We remeasured the Class B LP Units at December 31, 2014 and recognized a fair value gain of $9,880 during the year (2013 - fair value loss of $3,812). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 27.

At December 31, 2014 there were 14,615,878 Class B LP Units issued and outstanding at a fair value of $9.46 per unit or $138,266 (December 31, 2013 - 9,530,798 Class B LP Units issued and outstanding at a fair value of $10.40 per unit or $99,120).

## 16. UNITHOLDERS' EQUITY

### A. TRUST UNITS

The REIT is authorized to issue an unlimited number of trust units and an unlimited number of special voting units. Each trust unit represents a holder's proportionate undivided beneficial ownership interest in the REIT and will confer the right to one vote at any meeting of the unitholders and to participate pro rata in any distributions by the REIT.

Unitholders are entitled to demand, at any time, the REIT to redeem all or part of the trust units at a "Redemption Price" as defined in the REIT's DOT. Upon receipt of notice to redeem trust units, the Unitholder surrenders all rights to and under the units tendered for redemption.

### B. SPECIAL VOTING UNITS

Pursuant to the DOT, special voting units have no economic entitlement in the REIT or in the distributions or assets of the REIT but entitle the holder to one vote per special voting unit at any meeting of the unitholders. Special voting units may only be issued in connection with or in relation to securities exchangeable into Units, including Class B LP Units, for the purpose of providing voting rights with respect to the REIT to the holders of such securities. Special voting units will not be transferable separately from the exchangeable securities to which they are attached and will be automatically transferred upon the transfer of such exchangeable securities.

### C. UNITS OUTSTANDING

On May 7, 2014 the REIT issued 1,900,000 trust units to the public at $10.65 per unit for gross proceeds of $20,235. On May 16, 2014 an additional 245,000 trust units were issued to the public at $10.65 per unit pursuant to the underwriters over-allotment option for gross proceeds of $2,609. Issued and outstanding trust units at December 31, 2014 are 11,275,000 (December 31, 2013 - 9,130,000).

The following table summarizes the change in trust units for the year.

| | 2014 | |
|---|---|---|
| | Units | Amount |
| Balance, beginning of year | **9,130,000** | **82,709** |
| Issuance of Units - net of $1,594 in costs | **2,145,000** | **21,250** |
| Balance, end of year | **11,275,000** | **103,959** |

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| | 2013 | |
|---|---|---|
| | Units | Amount |
| Balance, beginning of year | — | — |
| Issuance of Units - IPO, net of $8,591 in costs | 8,300,000 | 74,409 |
| Conversion of Class B LP Units | 830,000 | 8,300 |
| Balance, end of year | 9,130,000 | 82,709 |

## 17. RENTAL REVENUE

The components of rental revenue are as follows:

| | 2014 | 2013 |
|---|---|---|
| Rental revenue | **46,441** | 41,225 |
| Amortization of tenant incentives (note 9) | **(2,539)** | (2,297) |
| Straight-line adjustments | **607** | 397 |
| | **44,509** | 39,325 |

## 18. FINANCE COSTS

The components of finance costs are as follows:

| | 2014 | 2013 |
|---|---|---|
| Interest on mortgages payable and revolving credit facility | **5,264** | 5,586 |
| Interest on Class C LP Units | **3,971** | 2,721 |
| Amortization of fair value adjustments on Class C LP Units | **(440)** | (293) |
| Distributions on Class B LP Units | **6,993** | 4,289 |
| Interest on convertible debenture | **151** | — |
| Non-cash finance costs | **273** | 108 |
| | **16,212** | 12,411 |

Total finance costs paid during the year were $15,174 (2013 - $12,060).

## 19. INCOME TAXES

As at December 31, 2014 the REIT qualifies as a mutual fund trust within the meaning of the Tax Act and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through ("SIFT"); accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT. In addition, we recorded a deferred income tax recovery of $40,585 on May 1, 2013 related to the de-recognition of a deferred income tax liability as a result of qualifying for the REIT Exception at the time of the IPO.

The components of income tax recovery are as follows:

| | 2014 | 2013 |
|---|---|---|
| **Deferred tax expense** | | |
| Origination and reversal of temporary differences | **—** | 324 |
| Reversal of deferred taxes upon reorganization and recapitalization and allocation of taxable income to unitholders (note 3m and 6) | **—** | (40,585) |
| | **—** | (40,261) |

Reconciliation of income tax expense based on the statutory rate to the recovery recorded using the effective tax rate is as follows:

| | 2014 | 2013 |
|---|---|---|
| **Net income before income taxes** | **18,348** | 22,458 |
| Statutory rate | **25%** | 25% |
| | **4,587** | 5,615 |
| Non-deductible expenses | **5** | 79 |
| Non-taxable portion of capital gains and fair value adjustments | **(12)** | (2,119) |
| Allocation of taxable income to unitholders (note 3m) | **(4,580)** | (3,251) |
| Reversal of current and deferred taxes upon reorganization and recapitalization (note 3m) | **—** | (40,585) |
| | **—** | (40,261) |

The movement of deferred tax balances for the year are as follows:

| | December 31, 2014 | | |
|---|---|---|---|
| | Opening | Recognized in net income | Closing |
| Investment properties | — | — | — |
| Tenant incentives | — | — | — |
| Straight-line rent adjustment | — | — | — |
| Provision for decommissioning obligation | — | — | — |
| | — | — | — |

| | December 31, 2013 | | |
|---|---|---|---|
| | Opening | Recognized in net income | Closing |
| Investment properties | 37,993 | (37,993) | — |
| Tenant incentives | 2,658 | (2,658) | — |
| Straight-line rent adjustment | 60 | (60) | — |
| Provision for decommissioning obligation | (450) | 450 | — |
| | 40,261 | (40,261) | — |

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## 20. RESULTS OF THE REIT AND ITS PREDECESSOR

The following consolidated statement of income and comprehensive income and consolidated statement of cash flows disaggregate the financial results of the REIT for the year ended December 31, 2013 between the activities of the REIT, subsequent to April 30, 2013, and those of Melcor, prior to May 1, 2013.

| | Melcor 1–Jan to 30–Apr | REIT 1–May to 31–Dec | Year ended 2013 |
|---|---|---|---|
| Rental revenue (note 17 and 22) | 12,942 | 26,383 | 39,325 |
| Direct operating expenses (note 22) | (5,037) | (10,893) | (15,930) |
| Net rental income | 7,905 | 15,490 | 23,395 |
| General and administrative expenses (note 22) | (507) | (1,221) | (1,728) |
| Fair value adjustment on investment properties (note 8 and 27) | 2,594 | 14,359 | 16,953 |
| Fair value adjustment on Class B LP Units (note 15 and 27) | — | (3,812) | (3,812) |
| Income before finance costs and income taxes | 9,992 | 24,816 | 34,808 |
| Interest income | 8 | 53 | 61 |
| Finance costs (note 18 and 22) | (2,737) | (9,674) | (12,411) |
| Net finance costs | (2,729) | (9,621) | (12,350) |
| Net income before income taxes | 7,263 | 15,195 | 22,458 |
| Deferred income tax recovery (note 19) | 40,261 | — | 40,261 |
| Income tax recovery | 40,261 | — | 40,261 |
| Net income and comprehensive income | 47,524 | 15,195 | 62,719 |

| | Melcor 1–Jan to 30–Apr | REIT 1–May to 31–Dec | Year ended 2013 |
|---|---|---|---|
| **CASH FLOWS FROM (USED IN)** | | | |
| **OPERATING ACTIVITIES** | | | |
| Net income for the year | 47,524 | 15,195 | 62,719 |
| Noncash items: | | | |
| Amortization of tenant incentives (note 9 and 17) | 773 | 1,524 | 2,297 |
| Straight-line rent adjustments (note 17) | (125) | (272) | (397) |
| Fair value adjustment on investment properties (note 8 and 27) | (2,594) | (14,359) | (16,953) |
| Fair value adjustment on Class B LP Units (note 15 and 27) | — | 3,812 | 3,812 |
| Amortization of fair value adjustment on Class C LP Units (note 18) | — | (293) | (293) |
| Non-cash finance costs (note 18) | 20 | 88 | 108 |
| Deferred income tax recovery (note 19) | (40,261) | — | (40,261) |
| | 5,337 | 5,695 | 11,032 |
| Changes in operating assets and liabilities (note 3o) | (1,975) | 1,445 | (530) |
| | 3,362 | 7,140 | 10,502 |
| **INVESTING ACTIVITIES** | | | |
| Additions to investment properties (note 7 and 8) | — | (25,851) | (25,851) |
| Payment of tenant incentives (note 9) | (743) | (1,309) | (2,052) |
| Investment property improvements, development and direct leasing costs (note 8) | (1,746) | (2,077) | (3,823) |
| Change in restricted cash | — | (3,141) | (3,141) |
| | (2,489) | (32,378) | (34,867) |
| **FINANCING ACTIVITIES** | | | |
| Proceeds from issuing units, net of costs (note 16) | — | 74,409 | 74,409 |
| Proceeds from issuing convertible debenture, net of costs (note 14) | — | — | — |
| Acquisition of Initial Properties (note 6) | — | (66,016) | (66,016) |
| Change in revolving credit facility | — | 24,000 | 24,000 |
| Proceeds from mortgages payable | 55,000 | 12,000 | 67,000 |
| Repayment of mortgages payable | (48,195) | (5,240) | (53,435) |
| Repayment on Class C LP Units | — | (1,966) | (1,966) |
| Change in restricted cash | — | (2,828) | (2,828) |
| Net distribution to Melcor Developments Ltd. | (7,447) | — | (7,447) |
| Distributions to unitholders | — | (4,109) | (4,109) |
| | (642) | 30,250 | 29,608 |
| **INCREASE IN CASH & CASH EQUIVALENTS DURING THE YEAR** | 231 | 5,012 | 5,243 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR** | 689 | 920 | 689 |
| **CASH AND CASH EQUIVALENTS, END OF THE YEAR** | 920 | 5,932 | 5,932 |

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

## 21. INCOME PER UNIT

Basic and diluted earnings per trust unit for the year ended December 31, 2014 and the comparative post-formation period of May 1, 2013 to December 31, 2013 are calculated as follows:

| | 2014 | 1-May-13 to 31-Dec-13 |
|---|---|---|
| Net income - basic ($000s) (note 20) | **18,348** | 15,195 |
| Impact of Class B LP Unit fair value adjustment and distributions ($000s) | **(2,887)** | 8,101 |
| Impact of convertible debenture interest and amortization ($000s) | **189** | — |
| Net income - diluted ($000s) | **15,650** | 23,296 |
| | | |
| Basic weighted average trust units outstanding during the year | **10,522,616** | 9,099,385 |
| Impact of conversion of Class B LP Units | **10,136,427** | 9,530,798 |
| Impact of conversion of convertible debenture | **209,215** | — |
| Diluted weighted average trust units outstanding during the year | **20,868,258** | 18,630,183 |
| Basic earnings per trust unit | **$1.74** | $1.67 |
| Diluted earnings per trust unit | **$0.75** | $1.25 |

## 22. RELATED PARTY TRANSACTIONS

Pursuant to the transaction detailed in note 6, the consolidated financial statements of the REIT include the following related party transactions with Melcor, and its affiliates, as the ultimate controlling party of the REIT:

### A. PROPERTY AND ASSET MANAGEMENT AGREEMENTS

Effective May 1, 2013, the REIT and Melcor entered into a Property Management Agreement and an Asset Management Agreement which set forth the terms and conditions under which the REIT is managed, administered and operated.

Asset Management Agreement – we pay a quarterly management fee which is comprised of the following: (a) a base annual management fee calculated and payable on a quarterly basis, equal to 0.25% of the REIT's gross book value; (b) a capital expenditures fee equal to 5% of all hard construction costs incurred on capital projects in excess of $0.10 million; (c) an acquisition fee equal to 0.50% - 1.00% of the purchase price; (d) a financing fee equal to 0.25% of the debt and equity of all financing transactions completed for the REIT to a maximum of actual expenses incurred by Melcor.

Property Management Agreement – we pay a monthly fee which is comprised of the following: (a) a base fee of 1/12 of 3% of gross property revenue; (b) a leasing fee equal to 5% of aggregate base rent for new leases for the first 5 years and 2.5% thereafter, and 2.5% of aggregate base rent for lease renewals and expansions for the first 5 years.

Pursuant to the terms of the agreements the REIT incurred the following fees during the year (2013 - May 1, 2013 to December 31, 2013):

| | 2014 | 2013 |
|---|---|---|
| **Asset Management Agreement** | | |
| Base Annual Management Fee | **1,123** | 676 |
| Capital Expenditure Fee | **—** | — |
| Acquisition Fee | **428** | 256 |
| Financing Fee | **—** | — |
| **Property Management Agreement** | | |
| Monthly Fee | **1,333** | 746 |
| Lease Fee | **1,057** | 511 |
| | **3,941** | 2,189 |

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. In accordance with our policy (3e), Acquisition Fees and Lease Fees are capitalized to investment properties. As at December 31, 2014 there was $271 payable to Melcor related to these fees (2013 - December 31, 2013 - $447).

### B. DISTRIBUTIONS ON CLASS B LP UNITS AND REDEMPTIONS OF CLASS C LP UNITS

During the year $6,993 in distributions were recorded on Class B LP Units held by Melcor (May 1, 2013 to December 31, 2013 - $4,289). These distributions were recorded as finance costs (note 18). As at December 31, 2014 there was $822 payable to Melcor for the December distribution (December 31, 2013 - $536).

Also during the same period, Melcor, as holder of all Class C LP Units, was paid $7,030 to fund principal and interest payments on the Retained Debt (2013 - $4,687). These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs (note 18).

### C. RENTAL REVENUE

During the year the REIT collected $698 in rental revenue from Melcor and an affiliate for use of office space (May 1, 2013 to December 31, 2013 - $470). In addition, pursuant to the Head and Bridge Lease Agreements entered into upon closing of the Melcor Acquisition Properties (note 7), the REIT collected $45 in rental revenue from Melcor as compensation for certain vacant spaces at the properties acquired.

### D. KEY MANAGEMENT REMUNERATION

The REIT does not directly or indirectly pay any compensation to named executive officers of the REIT. The REIT has no employees and is externally managed, administered and operated by Melcor pursuant to the Asset Management Agreement and Property Management Agreement.

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

### E. PURCHASE OF INVESTMENT PROPERTIES

On May 9, 2014, the REIT purchased two properties from Melcor pursuant to the Development and Opportunities Agreement with Melcor. The purchase price of $13,500 was satisfied by issuing 694,836 Class B LP Units at $10.65 per unit, approximating $7,400 of the purchase price, and available cash (note 7).

On December 18, 2014, the REIT purchased six properties from Melcor pursuant to the Development and Opportunities Agreement with Melcor for a purchase price of $138,250. As part of the purchase, the REIT also assumed mortgages on certain properties totaling $78,444. The REIT satisfied approximately $45,000 of the purchase price by issuing 4,390,244 Class B LP Units at $10.25 per unit. The remainder of the purchase price was funded through the REIT's line of credit and available cash (note 7).

All related party transactions occurred in the normal course of operations, at market rates and under normal commercial terms.

## 23. JOINT ARRANGEMENTS

The table below discloses our rights to and share of the assets, liabilities, revenues, and earnings of three joint arrangements (2013 – three) that are recorded in these consolidated financial statements:

| | Interest |
|---|---|
| Capilano Investments Joint Venture | 50% |
| Westmere Properties Joint Venture | 50% |
| Watergrove Developments Joint Venture | 50% |

| For the year ended and as at December 31 | Assets | Liabilities | Revenue | Earnings |
|---|---|---|---|---|
| **2014** | **52,389** | **24,612** | **3,867** | **1,586** |
| 2013 | 48,712 | 22,472 | 3,741 | 4,138 |

## 24. SEGMENTED INFORMATION

All the properties included in these consolidated financial statements are located in Western Canada, and are viewed by the Chief Operating Decision Maker (determined to be the Chief Executive Officer) as one operating segment in the context of these consolidated financial statements.

## 25. MANAGEMENT OF CAPITAL RESOURCES

We define capital as unitholders' equity, Class B LP Units, Class C LP Units, mortgages payables, convertible debenture and our revolving credit facility. Our objective when managing capital is to ensure sufficient funds are available to make unitholder distributions, support the growth of our assets, and finance capital requirements. Specifically, we plan to utilize a combination of short, medium and long-term debt financing that aligns with the characteristics of each property.

Pursuant to the DOT, the REIT may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, the total indebtedness of the REIT would be more than 60% of Gross Book Value ("GBV") ("Degree of Leverage Ratio") (65% including any convertible debenture). At December 31, 2014, and throughout the period, we were in compliance with the Degree of Leverage Ratio and had a ratio of 56% (50% excluding convertible debenture) as at December 31, 2014.

We are also subject to financial covenants on our $25,000 revolving credit facility. The covenants include a maximum debt to total capital ratio of 60%, a minimum interest coverage ratio of 1.50, and a minimum net book value of unitholders' equity of $140,000. As at December 31, 2014, we were in compliance with our financial covenants with a debt to total capital ratio of 56% (50% excluding convertible debenture), interest coverage ratio of 1.67, and a net book value of unitholders equity, based on the definition of unitholders equity in our revolving credit facility agreement, of $288,270. We also have financial covenants on certain mortgages for investment properties. At December 31, 2014, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

## 26. FINANCIAL RISK MANAGEMENT

We are exposed to the following risks as a result of holding financial instruments:

### A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents, restricted cash and accounts receivable. Our maximum exposure to credit risk is the carrying amount of these instruments.

We invest our cash and cash equivalents and restricted cash in bank accounts with major Canadian chartered banks. Accounts receivable balances include amounts due from tenants and various smaller amounts due from vendors.

We manage our credit risk through careful selection of tenants and look to obtain national tenants or tenants in businesses with a long standing history, or perform financial background checks including business plan review for smaller tenants. We manage our concentration risk by renting to an expansive tenant base, with no dependency on rents from any one specific tenant. Management has reviewed outstanding receivable balances at December 31, 2014 and made a provision of $61 related to accounts where collectability is doubtful. We expect full payment of remaining balances outstanding, and accordingly, no additional allowance for doubtful accounts has been recorded.

### B. LIQUIDITY RISK

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We manage liquidity risk to ensure that we have sufficient liquid financial resources to finance operations, meet long-term mortgage repayments, Class C LP Unit redemptions, convertible debenture payments and make monthly distributions on Class B LP Units and trust units. We monitor rolling forecasts of our liquidity, which includes cash, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against capital requirements and maintain ongoing debt financing plans. We believe that we have access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

Refer to notes 12, 13 and 14 for the maturity analysis of mortgages payable, Class C LP Units and Convertible Debenture. Amounts drawn under the revolving credit facility are due upon the maturity of the facility, on or before May 1, 2015. Accounts payable are expected to be repaid in the next twelve months. Distributions declared on trust units and Class B LP Units are paid one month following the date of declaration.

($000s except unit and per unit amounts)

### C. MARKET RISK

We are subject to interest rate cash flow risk as our revolving credit facility bears interest at rates that vary in accordance with borrowing rates in Canada. For each 1% change in the rate of interest on our revolving credit facility, the change in annual finance costs is approximately $50 (December 31, 2013 - $240) based upon applicable period end debt balances. We are also subject to interest rate risk on refinancing of our fixed rate debts in the year of maturity. We are not subject to other significant market risks pertaining to our financial instruments.

## 27. FAIR VALUE MEASUREMENT

Fair value is the price that market participants would be willing to pay for an asset or liability in an orderly transaction under current market conditions at the measurement date.

The fair value of the REIT's financial instruments were determined as follows:

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.
- fair values of mortgages payable and Class C LP Units are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of derivative financial liability, the conversion feature on our convertible debenture, is estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units (Level 1).

In addition, the REIT carries its investment properties at fair value, as detailed in note 3e, which is determined by either the direct capitalization approach or by discounting future cash flows at a property specific discount rate (Level 3).

The following table summarizes the REIT's assets and liabilities carried at fair value and its financial assets and liabilities where carrying value does not approximate fair value.

| | December 31, 2014 | | | |
|---|---|---|---|---|
| | Fair Value | Amortized Cost | Total Carrying Value | Total Fair Value |
| **Non-financial assets** | | | | |
| Investment properties | **630,003** | **—** | **630,003** | **630,003** |
| **Financial liabilities** | | | | |
| Mortgages payable | **—** | **215,675** | **215,675** | **219,492** |
| Class B LP Units | **138,266** | **—** | **138,266** | **138,266** |
| Class C LP Units | **—** | **90,748** | **90,748** | **90,748** |
| Convertible debenture | **—** | **31,780** | **31,780** | **31,780** |
| Derivative financial liability | **185** | **—** | **185** | **185** |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Fair Value | Amortized Cost | Total Carrying Value | Total Fair Value |
| **Non-financial assets** | | | | |
| Investment properties | 429,117 | — | 429,117 | 429,117 |
| **Financial liabilities** | | | | |
| Mortgages payable | — | 99,023 | 99,023 | 105,165 |
| Class B LP Units | 99,120 | — | 99,120 | 99,120 |
| Class C LP Units | — | 94,247 | 94,247 | 94,247 |
| Convertible debenture | — | — | — | — |
| Derivative financial liability | — | — | — | — |

The table below analyzes assets and liabilities carried at fair value in the consolidated statement of financial position, by the levels in the fair value hierarchy. The fair value hierarchy categorizes fair value measurement into three levels based upon the inputs to valuation technique, which are defined as follows:

- Level 1: quote prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: unobservable inputs for the asset or liability.

There were no transfers between the levels of the fair value hierarchy during the year.

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Non-financial assets** | | | | |
| Investment properties | — | — | 630,003 | 630,003 |
| **Financial liabilities** | | | | |
| Derivative financial liability | — | — | 185 | 185 |
| Class B LP Units | 138,266 | — | — | 138,266 |

# Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

### *INVESTMENT PROPERTIES*

Investment properties are remeasured to fair value on a recurring basis and categorized as Level 3 in the fair value hierarchy. Investment properties were valued by qualified independent external valuation professionals as at December 31, 2014 and 2013 which resulted in fair value gains of $93 (2013 - $16,953) recorded as fair value adjustment on investment properties in income during the year. Fair values are primarily determined by discounting the expected future cash flows over ten years plus a terminal value determined by applying a terminal capitalization rate to estimated year eleven cash flows, or by applying a capitalization rate to the estimated future net operating income under the direct capitalization approach. The significant unobservable inputs in the Level 3 valuations are as follows:

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items;
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;
- Terminal capitalization rate - taking into account assumptions regarding vacancy rates and market rents; and
- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

An increase in the cash flows or stabilized net operating income results in an increase in fair value of investment property whereas an increase in the capitalization rate, discount rate or terminal capitalization rate decreases the fair value of the investment property.

In determining the fair value of our investment properties judgment is required in assessing the 'highest and best use' as required under IFRS 13, Fair value measurement. We have determined that the current uses of our investment properties are their 'highest and best use'.

The REIT's management company, Melcor, lead by Melcor's executive management team is responsible for determining fair value measurements including verifying all major inputs included in the valuation and reviewing the results with the independent valuator. Melcor's management, along with the REIT's Audit Committee, discuss the valuation process and key inputs on a quarterly basis.

Weighted average stabilized net operating income for investment properties is $1,414 (2013 - $1,176). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

| | December 31, 2014 | | |
|---|---|---|---|
| | Min | Max | Weighted Average |
| Capitalization rate | 5.50% | 9.00% | 6.49% |
| Terminal capitalization rate | 5.75% | 9.25% | 6.77% |
| Discount rate | 6.50% | 10.00% | 7.69% |

| | December 31, 2013 | | |
|---|---|---|---|
| | Min | Max | Weighted Average |
| Capitalization rate | 5.50% | 9.00% | 6.41% |
| Terminal capitalization rate | 5.75% | 9.25% | 6.69% |
| Discount rate | 6.50% | 10.00% | 7.57% |

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $43,828 (2013 - $31,881). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $51,148 (2013 - $37,278).

### *DERIVATIVE FINANCIAL LIABILITY*

Our financial derivative liability is comprised of the conversion feature on our convertible debenture.

The significant unobservable inputs used in the fair value measurement of the conversion feature on the convertible debenture as at December 31, 2014 are as follows:

- Volatility - expected volatility as at December 31, 2014 was derived from the historical prices of the REIT's trust units. As the REIT was formed on May 1, 2013, price history is limited and we have used the entire historical data up until December 31, 2014. Volatility was 15.17%.
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at December 31, 2014. The credit spread used was 3.76%.

### *CLASS B LP UNITS*

Class B LP Units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the trust units at the period end date. At December 31, 2014 the fair value of the Class B LP Units was $138,266, resulting in a fair value gain of $9,880 in income for the year (2013 - fair value loss of $3,812).

## 28. SUBSEQUENT EVENTS

### *DISTRIBUTION DECLARED*

On January 15, 2015 we declared a distribution of $0.05625 per unit for the months of January, February and March 2015. The distributions will be payable as follows:

| Month | Record Date | Distribution Date | Distribution Amount (per unit) |
|---|---|---|---|
| January 2015 | January 30, 2015 | February 16, 2015 | $0.05625 |
| February 2015 | February 27, 2015 | March 16, 2015 | $0.05625 |
| March 2015 | March 31, 2015 | April 15, 2015 | $0.05625 |

# Corporate & Unitholder Information

## Trustees



## Officers

Darin Rayburn, Chief Executive Officer

Jonathan Chia, Chief Financial Officer

## Annual General Meeting

Please join us at our annual general meeting. Breakfast will be served prior to the meeting. We look forward to seeing you there.

**Thursday, April 23, 2015**
8:30 am Breakfast
9:00 am Meeting Start
**Empire Ballroom - Fairmont Hotel Macdonald**
**Edmonton, Alberta**

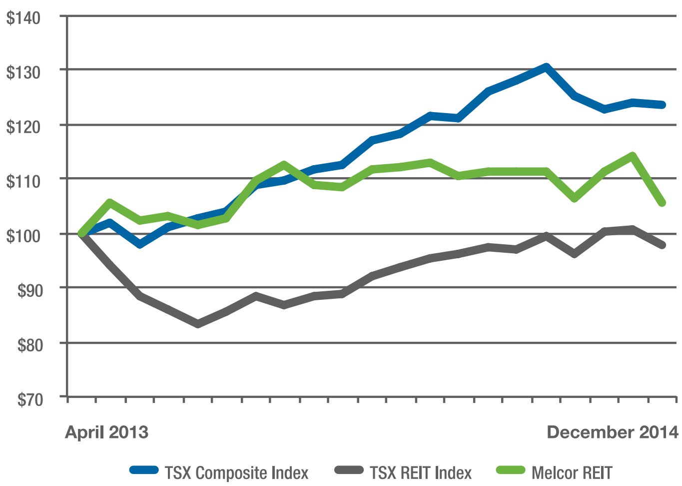
## Distributions

$0.05625 per month
70% of distributions to unitholders were classified as return of capital.

## Key Dates

Annual General Meeting – April 23, 2015
Q1 Earnings Announcement – May 7, 2015
Q2 Earnings Announcement – August 7, 2015
Q3 Earnings Announcement – November 6, 2015
Q4 Earnings Announcement – March 10, 2016

## 20 Month Return




## Unitholder Services

For unitholder services including distribution information, contact:

**Valiant Trust Company**
**Shareholder Services**
**Suite 3000, 10303 Jasper Avenue**
**Edmonton, AB T5J 3X6**
**P| 1-780-441-2267**
**F| 1-780-441-2247**
**inquiries@valianttrust.com**

## Investor Relations

For all other shareholder inquiries and requests, including institutional investors and research analysts, contact:

**Jonathan Chia, CFO**
**P| 1-855-673-6931**
**ir@MelcorREIT.ca**

## Customer Service

For tenant service, contact:

**P| 1-866-MELCOR1**
**care.melcor.ca**
**service@care.melcor.ca**

## Auditors

PricewaterhouseCoopers LLP

## Legal Counsel

Bryan & Company LLP

## Stock Exchange Listing

Toronto Stock Exchange:
**REIT Units: MR.UN**
**5.5% Convertible Debenture: MR.DB**


**MELCOR | REIT**

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