MELCOR | REIT

2016

MELCOR | REIT 2016

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 2.78 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 7 million sf in current and future projects to be built over the next 5 to 10 years.

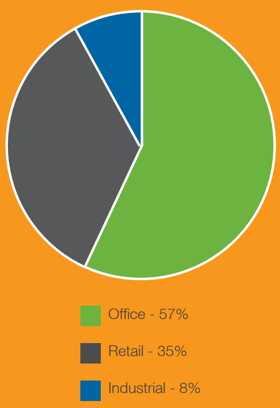
Facts & Data

38 Assets

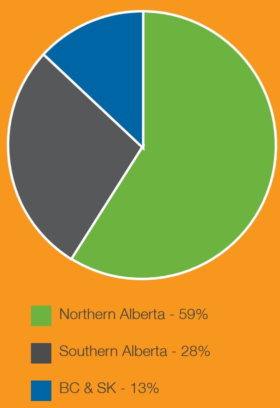
$66.0M Revenue

$663.9M Asset Fair Value

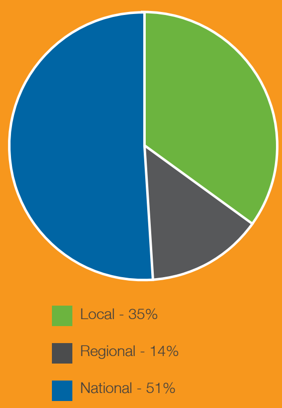
GLA By Property Type



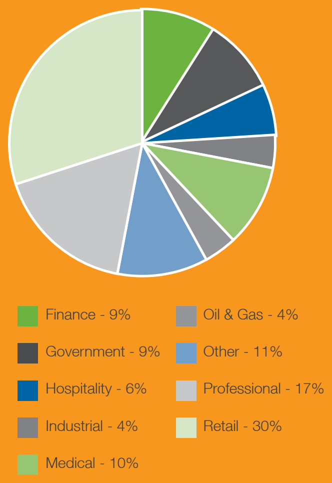
GLA by Region



GLA by Tenant Profile

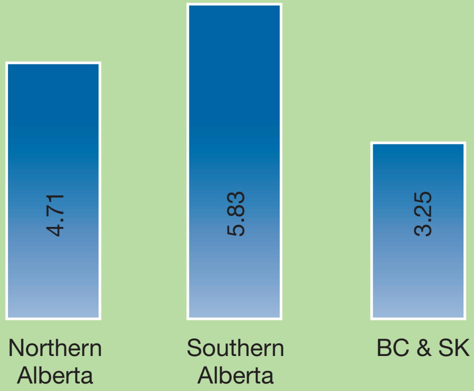


GLA By Tenant Industry



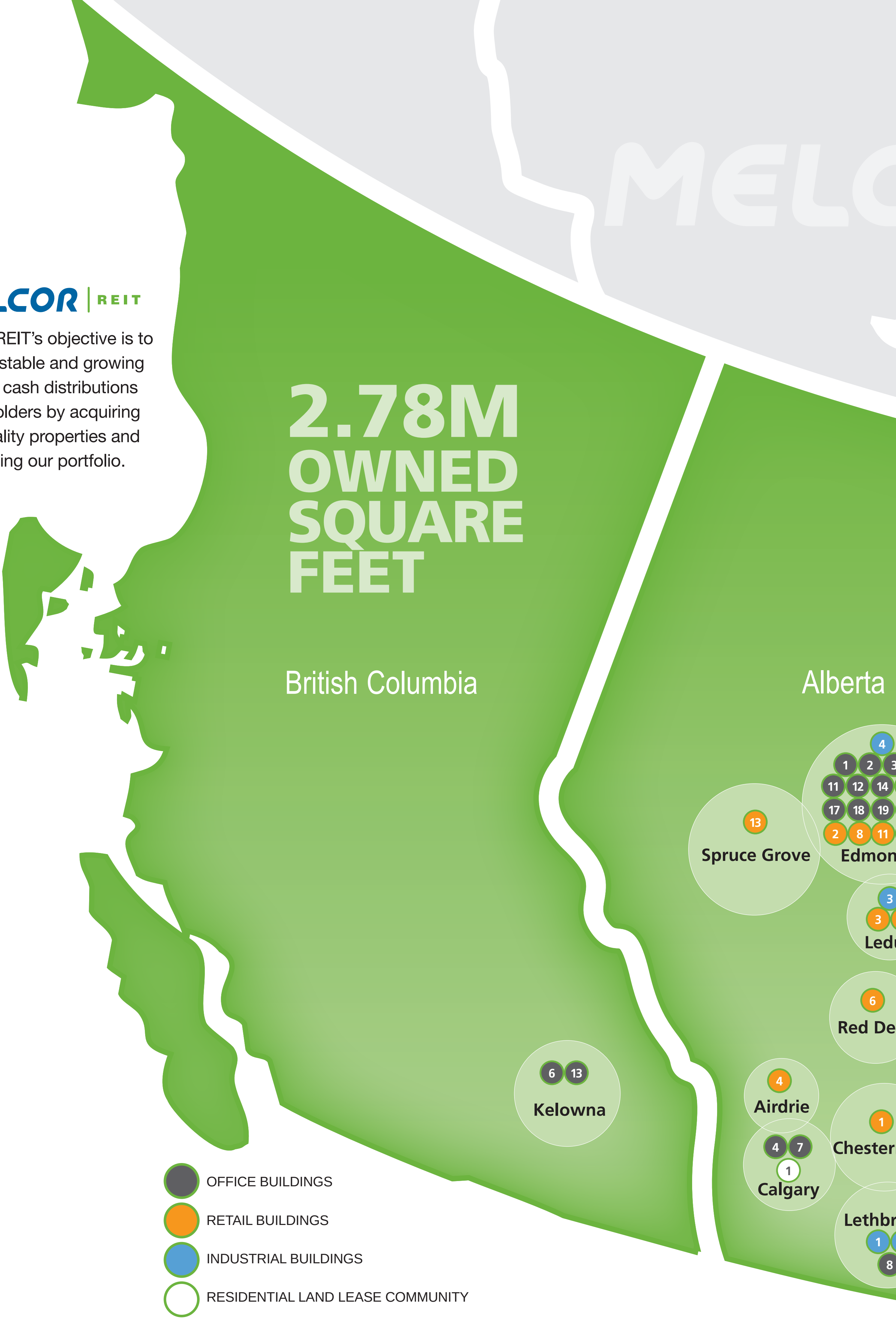
GLA Expiring (%)

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.



	OFFICE BUILDINGS	LOCATION	GLA	OCC %
1	100 Street Place	Edmonton	44,295	87
2	Birks Building	Edmonton	33,987	95
3	Capilano Centre	Edmonton	45,487	99
4	Crowfoot Business Centre	Calgary	67,216	91
5	Executive Terrace	Regina	42,843	68
6	Kelowna Business Centre	Kelowna	72,076	91
7	Kensington Road Building	Calgary	24,044	90
8	Lethbridge Centre	Lethbridge	446,272	94
9	Melton Building	Edmonton	114,612	73
10	Parliament Place	Regina	24,411	86
11	Princeton Place	Edmonton	59,081	75
12	Royal Bank Building	Edmonton	132,373	70
13	Richter Street	Kelowna	28,978	84
14	Select Building	Edmonton	23,432	100
15	Stanley Buildings	Edmonton	34,976	99
16	Sterling Business Centre	Edmonton	67,909	100
17	The Village at Blackmud Creek	Edmonton	48,335	99
18	Trail Business Centre	Edmonton	77,296	93
19	Westcor Building	Edmonton	72,810	93
20	Westgate Business Centre	Edmonton	75,141	100
21	White Oaks Square	Edmonton	30,497	84
	TOTAL		**1,566,071**	**89**

	RETAIL BUILDINGS	LOCATION	GLA	OCC %
1	Chestermere Station	Chestermere	74,038	100
2	Coast Home Centre	Edmonton	59,725	88
3	Corinthia Plaza	Leduc	23,179	81
4	Kingsview Market	Airdrie	47,558	100
5	Leduc Common	Leduc	283,305	99
6	Liberty Crossing	Red Deer	63,317	100
7	Market Mall	Regina	42,912	92
8	Miller Crossing	Edmonton	27,336	97
9	Towers Mall	Regina	114,331	90
10	University Park Mall	Regina	41,238	93
11	West Henday Promenade	Edmonton	34,987	100
12	The Village at Blackmud Creek	Edmonton	9,046	100
13	Westgrove Common	Spruce Grove	29,542	92
14	White Oaks Square	Edmonton	127,824	100
	TOTAL		**978,338**	**96**

	INDUSTRIAL BUILDINGS	LOCATION	GLA	OCC %
1	LC Industrial	Lethbridge	67,610	100
2	Lethbridge Industrial	Lethbridge	49,005	100
3	Telford Industrial	Leduc	98,790	100
4	TKE Building	Edmonton	15,968	100
	TOTAL		**231,373**	**100**

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

MELCOR | REIT 2016

WHAT'S INSIDE

Message from the Chairman

I am pleased to once again report to you on behalf of your board of trustees. The close of 2016 marked the end of a two-year very difficult environment for Alberta. Once again, in spite of this economic backdrop, your REIT continued to perform.

Our focus throughout 2016 was on the present: existing tenants, existing assets and existing stakeholders. By ensuring that these fundamentals were well taken care of, we delivered stable results on all key operating metrics. Our portfolio remains stable and balanced, with stable occupancy and increased average rent over last year. Our growth in cash flow and conservative payout ratio continue to demonstrate the sustainability of our distributions.

On behalf of the board, I thank your management team for their ongoing dedication to doing the right things that ensure the REIT is well positioned regardless of the economic environment. They remained committed to proactive leasing programs and hands-on tenant retention initiatives.

Our building operations and asset management teams also continue to do an incredible job of staying engaged with our tenants, addressing their concerns and supporting them with exceptional customer service. I thank them for their commitment to excellence.

As we continued to navigate our course throughout 2016, we were again grateful to our board of trustees for their ongoing support and encouragement. We are fortunate to have their collective experience and wisdom to guide us.

Over the past year, we continued to look for new deals and acquisition opportunities. Although it would seem that economic conditions would make finding and completing attractive acquisitions easier, this in reality was not the case. Good quality real estate that would be appropriate for Melcor REIT continued to trade at aggressive pricing, indicating that investors looking for yield still consider Alberta (and western Canada) to be a good bet. This brings into sharp focus our biggest frustration, which is that our unit price in 2016 traded at a yield that exceeds what you could buy our assets for in the market.

Once again, I personally thank our investors for your ongoing trust in us and our business.

While we see some early indicators of a more positive outlook for our province – and by extension our business – we remain cautious and watchful. We will continue to prudently and conservatively manage your investment for the long term.

Andrew Melton

Message from the Chief Executive Officer

It is my privilege to report to you on our 2016 results. 2016 delivered its challenges, which your team met head on through understanding and responding to market demand and their ongoing commitment to building strong relationships and delivering exceptional customer care. The market has been noisy over the past few years, yet we have remained consistent and stable.

Landlord of Choice

Our property management practices are designed to improve operating efficiency and reduce cost while at the same time increasing client satisfaction. Achieving excellence in our customer care program is an essential part of our culture. We are proud of our property management team, leasing professionals and building operators, whose commitment to customer service and building strong relationships with our tenants is a significant part of our ability to distinguish Melcor REIT in the marketplace.

One way we measure the success of our signature care program is how frequently we are able to respond to client requests within 30 minutes. In 2016, we achieved this goal on 99% of service requests, exceeding our target of a 95% on-time response rate.

In 2016 we also continued to seek feedback from our tenants by surveying five office buildings. We are proud of what the surveys told us:

- 93.9% of respondents rated our property management team as good, very good or excellent.
- 95.2% of respondents rated our building operations team as good, very good or excellent.

The strength of our portfolio is in our people, the relationships they build with our clients and their commitment to providing unrivalled customer care. We remain committed to being the landlord of choice for our tenants.

Darin Rayburn

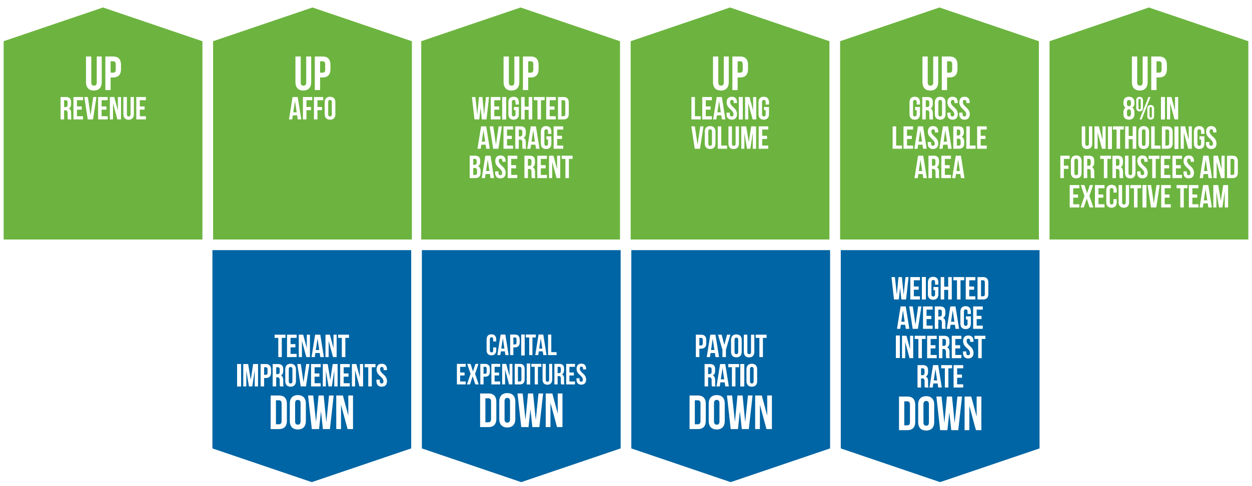
Continuous Improvement

We remain dedicated to achieving and maintaining BOMA BESt standards. BOMA BESt is the leading environmental certification program for existing buildings in Canada. We achieved BOMA BESt certified Green & Responsible on our sixth office building in February 2017. We continue to assess our buildings against the BOMA BESt standards and apply for certification once they meet the criteria as a result of our capital expenditures and improvements program.

Through continuous review and improvement of our programs, we decreased energy usage in our Edmonton office properties by 14% for electricity and 11% for gas since 2012.

Growth

Since our IPO in 2013, we've grown our REIT significantly – by 67% in asset value, 68% in revenue and 77% in gross leasable area (GLA). We intend to continue to grow, but did not identify any acquisitions that we could execute at an attractive price in 2016. Instead, we explored and took advantage of opportunities to create additional value in our existing properties through densification. We completed construction on a new commercial retail unit at a regional shopping centre which increased gross leasable area by 7,732 sf. Over the past 2 years, we have added 14,884 sf (at 100%) via densification and we continue to look for more opportunities across our portfolio.



Strategic Leasing

In response to the influx of new office space in the downtown Edmonton office market, we identified and targeted niche tenants for one office property right in the heart of the new office towers. In doing so, we increased occupancy at the property from 68% at the end of 2015 to 91% today. Although – at 12% of our total gross leasable area – downtown office properties make up a small percent of our portfolio, they will continue to challenge us to systematically approach vacancies and target potential tenants to build on the momentum of our strategic leasing programs. Our proactive leasing strategy resulted in close to 170,000 sf in renewals and 88,500 sf in new leasing, representing 88% of 2016 expiries and early terminations.

2017 Outlook

We see the mood improving across the business community, and the outlook – especially in Edmonton – seems more buoyant than it did at the outset of 2016. However we are not content to rest on what we did in the past. We continue to seek opportunities to improve all elements of our business – from maintenance programs to tenant interactions.

We are continuing to monitor macroeconomic factors and plan for any potential impact to our business. We continue to look for opportunities to build and strengthen our portfolio via acquisition and densification. We continue to focus on the details and ensure that we have the right mix of properties and clients. We continue to focus on providing our customers the best service so that when it comes time to renew, we remain the landlord of choice.

With our strong history, diverse portfolio, focus on property management and customer care, and our pipeline of over 7 million sf of high quality assets being developed over the next 5-10 years, we remain well positioned for the future.

We added a bold message to one of our buildings to encourage our fellow citizens. This public message has been a conversation starter and has been featured in international media. It's also an appropriate message for a building that has BDC and Junior Achievement as tenants.

Andrew Melton
Calgary, Alberta

RELATED

Principal Occupation:
Executive Vice-Chairman,
Melcor Developments Ltd.

Trustee Since: 2013
Attendance: 100%
Compensation[1]: $nil
Unitholdings: 108,400
Committees: Investment

Brian Hunt
Calgary, Alberta

INDEPENDENT

Principal Occupation:
President & Director, Taviston Inc.

Trustee Since: 2013
Attendance: 100%
Compensation: $41,500
Unitholdings: 40,000
Committees: Audit (Chair)

Larry Pollock
Edmonton, Alberta

INDEPENDENT

Principal Occupation:
Corporate Director

Trustee Since: 2013
Attendance: 100%
Compensation: $31,500
Unitholdings: 75,800
Committees: Audit, Investment

Corporate Governance

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 of a majority of independent directors. The audit committee is 100% independent. The independent directors meet in camera (without management and related directors) for a portion of each in person meeting held. As our executive chairman is related, we have appointed a lead director, Don Lowry, who is independent. Mr. Lowry chairs the in camera sessions 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 our operating philosophy. All employees, directors 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 & Ethics, which is essentially the same.

Ralph Young
Edmonton, Alberta

RELATED

Principal Occupation:
Corporate Director

Trustee Since: 2013
Attendance: 100%
Compensation[2]: $nil
Unitholdings: 23,800
Committees: Compensation & Governance

Brian Baker
Edmonton, Alberta

RELATED

Principal Occupation:
Chief Executive Officer, Melcor Developments Ltd.

Trustee Since: 2013
Attendance: 100%
Compensation[1]: $nil
Unitholdings: 7,000
Committees: Investment

Donald Lowry ICD.D
Edmonton, Alberta

INDEPENDENT (LEAD TRUSTEE)

Principal Occupation:
Corporate Director

Trustee Since: 2013
Attendance: 83%
Compensation: $36,500
Unitholdings: 51,600
Committees: Audit, Compensation & Governance

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's initial public offering. In 2016, trustees and officers increased their holdings by 8% to an average of 51,694 units, ensuring alignment with unitholder interests and a focus on long-term value creation. Additional information on our governance practices can be found in our 2016 Information Circular.

1 Melcor employees do not receive trustees compensation.

2 As the Melcor nominee to the Melcor REIT Board of Trustees, Melcor pays Mr. Young's Trustee fees.

Patrick Kirby
Edmonton, Alberta

INDEPENDENT

Principal Occupation:
Counsel, Felesky Flynn LLP

Trustee Since: 2013
Attendance: 100%
Compensation: $28,500
Unitholdings: 28,000
Committees: Compensation & Governance

Table of Contents

Management's Discussion & Analysis

March 9, 2017

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, 2016. 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 2015 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted. All dollar amounts included in this MD&A are Canadian dollars unless otherwise specified.

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on March 9, 2017. Disclosure contained in this MD&A is current to March 9, 2017, unless otherwise indicated.

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 in the Non-standard Measures section.

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 or 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 2017 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 for 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.

Regulatory Filings

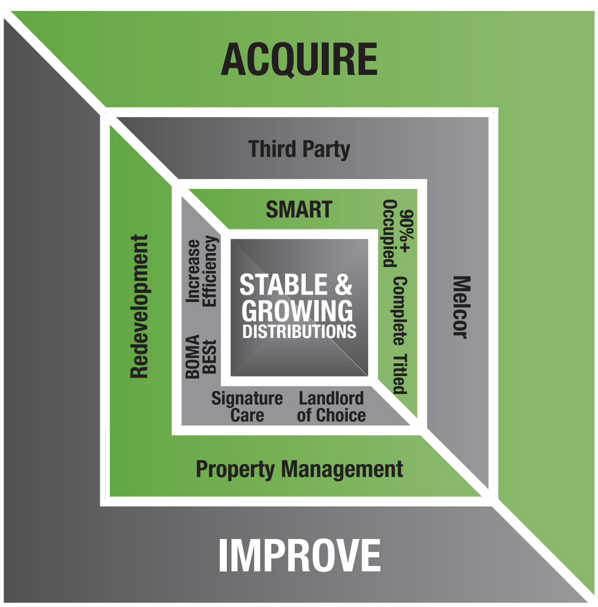
Additional information about the REIT, including our annual information form, management information circular and quarterly reports, is available on our website at melcorREIT.ca and on SEDAR at sedar.com.

Our Business
Vision, Goals & Strategy

The REIT has an established and diversified portfolio focused on western Canada. We owned 38 income-producing office, retail and industrial properties representing 2.78 million sf (square feet) in gross leasable area (GLA) at December 31, 2016. 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. (Melcor) pursuant to the asset management and property management agreements entered into in conjunction with the IPO.

As of March 9, 2017, Melcor holds an approximate 56.7% 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.

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 providing stable 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:

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

The section titled Our Business: Vision, Goals & Strategy 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 8.

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 7 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.

We continue to actively monitor the development pipeline; however we have not completed any acquisitions from Melcor in 2016. Since our IPO in 2013, we have acquired approximately 832,000 sf via our proprietary pipeline.

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 Story, 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.

We continue to actively seek acquisitions that meet these criteria within the markets where we are active; however, we did not complete any acquisitions in 2016. Since our IPO, we have acquired approximately 372,000 sf in third party acquisitions.

SMART ACQUISITION STRATEGY

Strategic

Market

Accretive

Right Price

Targeted

Acquisition Targets

- Stable, accretive properties
- Penetrate existing geographic markets
- Expand into adjacent markets
- Properties with redevelopment and repositioning potential

Acquisition & Integration Strengths

- Proven due diligence process
- Agility to quickly execute on decisions
- Ability to close within 30 days (preferred access to unmarketed opportunities)
- Clustering of properties for efficient management & strong market knowledge

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 to our clients.

Efficient property management optimizes operating costs, occupancy and rental rates. Our hands-on, on-site building management identify 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 long-term 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 the solution centre for client service requests via telephone, email or website. We continue to provide responsive service and are proud of our track record of responding to over 99% of service requests within 30 minutes during business hours.

Our commitment to customer satisfaction shows in our 2016 survey of 5 office buildings. 93.9% of respondents rated our property management team as good, very good or excellent, and 95.2% rated our building operations team as good, very good or excellent.This high level of satisfaction contributes to other metrics, such as our retention rate which was a healthy 71.0% in 2016.

We continue to be proactive with leasing strategies designed 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.

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

Another element of asset enhancement is seeking and taking advantage of opportunities to create additional value out of existing properties through densification (adding GLA). In 2016, we completed construction on an additional CRU in a retail power centre which increased GLA by 7,732 sf. This is the second densification project we have undertaken in the past two years and we have identified additional opportunities to densify existing properties.

In June 2016 we partnered with Make Something Edmonton to create and install a mural on the north wall of our 100 Street Place building in downtown Edmonton, which reads, "Take a risk. It's the most Edmonton thing you can do." The message was meant to encourage our fellow citizens and spark a conversation about our values as a city. The initiative has been successful in transforming a bare wall into a conversation piece and generating buzz about our city and our company.

Our buildings undergo annual assessments to identify preventative maintenance and capital investment requirements, and we continuously monitor and log all equipment and maintenance activity. 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 received BOMA BESt certified Green & Responsible silver status on sixth building in February 2017. 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.

Key Metrics & 2016 Accomplishments

Metric	Target	2016
Debt/gross book value	50-55%	50%
Debt/gross book value including debenture	55-60%	55%
Tenant retention	75%	71.0%
Occupancy	90%+	92.4%
Portfolio diversification		
Retail	40%	35.2%
Office	40%	56.4%
Industrial	20%	8.3%
Weighted average base rent		
Retail	$18.50+	$19.04
Office	$14.00+	$14.43
Industrial	$8.00+	$9.61
Customer Care On-time Response	95%+	99%

2016 Highlights & Key Performance Indicators

	Year ended December 31		
($000s)	2016	2015	△%
Non-Standard KPIs			
Net operating income (NOI)	42,329	41,313	2%
Funds from operations (FFO)	26,668	26,345	1%
Adjusted funds from operations (AFFO)	22,284	21,728	3%
Rental revenue	66,042	65,482	1%
Income before fair value adjustments	13,694	13,422	2%
Fair value adjustment on investment properties	(6,546)	(5,418)	nm
Distributions to unitholders	7,527	7,582	(1)%
Cash flows from operations	12,312	10,563	17%
Same asset NOI	38,980	39,696	(2)%
Per Unit Metrics			
Income (loss) - diluted	($1.00)	$0.71	(241)%
FFO	$1.03	$1.02	1%
AFFO	$0.86	$0.84	3%
Distributions	$0.68	$0.68	—%
Payout ratio	78%	80%	(3)%
IFRS Measures			
Total assets ($000s)	663,724	666,458	—%
Equity ($000s)(1)	260,600	260,600	—%
Debt ($000s)(2)	351,947	353,521	—%
Weighted average interest rate on debt	3.63%	3.80%	(4%)
Debt to GBV ratio(3)	55%	56%	(2)%
Finance costs coverage ratio(4)	2.88	2.87	—%
Debt service coverage ratio(5)	2.65	2.76	(4)%
Operational Highlights			
Number of properties	38	38	0%
Gross leasable area (GLA) (sf)	2,775,782	2,768,750	—%
Occupancy (weighted by GLA)	92.4%	93.6%	(1%)
Retention (weighted by GLA)	71.0%	73.0%	(3)%
Weighted average remaining lease term (years)	4.85	5.27	(8)%
Weighted average base rent (per sf)	$15.73	$15.49	2%

1. Calculated as the sum of trust units and Class B LP Units at their book value. In accordance with IFRS the Class B LP Units are presented as a financial liability in the consolidated financial statements.
2. 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.
3. Excluding convertible debentures, Debt to GBV ratio is 50% (December 31, 2015 - 50%).
4. Calculated as the sum of FFO and finance costs; divided by finance costs, excluding distributions on Class B LP Units and fair value adjustment on derivative instruments.
5. 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.

2016 Highlights:

Our portfolio performance remained steady throughout 2016. The stability and diversity of our portfolio with respect to both tenant profile and asset class position the REIT well for managing through economic cycles. We are focused on the real estate fundamentals of asset enhancement and property management while conservatively managing our debt. At 78%, our payout ratio is a strong indicator of our overall health and our ability to sustain distributions at current rates.

Highlights of our performance in the year include:

- Property acquisitions completed via the Melcor proprietary pipeline over the past 14 months coupled with densification activity on two existing properties led to revenue growth of 1% and AFFO growth of 3% over 2015.
- Leasing activity remains steady, with 256,945 sf in new and renewed leases (90% of expiring and early termination GLA) completed during the year. Occupancy remained above target at 92.4%. Step-ups on leases with escalating rents and a proportionate increase in revenue from higher rental rate retail assets led to a 2% increase in weighted average base rents over 2015.
- We achieved an on-time response rate in our signature care program of over 99% in 2016. In September, we completed a tenant survey at select Edmonton area office buildings. Respondents rated our property management team (94%) and building operations team (95%) as good, very good or excellent. We view these metrics as an important indication of our commitment to ongoing client care, which contributes to tenant satisfaction and ultimately retention.
- We renewed and re-financed $45.48 million in mortgage and Class C LP debt at an average interest rate of 2.98%. Recent renewals and re-financings have resulted in a downward trend in our weighted average interest rate, which declined 17 basis points over December 31, 2015.
- We paid monthly distributions of $0.05625 per trust unit during 2016 for an annual payout ratio of 78% (2015 - 80%).
- Our working capital position remains healthy and we continue to collect receivables in a timely manner. Funds available under our revolving credit facility at December 31, 2016 provide the REIT with the capacity to respond to market demands and investment opportunities while maintaining and sustaining operational and capital requirements.

Consolidated Revenue & NOI

	Year ended December 31		
($000s)	2016	2015	△%
Base rent	41,673	40,563	3%
Recoveries	24,054	24,252	(1)%
Other	2,372	2,111	12%
Amortization of tenant incentives	(3,216)	(3,057)	5%
Straight-line rent adjustments	1,159	1,613	(28)%
Rental revenue	66,042	65,482	1%
Operating expenses	12,822	12,696	1%
Utilities and property taxes	12,948	12,917	—%
Direct operating expenses	25,770	25,613	1%
Net rental income	40,272	39,869	1%
NOI	42,329	41,313	2%
Same asset NOI	38,980	39,696	(2)%
Operating margin	61%	61%	—%

Revenue

Rental revenue for the year ended December 31, 2016 increased $0.56 million or 1% over 2015 as a result of portfolio growth of 42,937 sf. We acquired additional phases at two existing properties in late 2015 and densified existing retail properties with two newly constructed CRUs. Rental revenue from the newly acquired/constructed GLA was $1.58 million in 2016 (2015 - $0.23 million). On a same-asset basis, base rent was stable with an increase in average base rent as rent-steps on escalating leases kicked in and there were fewer tenants on rent-free periods, which offset the slight decline in occupancy.

We continue to be proactive and strategic in our leasing programs to meet the demands of an evolving market while retaining and attracting new tenants. In 2016 we retained and renewed 66 (of 88) expiring tenancies representing 168,407 sf of GLA. Our 71% retention rate was healthy in light of challenging market conditions in many of our markets; however fell short of our targeted 75%. We took back an additional 53,795 sf of GLA due to early terminations (both tenant and landlord initiated) during the year which further impacted occupancy. Additional vacancy from lease rollovers was partially mitigated with 88,538 sf in new leasing completed during the year. The table below summarizes the leasing activity for 2016:

	Square feet	Weighted average base rent (per sf)	Occupancy (%)
Opening occupancy	2,591,550	$15.49	93.6%
Expiring Leases	(238,700)	$14.72	
Early Terminations	(53,795)	$18.19	
Renewals/Holdovers	168,407	$13.37	
New Leasing	88,538	$13.96	
New GLA Developed	7,732	$23.28	
Other Adjustments	1,090	$—	
Closing occupancy	2,564,822	$15.73	92.4%

Weighted average base rent was $15.73 per sf at December 31, 2016, an increase of 2% compared to 2015. Fewer tenants on rent-free periods and step-ups on leases with multiple rent escalations drove the increase over the comparative period. Leasing activity across our Alberta retail portfolio in conjunction with upward movement in rates in our industrial asset class also contributed to increasing combined rates. Increases in weighted average base rents were tempered by the compression of net effective rent due to increases in tenant incentives.

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

	31-Dec-16	31-Dec-15	△%
Weighted average base rent (per sf)	$15.73	$15.49	2%
Weighted average remaining lease term	4.85	5.27	(8)%
GLA	2,775,782	2,768,750	—%
Occupancy	92.4%	93.6%	(1)%
Retention	71.0%	73.0%	(3)%

Recoveries are amounts recovered from tenants for direct operating expenses incurred during the year and include a nominal administrative charge. During 2016, recoveries decreased by $0.20 million or 1% while direct operating expenses were up 1% or $0.16 million over 2015. Our recovery ratio (calculated as recoveries divided by direct operating expenses) declined 2% over 2015 as a result of a decrease in occupancy on our office portfolio, lower participation in recoverable costs on certain assets and prior year adjustments. Recovery revenue from the newly acquired/constructed GLA contributed $0.27 million in 2016 (2015 - $0.01 million).

Other revenue is comprised of parking revenue and other miscellaneous revenue which fluctuates from period to period.

Amortization of tenant incentives increased over 2015 as a result of lease rollovers during the year and strategic leasing programs in 2016. Lower net effective rent reflects market conditions, particularly in our office portfolio. Straight-line rent adjustments relate to new leases which have escalating rent rates and/or rent-free periods. The decrease in straight-line rent adjustments is a result of rent-steps on escalating leases kicking in and fewer tenants on rent-free periods. Straight-line rent adjustments fluctuate due to the timing of signed leases.

Direct operating expenses

Direct operating expenses increased by $0.16 million or 1% over 2015. Excluding the impact of the newly acquired/constructed GLA, direct operating expenses were steady over 2015. On a same-asset basis, property taxes increased 4% over 2015 as a result of recently constructed suburban retail properties converting from land based valuation to income based taxation. These increases were offset by a 9% reduction in utility costs as a result of lower energy consumption combined with cost savings on utility contracts and several 'green' initiatives'. Mill rates and appraised values across the rest of the portfolio remained relatively stable over 2015. On a same-asset basis, operating expenses were stable over 2015 and reflect inflationary growth in the cost of goods and services, offset by various initiatives to reduce costs so as to improve our competitiveness within the market.

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.

GLA added through the property acquisition completed in November 2015 and new construction in 2015 and 2016 led to a 2% increase in NOI over 2015. The slight decline in occupancy was offset by rent steps-ups and fewer tenants on rent-free periods over the comparative period. On a same-asset basis, NOI declined by 2% as a result of negative movement in non-cash adjustments with lower straight-line rent adjustments and higher tenant incentive amortization.

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)	2016	2015	△%
Same asset NOI	38,980	39,696	(2)%
Acquisitions	1,292	173	
NOI before adjustments	40,272	39,869	1%
Amortization of tenant incentives	3,216	3,057	
Straight-line rent adjustments	(1,159)	(1,613)	
NOI	42,329	41,313	2%

Property Profile

At December 31, 2016 our portfolio includes interests in 38 retail, office and industrial income-producing properties located in Western Canada for a total of 2,775,782 sf of GLA, and a land lease community.

The following table summarizes the composition of our properties by property type:

	Number of Properties	GLA (sf)/Lots	% of Portfolio (GLA)	Fair Value ($000s)	NOI ($000s)
Retail	13	978,338	35.2%	308,264	17,908
Office	20	1,566,071	56.4%	302,789	21,131
Industrial	4	231,373	8.3%	32,508	2,322
Land Lease Community	1	308 lots	n/a	16,050	968
	38	2,775,782	100.0%	659,611	42,329

The following table details key financial and operational metrics for each property type:

	Retail		Office		Industrial		Land Lease Community	
	2016	2015	2016	2015	2016	2015	2016	2015
Year ended December 31 ($000s)								
Rental revenue	**25,798**	25,116	**35,983**	36,590	**2,960**	2,495	**1,301**	1,281
NOI	**17,908**	17,324	**21,131**	21,286	**2,322**	1,750	**968**	953
As at December 31								
Average base rent (sf)	**$19.04**	$18.54	**$14.43**	$14.41	**$9.61**	$9.27	**n/a**	n/a
Occupancy %	**96.3**	96.7	**88.9**	91.2	**100.0**	100.0	**100.0**	100.0

Retail - our 13 retail properties include 5 multi-building retail power centres and 8 neighborhood shopping centres. Retail GLA increased by 32,846 sf over the past 24 months as we acquired an additional phase at Chestermere Station and constructed two additional CRUs within existing properties. Rental revenue from newly acquired/constructed retail properties was $1.19 million in 2016 (2015 - $0.17 million). Same-asset average occupancy and weighted average base rent improved across our Alberta assets, while our Saskatchewan assets saw an increase in vacancy, resulting in a net 1% increase in base rents over 2015. Same-asset NOI declined 1% over 2015 as a result of an increase in the number of tenants with gross lease deals or caps on recovery participation.

Office - our 20 office properties include low and medium-rise buildings located in strategic urban and suburban centres. Rental revenue declined 2% over 2015. Increased vacancy across much of our portfolio led to the 1% decline in base rent. The decline in base rents was partially mitigated with rent-steps on escalating leases kicking in and fewer tenants on rent-free periods. Recoveries were down 2%, over 2015, correlating with a 1% decline in direct operating expenses and reduced occupancy. NOI decreased 1% over 2015.

Industrial - our 4 industrial properties include single and multi-tenant buildings. Industrial GLA increased by 10,091 sf in November 2015 as we acquired an additional phase at Telford Industrial Park in the greater Edmonton area. Rental revenue from the new property recognized during the year was $0.39 million with NOI of $0.29 million. Same-asset rental revenue improved by 5% over 2015 as we leased up 26,000 sf of vacant space in one of our Lethbridge properties. Same-asset NOI increased 19% due to lower straight-line rent.

Land Lease Community – we have one land lease community in Calgary, AB consisting of 308 pad lots. It was 100% occupied at December 31, 2016 (December 31, 2015 – 100%). Rental revenue and NOI improved 2% over 2015 due to rate increases.

Regional Analysis

The following table summarizes the composition of our properties at December 31, 2016 by geographic region:

	Number of Properties	GLA (sf)/Lots	% of Portfolio (GLA)	Fair Value ($000s)	NOI ($000s)
Northern Alberta	24	1,633,250	58.9%	411,745	25,593
Southern Alberta	7	775,743	27.9%	180,745	12,700
Saskatchewan & British Columbia	7	366,789	13.2%	67,121	4,036
	38	2,775,782	100.0%	659,611	42,329

The following table details key financial and operational metrics for each of our geographic regions for the year ended December 31, 2016:

	Northern AB		Southern AB		SK & BC	
	2016	2015	2016	2015	2016	2015
Year ended December 31 ($000s)						
Rental revenue	**40,423**	40,218	**18,821**	17,728	**6,798**	7,536
NOI	**25,593**	25,179	**12,700**	11,369	**4,036**	4,765
As at December 31						
Average base rent (sf)	**$16.70**	$16.59	**$14.67**	$14.06	**$13.63**	$13.65
Occupancy %	**92.2**	93.7	**95.3**	95.4	**87.2**	91.6

Northern Alberta - our Northern Alberta assets are located throughout the greater Edmonton area (including Leduc and Spruce Grove) and in Red Deer. Rental revenue grew 1% over 2015 as a result of the increase in GLA. 10,091 sf industrial GLA was purchased from Melcor in November 2015 and construction of a 7,732 sf CRU was completed in Spruce Grove in April 2016. Rental revenue from the newly acquired/constructed properties was $0.60 million (2015 - $0.05 million). On a same-asset basis, rental revenue declined 1% as a result of increased vacancy rates. Net effective rent compression in the region's office assets is due to increasing competition over the past two years. The decline in base rents was partially mitigated with rent-steps on escalating leases kicking in and fewer tenants on rent-free periods. Same-asset NOI was stable.

Southern Alberta - our Southern Alberta assets are located throughout the greater Calgary area (including Chestermere and Airdrie) and in Lethbridge. GLA increased by 21,538 sf as we acquired an additional phase in Chestermere and constructed a new CRU on the property late in 2015. Rental revenue from the newly acquired/constructed retail properties was $0.98 million in 2016 (2015 - $0.17 million). On a same-asset basis, rental revenue was up 2% as a result of improvements in average base rent and stable occupancy. This translated into a 6% increase in same-asset NOI due to lower non-cash adjustments in 2016.

Saskatchewan and British Columbia - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue declined 10% over 2015 as a result of higher vacancy in our Saskatchewan portfolio in the early part of the year. NOI was also impacted by bad debt expense for a Saskatchewan retail tenant that was terminated during 2016 and a lower recoverable ratio. We completed 25,093 sf in new leasing in the region in the last half of 2016, which has mitigated the decline.

General & Administrative Expense

	Year ended December 31		
($000s)	2016	2015	△%
Asset management fee	1,592	1,524	4%
Professional fees	412	356	16%
Public company costs	244	258	(5)%
Other	405	391	4%
	2,653	2,529	5%

General & administrative expenses (G&A) was $2.65 million (4% of rental revenue) in 2016. The acquisition of 31,629 sf from Melcor in November 2015 combined with the construction of 11,308 sf drove the increase in asset management fee which is charged at an annual rate of 0.25% of gross book value. Increased usage of external valuators as part of our valuation process over the comparative period led to the increase in professional fees. We are committed to prudent financial stewardship, including carefully monitoring discretionary G&A expenses to ensure maximum value to our unitholders. We expect G&A to be approximately 5% of rental revenue.

Finance Costs

	Year ended December 31		
($000s)	2016	2015	△%
Interest on mortgages payable and revolving credit facility	8,564	8,416	2%
Interest on Class C LP Units	3,080	3,537	(13)%
Amortization of fair value adjustment on Class C LP Units	(227)	(339)	(33)%
Interest on convertible debenture	1,898	1,898	—%
Fair value adjustment on derivative instruments	(54)	(180)	(70)%
Non-cash finance costs	887	596	49%
Finance costs before distributions	14,148	13,928	2%
Distributions on Class B LP Units	9,866	9,866	—%
Finance costs	24,014	23,794	1%

Finance costs for 2016 were $0.22 million or 1% higher compared to 2015. Interest on mortgages payable and our revolving credit facility increased $0.15 million as a result of higher average mortgage indebtedness and amounts drawn under our credit facility. This was partially offset by interest rate savings on new and renewed mortgage financings which resulted in a 17 basis point decrease in our weighted average interest rate over 2015. Interest on Class C LP Units decreased over the comparative period as we repaid the maturing balance on 333,100 Class C LP Units in February 2015 for approximately $3.10 million and reduced the interest rate on extension of 2,195,911 Class C LP Units in August 2015 and 997,220 Class C LP Units in August 2016. Our $34.50 million convertible debenture pays a coupon of 5.50% annually.

Distributions on Class B LP Units were unchanged over 2015 at $9.87 million. Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units which were $0.68 per unit during the year.

Non-cash finance costs increased over 2015 as a result of fully unwinding the discount recognized on a 2014 mortgage assumption which was re-refinanced during Q1-2016. This was partially offset by higher amortization of deferred finance costs on recent re-financings, including our revolving credit facility. We have a floating for fixed interest rate swap on one of our mortgages. At December 31, 2016 we re-valued the instrument, resulting in a gain of $0.11 million.

As at December 31, 2016, the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debenture was 3.63% based on period end balances (December 31, 2015 – 3.80%).

Income Taxes

As at December 31, 2016, 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.

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.

($000s, except per unit amounts)	Year ended December 31 2016	 2015	 △%
Net income (loss) for the year	(11,176)	41,070	
Add / (deduct)			
Fair value adjustment on investment properties	6,546	5,418	
Fair value adjustment on Class B LP Units	18,270	(32,886)	
Amortization of tenant incentives	3,216	3,057	
Distributions on Class B LP Units	9,866	9,866	
Fair value adjustment on derivative instruments	(54)	(180)	
Funds From Operations (FFO)	26,668	26,345	1%
Add / (deduct)			
Straight-line rent adjustments	(1,159)	(1,613)	
Non-cash finance costs	887	596	
Net impact of amortization of fair value adjustment and interest subsidy[1]	153	254	
Normalized capital expenditures[2]	(2,559)	(1,289)	
Normalized tenant incentives and leasing commissions[2]	(1,706)	(2,565)	
Adjusted Funds from Operations (AFFO)	22,284	21,728	3%
FFO/Unit	$1.03	$1.02	1%
AFFO/Unit	$0.86	$0.84	3%

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 6% and 4% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively (2015 - 3% and 6% of annual NOI respectively). Amounts are net of usage of the capital expenditure subsidy provided by Melcor as part of the transfer of Initial Properties.

In 2016 we re-assessed our normalized capital expenditures, tenant incentives and leasing commissions and increased the allowance to 10% of annualized NOI, up from 9% in 2015. We determined that an upward revision was appropriate based on significant changes to the economic environment in which we operate and the impact on our strategy moving forward.

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

($000s, except per unit amounts)	Year ended December 31 2016	 2015	 △%
Funds From Operations (FFO)	26,668	26,345	1%
Interest on convertible debenture	1,898	1,898	
Non-cash finance costs on convertible debenture	503	466	
Funds From Operations - Diluted (FFO - Diluted)	29,069	28,709	1%
FFO - Diluted/Unit	$1.02	$1.00	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 $7.53 million (2015 - $7.58 million).

Distributions made during the year ended December 31, 2016 represent a payout ratio of approximately 78% of AFFO (2015 - 80%). The improved payout ratio over 2015 is due to accretive acquisitions and densification projects completed over the past 14 months. We generate sufficient cash flows from operations to sustain our current distribution rate for the foreseeable future. We use AFFO in evaluating our ability to continue to fund distributions. The most similar IFRS measure is cash flow from operations. Cash flow from operations for 2015 was $12.31 million, exceeding trust unit distributions by $4.79 million (2015 - $10.56 million, exceeding trust unit distributions by $2.98 million).

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

($000s)	Year ended December 31 2016	 2015	 △%
Cash flows from operations	12,312	10,563	17%
Distributions on Class B LP Units	9,866	9,866	
Payment of tenant incentives and direct leasing costs	3,410	4,637	
Change in restricted cash	—	(64)	
Changes in operating assets and liabilities	581	(13)	
Interest subsidy	380	593	
Normalized capital expenditures	(2,559)	(1,289)	
Normalized tenant incentives and leasing commissions	(1,706)	(2,565)	
Adjusted Funds from Operations (AFFO)	22,284	21,728	3%

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:

	31-Dec-16	31-Dec-15
Number of properties	38	38
Total GLA (sf)	2,895,306	2,888,246
GLA (REIT owned %) (sf)	2,775,782	2,768,750
Fair value of portfolio ($000s)	659,611	660,935
Value per square foot	$238	$239
NOI ($000s)	42,329	41,313
Weighted average capitalization rate	6.63%	6.57%
Weighted average terminal cap rate	6.83%	6.81%
Weighted average discount rate	7.70%	7.71%

For the year ended December 31, 2016, Melcor's internal valuation team performed the valuation assessment. Of 47 legal phases assessed, 22 investment properties with a fair value of $287.00 million were valued by qualified independent external valuation professionals during the year, resulting in a fair value loss of $6.55 million recorded on investment properties in the statements of income and comprehensive income. In 2015, 27 properties of 47 legal phases with a fair value of $443.75 million were valued by external valuation professionals, resulting in a fair value loss of $5.42 million. Refer to note 26 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 is as follows:

	Year ended December 31		
($000s)	2016	2015	$△
Northern Alberta	(3,773)	(8,253)	4,480
Southern Alberta	(3,322)	1,833	(5,155)
Saskatchewan & British Columbia	549	1,002	(453)
	(6,546)	(5,418)	(1,128)

Fair value losses in Northern Alberta were primarily driven by capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. This was partially offset by fair value gains realized upon completion of construction of a 7,732 sf CRU at a regional shopping centre. Capitalization rates and stabilized NOI remained stable over 2015 within our Northern Alberta portfolio. Fair value losses in our Southern Alberta portfolio was the result of a decrease in stabilized NOI on one of our suburban office properties in the greater Calgary area. Fair value adjustments represent a change of approximately 1% in the fair value of our portfolio.

Fair values are most sensitive to changes in capitalization rates.

	December 31, 2016			December 31, 2015		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.63%	5.50%	9.00%	6.57%
Terminal capitalization rate	5.75%	9.00%	6.83%	5.75%	9.25%	6.81%
Discount rate	6.50%	9.75%	7.70%	6.50%	10.00%	7.71%

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by $46.37 million (2015 - $46.95 million) while a 50 basis points decrease (-0.5%) would increase it by $53.94 million (2015 - $54.69 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)	2016	2015	$△
Cash from operating activities	12,312	10,563	1,749
Cash used in investing activities	(2,828)	(18,113)	15,285
Cash from (used in) financing activities	(7,854)	838	(8,692)
Increase (decrease) in cash and cash equivalents	1,630	(6,712)	8,342
Cash and cash equivalents, beginning of year	—	6,712	(6,712)
Cash and cash equivalents, end of year	1,630	—	1,630

Operating activities

Cash from operating activities increased $1.75 million or 17% over 2015. Properties acquired from Melcor in November 2015 and the construction of two CRUs at existing properties added $1.10 million in NOI (2015 - $0.16 million). Cash finance costs (finance costs excluding non-cash finance costs, amortization and fair value adjustments) decreased $0.31 million over 2015 as a result of interest rate savings on new and renewed mortgage financings over the past 24 months. Higher NOI and lower cash finance costs was partially offset by an increase of $0.12 million in G&A.

We continued to execute strategies to maintain occupancy and invested $3.41 million on tenant incentives and direct leasing costs for new and renewed leases in 2016 (2015 - $4.64 million). As at December 31, 2016 we have completed 256,945 sf in new and renewed leasing, resulting in a year-end occupancy rate of 92.4%. The timing of lease expiries impacts the level of spending on tenant incentives and direct leasing costs and will fluctuate from year to year. Changes in working capital decreased operating cash flows by $0.59 million over 2015.

Investing activities

During 2016 we substantially completed construction on a 7,732 sf single-tenant CRU to densify an existing regional power center in Northern Alberta, investing $1.64 million in development costs (2015 - $0.36 million invested in construction of a 3,576 sf (JV%) CRU in an existing Southern Alberta regional power centre). We remain committed to strategic value-adding asset enhancement and preservation projects as a integral component of our strategy to improve our assets and retain and attract tenants. We spent $2.23 million on our capital program in 2016 (2015 - $2.43 million). Asset enhancement and preservation investments fluctuate based on the nature and timing of projects undertaken. 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.

During 2016 we recognized $1.04 million in cash inflows related to the expiration of our restricted cash covenant with the underwriters, thus allowing us to use the remaining balance for general purposes.

In 2015 we acquired additional phases at two existing properties for an investment of $15.33 million.

Financing activities

During 2016 we re-financed two mortgages on two properties with a principal balance of $26.50 million for net proceeds of $7.30 million. We also obtained mortgage financing on a recently acquired and previously unencumbered property for proceeds of $2.80 million.

In 2015 we renewed and re-financed four mortgages on three properties with a principal balance of $12.69 million for net proceeds of $1.49 million. A fifth mortgage, which had a principal balance of $3.94 million was repaid and retired in November 2015 leaving the $7.50 million property unencumbered. In November 2015 we obtained mortgage financing on a recently acquired and previously unencumbered property for proceeds of $6.25 million (held with joint arrangement partners). Also during 2015, we repaid the maturing balance on 333,100 Class C LP Units with a carrying value of $3.10 million on one of our commercial properties by issuing a mortgage.

Partial proceeds from mortgage financings in the current and comparative period were used to repay amounts drawn under the revolving credit facility. During 2016 we recognized $1.25 million in cash inflows related to the expiration of our restricted cash covenant with the underwriters, thus allowing us to use the remaining balance for general purposes.

In 2015, we purchased and canceled 123,703 units at a cost of $1.00 million under our normal course issuer bid (NCIB).

We continued our monthly distribution of $0.05625 per unit for total annual distributions of $7.53 million to unitholders (2015 - $7.58 million).

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, 2016 we had $1.63 million in cash and cash equivalents and additional available funds under our revolving credit facility. These funds will enable us to capitalize on future acquisition opportunities as well as meet ongoing capital needs.

The REIT has an available credit limit based on the carrying values of specific investment properties up to a maximum of $35.00 million for general purposes, including a $5.00 million swingline sub-facility. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.15% or bankers acceptance plus 2.25% stamping fee. The facility matures May 1, 2018.

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 Degree of Leverage Ratio, 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). Throughout the year, we were in compliance with the Degree of Leverage Ratio and had a ratio of 50% as at December 31, 2016 (55% including the convertible debenture).

As at December 31, 2016, the REIT's total capitalization was $612.55 million and is comprised as follows:

($000s)	31-Dec-16
Revolving credit facility(1)	17,480
Mortgages payable(1)	220,062
Class C LP Units(2)	79,905
Indebtedness, excluding convertible debenture	**317,447**
Convertible debenture(3)	34,500
Indebtedness	**351,947**
Class B LP Units(4)	147,708
Trust units	112,892
Equity	**260,600**
Total capitalization	**612,547**
Gross Book Value ("GBV")(5)	**636,903**
Debt to GBV, excluding convertible debenture (maximum threshold - 60%)	50%
Debt to GBV (maximum threshold - 65%)	55%

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, subsequent asset purchases and development costs.

We are subject to financial covenants on our $35.00 million revolving credit facility. The covenants include a maximum debt to gross book value ratio of 60% (excluding convertible debentures), a minimum debt service coverage ratio of 1.50, and a minimum adjusted unitholders' equity of $140.00 million. As at December 31, 2016, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 48%, debt service coverage ratio of 1.68, and an adjusted unitholders' equity of $291.06 million. We also have financial covenants on certain mortgages for investment properties. At December 31, 2016, 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.

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	**17,480**	**220,062**	**79,905**	**34,500**	**351,947**	**100%**
2017	17,480	6,821	6,074	—	30,375	9%
2018	—	46,399	14,637	—	61,036	17%
2019	—	68,577	9,634	34,500	112,711	32%
2020	—	8,723	26,299	—	35,022	10%
2021	—	33,791	8,088	—	41,879	12%
Thereafter	—	55,751	15,173	—	70,924	20%

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	**17,480**	**220,062**	**79,905**	**34,500**	**351,947**
Fixed	—	201,926	79,905	34,500	**316,331**
Variable	17,480	18,136	—	—	**35,616**
Weighted average interest rate	3.48%	3.45%	3.34%	5.50%	**3.63%**
Weighted average term to maturity	1.33	4.29	3.79	3.00	**3.90**

The weighted average interest rate on our debts decreased to 3.63% (December 31, 2015 - 3.80%) as a result of mortgage and Class C LP Unit financings.

In 2016, five mortgages on five properties (one of which is held with a joint arrangement partner) were up for renewal. We re-financed two Edmonton area property mortgages for $26.50 million at 3.05% (previously 5.43%) with net proceeds of $7.30 million. The three remaining mortgages were renewed with existing lenders which had a principal balance of $9.00 million at 3.14%, securing a reduced interest rate of 3.06% on renewal. During the year we also placed mortgage financing on a recently acquired and previously unencumbered property for proceeds of $2.80 million at a fixed interest rate of 3.16%.

During the year we also extended the maturity of a $9.03 million mortgage that secures Retained Debt relating to one of the Initial Properties from August 1, 2016 to August 1, 2021, at a reduced interest rate of 2.54% (previously 3.85%).

The financing environment remains competitive and we expect to be able to secure new financing on remaining upcoming mortgage and Class C LP Unit renewals at favourable rates.

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)	**2016**	**2015**
FFO	**26,668**	26,345
Principal repayments on Mortgages payable	**6,491**	6,139
Principle repayments on Class C LP Units	**3,590**	3,485
Debt service coverage ratio	**2.65**	2.74
FFO plus finance costs	**40,870**	40,453
Finance costs[1]	**14,202**	14,108
Finance costs coverage ratio	**2.88**	2.87

1. Finance costs excluding finance expense recognized on Class B LP Unit distributions and fair value adjustment on derivative instruments.

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 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.

In 2015 we purchased and canceled 123,703 trust units at a cost of $1.00 million under our normal course issuer bid (NCIB).

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, 2016		December 31, 2015	
	Units	$ Amount	Units	$ Amount
Balance, beginning of year	11,151	112,892	11,275	114,144
Repurchase of Units	—	—	(124)	(1,252)
Balance, end of year	11,151	112,892	11,151	112,892
Dilutive securities				
Class B LP Units	14,616	147,708	14,616	147,708
Convertible debenture	2,727	34,500	2,727	34,500
Diluted balance, end of year	28,494	295,100	28,494	295,100

Off Balance Sheet Arrangements

As at December 31, 2016, we had no off-balance-sheet arrangements.

Quarterly Results

2016	Q4	Q3	Q2	Q1
Revenue ($000s)	16,170	16,439	16,807	16,626
Net income (loss) ($000s)	2,790	153	(4,153)	(9,966)
Income per unit	$0.25	$0.01	$(0.37)	$(0.89)
Annualized distribution rate	$0.675	$0.675	$0.675	$0.675
Period-end closing unit price	$8.46	$8.67	$8.50	$8.00
Annualized distribution yield on closing unit price (%)[1]	7.98%	7.79%	7.94%	8.44%

2015	Q4	Q3	Q2	Q1
Revenue ($000s)	16,963	15,938	16,323	16,258
Net income ($000s)	16,381	11,287	111	13,291
Income per unit	$1.46	$1.00	$0.01	$1.18
Annualized distribution rate	$0.675	$0.675	$0.675	$0.675
Period-end closing unit price	$7.21	$7.95	$8.73	$8.64
Annualized distribution yield on closing unit price (%)[1]	9.36%	8.49%	7.73%	7.81%

1. Annualized distribution yield is calculated as the annualized distribution rate divided by the period-end closing unit price.

Fourth Quarter Results

Consolidated Revenue & NOI

($000s)	Three months ended December 31 2016	2015	△%
Base rent	10,403	10,325	1%
Recoveries	5,766	6,304	(9)%
Other	572	596	(4)%
Amortization of tenant incentives	(787)	(681)	16%
Straight-line rent adjustment	216	419	(48)%
Rental revenue	16,170	16,963	(5)%
Operating expenses	3,415	3,546	(4)%
Utilities and property taxes	3,075	3,278	(6)%
Direct operating expenses	6,490	6,824	(5)%
Net rental income	9,680	10,139	(5)%
NOI	10,251	10,401	(1)%
Same asset NOI	9,338	9,991	(7)%
Operating margin	60%	60%	—%

Rental revenue for the fourth quarter was $16.17 million, a decrease of $0.79 million over Q4-2015. Reduced recoveries in the fourth quarter drove the decline due to the increase in vacancies and in the number of tenants with gross lease deals or caps on recovery participation. Recoveries are trued up to actual expenses in the fourth quarter each year, which can result in greater variance in the quarter. Lower straight-line rent adjustments contributed to the decline in rental revenue. Newly acquired/constructed GLA mitigated the downward trend and contributed $0.42 million in revenue and $0.29 million in NOI in Q4-2016 (Q4-2015 - $0.19 million and $0.14 million respectively). Direct operating expenses continued to trend downward in the fourth quarter as a result of reduced utility costs and a reduction in operating expenses due to the timing of maintenance projects.

General & Administrative Expense

($000s)	Three months ended December 31 2016	2015	△%
Asset management fee	400	385	4%
Professional fees	89	101	(12)%
Public company costs	39	53	(26)%
Other	104	158	(34)%
	632	697	(9%)

General & administrative expenses in Q4-2015 were inflated by the retroactive amendment to a JV agreement resulting in a higher than normal fourth quarter expense. Q4-2016 reflects a more typical run rate.

Finance Costs

($000s)	Three months ended December 31 2016	2015	△%
Interest on mortgages payable and revolving credit facility	2,078	2,137	(3%)
Interest on Class C LP Units	767	788	(3)%
Amortization of fair value adjustment on Class C LP Units	(56)	(57)	(2%)
Interest on convertible debenture	475	488	(3%)
Fair value adjustment on derivative instruments	(268)	(180)	49%
Non-cash finance costs	276	148	86%
Finance costs before distributions	3,272	3,324	(2%)
Distributions on Class B LP Units	2,467	2,467	—%
Finance costs	5,739	5,791	(1)%

Finance costs for the fourth quarter were $5.74 million or 1% lower than Q4-2015. Interest on mortgages and our revolving credit facility declined $0.06 million as a result of lower interest rates on new and renewed mortgages. Higher non-cash finance costs are the result of higher amortization of deferred finance costs on recent re-financings, including our revolving credit facility. Fully unwinding the discount recognized on a 2014 mortgage assumption which was re-refinanced during Q1-2016 also contributed to this increase. Fair value adjustments on derivative instruments further contributed to the decrease in finance costs over Q4-2015.

Funds from Operations & Adjusted Funds from Operations

($000s, except per unit amounts)	Three months ended December 31 2016	2015	△%
Net income for the period	2,790	16,381	
Add / (deduct)			
Fair value adjustment on investment properties	3,600	(1,904)	
Fair value adjustment on Class B LP Units	(3,070)	(10,816)	
Amortization of tenant incentives	787	681	
Distributions on Class B LP Units	2,467	2,467	
Fair value adjustment on derivative instruments	(268)	(180)	
Funds From Operations (FFO)	6,306	6,629	(5)%
Add / (deduct)			
Straight-line rent adjustments	(216)	(419)	
Non-cash finance costs	276	148	
Net impact of amortization of fair value adjustment and interest subsidy(1)	(2)	45	
Normalized capital expenditures(2)	(640)	(324)	
Normalized tenant incentives and leasing commissions(2)	(427)	(645)	
Adjusted Funds from Operations (AFFO)	5,297	5,434	(3)%
FFO/Unit	0.24	0.26	(6)%
AFFO/Unit	0.21	0.21	(2)%

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 6% and 4% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively (2015 - 3% and 6% of annual NOI respectively). Amounts are net of usage of the capital expenditure subsidy provided by Melcor as part of the transfer of Initial Properties.

Funds from operations (FFO) and Adjusted funds from operations (AFFO) were 5% and 3% lower in Q4-2016 than the comparative period. Lower occupancy and the timing lag on the lease up of space contributed to lower NOI. This was partially offset by lower G&A and finance costs in the quarter.

Fourth quarter distributions to unitholders were $1.88 million (2015 - $1.88 million).

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

($000s)	Three months ended December 31 2016	2015	△%
Cash flows from operations	3,078	3,842	(20)%
Distributions on Class B LP Units	2,467	2,467	
Payment of tenant incentives and direct leasing costs	971	849	
Changes in operating assets and liabilities	(206)	(857)	
Interest subsidy	54	102	
Normalized capital expenditures	(640)	(324)	
Normalized tenant incentives and leasing commissions	(427)	(645)	
Adjusted Funds from Operations (AFFO)	5,297	5,434	(3)%

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 year 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 monthly cash distributions to unitholders.

We continue to emphasize our strategic leasing program for lease renewals and new tenants. We also remain committed to our signature care program to ensure we are the landlord of choice for our tenants.

Occupancy at year end was 92.4% compared to 93.6% at the end of the 2015. 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.

The following table summarizes maturing mortgage balances, Class C LP Units, and the revolving credit facility and their respective weighted average interest rates relative to the fair value of encumbered assets:

	Revolving credit facility	Mortgages payable	Class C LP Units	Total
2017	17,480	—	2,578	**20,058**
2018	—	39,341	11,421	**50,762**
2019	—	62,959	6,576	**69,535**
2020	—	5,318	23,863	**29,181**
2021	—	30,497	7,181	**37,678**
Thereafter	—	48,294	14,265	**62,559**
Total	17,480	186,409	65,884	**269,773**

	FV of Collateral	Leverage (%)	Weighted Average Interest Rate
2017	61,647	33%	**3.44%**
2018	116,159	44%	**3.66%**
2019	156,678	44%	**3.30%**
2020	77,378	38%	**3.26%**
2021	86,381	44%	**2.96%**
Thereafter	139,544	45%	**3.73%**
Total	637,787		

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 8.

We have one property encumbered by Class C LP Units where the underlying mortgage - held by Melcor - is up for renewal in the next twelve months. At maturity the value of the Class C LP Units will be $2.58 million, representing 295,327 Class C LP Units, with a weighted average interest rate of 3.13%. We expect to be able to obtain new mortgage financing on the property, proceeds of which will be used to redeem the Class C LP Unit liability to Melcor.

We continually monitor our upcoming mortgage renewals to identify opportunities and risks.

With a strong, diversified portfolio, focus on property management and client relationships, and a solid pipeline of over 7 million sf of high quality assets being developed over the next 5-10 years, we remain well positioned for the future.

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 space in our properties becomes vacant and cannot be leased on economically favourable lease terms.

Concentration of Properties and Tenants

Of our total GLA, 86.79% is located in Alberta. Consequently, the market value of REIT's properties, the income generated by the REIT and the REIT's performance are particularly sensitive to changes in Alberta's real estate markets and general economic conditions. The factors impacting the real estate markets in Alberta and the Alberta economy in general may differ from those affecting other regions of Canada.

Adverse changes in economic conditions in Alberta may have a material adverse effect on the REIT's business, cash flows, financial condition and results of operations and on our ability to make distributions to unitholders. 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 competitive 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. New office towers in downtown Edmonton will add 1,745,000 sf of competing space over the next 2 years.

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 lease vacant 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 distributions. 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 properties required by new tenant.

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 is 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;
- 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 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 exposure to interest rate fluctuations. These fluctuations in interest rates may impact the earnings of the REIT. The REIT's financial and operating results could be materially adversely affected by higher interest rates.

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
2017	128	406,876	14.7%	$14.58
2018	67	320,159	11.5%	$14.74
2019	71	308,342	11.1%	$14.14
2020	70	249,805	9.0%	$17.20
2021	89	205,922	7.4%	$18.16
Thereafter	151	1,074,030	38.7%	$15.60
Vacant Space	—	210,647	7.6%	—
	576	**2,775,781**		

The following table illustrates the 2017 maturities by property type and geographic area:

	Northern AB	Southern AB	BC & SK	Total
Retail	113,998	6,085	34,746	**154,829**
Office	172,612	44,519	26,916	**244,047**
Industrial	—	8,000	—	**8,000**
	286,610	58,604	61,662	**406,876**

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 2017 and corresponding areas leased by each tenant.

Rank	Tenant (Operating Name)	% of Total Minimum Rent	Lease GLA (sf)	% of Total Owned GLA	Remaining Term (yrs)	No. of Locations in Properties	Credit Rating (S&P/Moody's/ DBRS)
1	Alberta Health Services	4.7%	146,798	5.4%	6	4	---
2	Government of Alberta	4.3%	109,652	4.0%	4	5	AA+ /Aaa/ AAA
3	Royal Bank of Canada	3.6%	60,515	2.2%	3	5	AA-/Aa3/AA
4	Shoppers Drug Mart	2.9%	44,228	1.6%	10	3	BBB+/-/BBB
5	BasinTek LLC	2.3%	88,699	3.2%	7	1	---
6	Fountain Tire	2.1%	30,514	1.1%	12	1	---
7	TD Bank	1.6%	25,675	0.9%	5	4	AA-/Aa1/AA
8	The Brick Warehouse LP	1.5%	39,481	1.4%	1	3	---
9	Melcor Developments	1.5%	39,014	1.4%	2	3	---
10	Select Engineering Consultants	1.0%	23,432	0.8%	10	1	---

Significant Ownership by Melcor

Melcor holds a 56.7% 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 entitle Melcor to priority distributions over holders of Class A LP and Class B LP Units in an amount 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 Trustees to the REIT board. 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 may 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 operating 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 managers 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 unitholder.

Taxation Matters

Although we currently meet the requirements of the REIT Exception, there can be no assurance that the REIT will continue to qualify for the REIT Exception to remain tax exempt 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 unitholders.

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 unitholders.

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 2016, we had three joint arrangements (2015 - three). Refer to note 21 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)	31-Dec-16	31-Dec-15	31-Dec-16	31-Dec-15
Revenue	5,182	4,219	10,364	8,438
Earnings	3,559	2,249	7,118	4,498
Assets	61,417	60,354	122,834	120,708
Liabilities	30,802	31,808	61,604	63,616

Related Party Transactions

Please refer to note 20 to the consolidated financial statements for information pertaining to transactions with related parties.

Subsequent Events

Please refer to note 27 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 and 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, 2016. 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 are 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, 2016.

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, 2016, 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.

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 9, 2017, the REIT was in compliance with all investment guidelines and operating policies stipulated in the DOT.

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 effective rent: is calculated as total base rent receivable over the term of the lease less any tenant incentives and direct leasing costs paid divided by the square footage of the space, as calculated on an annualized basis.

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

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			Year ended December 31		
($000s)	2016	2015	△%	2016	2015	△%
Net income (loss)	**2,790**	16,381		**(11,176)**	41,070	
Net finance costs	**5,728**	5,781		**23,979**	23,738	
Fair value adjustment on Class B LP Units	**(3,070)**	(10,816)		**18,270**	(32,886)	
Fair value adjustment on investment properties	**3,600**	(1,904)		**6,546**	5,418	
General and administrative expenses	**632**	697		**2,653**	2,529	
Amortization of tenant incentives	**787**	681		**3,216**	3,057	
Straight-line rent adjustment	**(216)**	(419)		**(1,159)**	(1,613)	
NOI	**10,251**	10,401	(1)%	**42,329**	41,313	2%

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) fair value adjustment on derivative instruments, 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.

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

Finance costs coverage ratio: is calculated as FFO plus finance costs for the period divided by finance costs expensed during the period excluding distributions on Class B LP Units and fair value adjustment on derivative instrument.

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.

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.

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 Trusts'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	**Naomi Stefura, CA**
Chief Executive Officer	Chief Financial Officer

Edmonton, Alberta | March 9, 2017

Auditor's Report to Unitholders

We have audited the accompanying consolidated financial statements of Melcor Developments Ltd. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015 and the consolidated statements of income, comprehensive income, changes in 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.

Auditor's 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 Developments Ltd. and its subsidiaries as at December 31, 2016 and December 31, 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants
Edmonton, Alberta | March 9, 2017

Consolidated Statements of Financial Position

As at December 31 ($000s)	2016	2015
ASSETS		
Current Assets		
Cash and cash equivalents	1,630	—
Accounts receivable	1,364	2,302
Other assets (note 8)	1,009	933
	4,003	3,235
Non-Current Assets		
Restricted cash (note 3d)	—	2,288
Investment properties (note 7 and 26)	641,365	643,421
Other assets (note 8)	18,246	17,514
Derivative financial asset (note 11 and 26)	110	—
	659,721	663,223
TOTAL ASSETS	663,724	666,458
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 9)	17,324	19,258
Accounts payable	1,516	1,487
Distribution payable	1,449	1,449
Accrued liabilities and other payables (note 10 and 20)	5,820	6,724
Class C LP Units (note 12)	6,074	12,301
Mortgages payable (note 11)	6,821	34,125
	39,004	75,344
Non-Current Liabilities		
Accrued liabilities and other payables (note 10)	1,475	1,408
Class B LP Units (note 14 and 26)	123,650	105,380
Class C LP Units (note 12)	74,494	71,857
Mortgages payable (note 11)	212,045	181,269
Convertible debenture (note 13)	32,749	32,246
Derivative financial liability (note 13 and 26)	61	5
TOTAL LIABILITIES	483,478	467,509
UNITHOLDERS' EQUITY	180,246	198,949
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	663,724	666,458

See accompanying notes to the consolidated financial statements.

By order of the REIT's Board of Trustees:

Brian Hunt
Audit Committee Chair

Andrew Melton
Chairman

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)

For the years ended December 31 ($000s)	2016	2015
Rental revenue (note 16 and 20)	**66,042**	65,482
Direct operating expenses (note 20)	**(25,770)**	(25,613)
Net rental income	**40,272**	39,869
General and administrative expenses (note 20)	**(2,653)**	(2,529)
Fair value adjustment on investment properties (note 7 and 26)	**(6,546)**	(5,418)
Fair value adjustment on Class B LP Units (note 14 and 26)	**(18,270)**	32,886
Income before finance costs	**12,803**	64,808
Interest income	**35**	56
Finance costs (note 17 and 20)	**(24,014)**	(23,794)
Net finance costs	**(23,979)**	(23,738)
Net income (loss) and comprehensive income (loss)	**(11,176)**	41,070
Basic earnings (loss) per trust unit (note 19)	**($1.00)**	$3.65
Diluted earnings (loss) per trust unit (note 19)	**($1.00)**	$0.71

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Unitholders' Equity

As at December 31 ($000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2014	11,275,000	103,959	40,196	22,306	166,461
Trust units repurchased (note 15)	(123,703)	(1,252)	252	—	(1,000)
Net income for the year	—	—	—	41,070	41,070
Distributions to unitholders	—	—	—	(7,582)	(7,582)
Balance at December 31, 2015	11,151,297	102,707	40,448	55,794	198,949
Net loss for the year	**—**	**—**	**—**	**(11,176)**	**(11,176)**
Distributions to unitholders	**—**	**—**	**—**	**(7,527)**	**(7,527)**
Balance at December 31, 2016	**11,151,297**	**102,707**	**40,448**	**37,091**	**180,246**

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended December 31 ($000s)	2016	2015
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income (loss) for the year	(11,176)	41,070
Non cash items:		
Amortization of tenant incentives (note 8 and 16)	3,216	3,057
Straight-line rent adjustments (note 16)	(1,159)	(1,613)
Fair value adjustment on investment properties (note 7 and 26)	6,546	5,418
Fair value adjustment on Class B LP Units (note 14 and 26)	18,270	(32,886)
Amortization of fair value adjustment on Class C LP Units (note 17)	(227)	(339)
Fair value adjustment on derivative instruments (note 17)	(54)	(180)
Non-cash finance costs (note 17)	887	596
	16,303	15,123
Payment of tenant incentives and direct leasing costs	(3,410)	(4,637)
Change in restricted cash (note 3d)	—	64
Changes in operating assets and liabilities (note 3o)	(581)	13
	12,312	10,563
INVESTING ACTIVITIES		
Additions to investment properties (note 6 and 7)	—	(15,327)
Investment property improvements and development (note 7)	(3,869)	(2,786)
Change in restricted cash (note 3d)	1,041	—
	(2,828)	(18,113)
FINANCING ACTIVITIES		
Change in revolving credit facility	(1,821)	14,301
Proceeds from mortgages payable	29,300	17,595
Repayment of mortgages payable	(25,690)	(16,818)
Repayment on Class C LP Units	(3,363)	(6,251)
Change in restricted cash (note 3d)	1,247	593
Trust units repurchased (note 15)	—	(1,000)
Distributions to unitholders	(7,527)	(7,582)
	(7,854)	838
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE YEAR	1,630	(6,712)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	—	6,712
CASH AND CASH EQUIVALENTS, END OF THE YEAR	1,630	—

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.

The principal business of the REIT is to acquire, own and manage office, retail and industrial properties in select markets across 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 20).

As at March 9, 2017, Melcor, through an affiliate, holds an approximate 56.7% effective interest in the REIT through ownership of all Class B LP Units of Melcor REIT Limited Partnership (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").

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 9, 2017.

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, Class B LP Units and derivative financial instruments 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

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.

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 (2015 – three) with 50% interests. Refer to note 21 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. On May 1, 2016 the term of the covenant elapsed, at which point the remaining restricted cash was re-classified to cash and cash equivalents.

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 fair value, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows.

The REIT's management company, Melcor Developments Ltd. ("Melcor") is responsible for determining the fair value of investment properties quarterly. Melcor has an internal valuation team consisting of individuals who are knowledgeable and have experience in the fair value techniques applied in valuing investment property. At least once every two years, the valuations are performed by qualified external valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment properties being valued. The quarterly valuations, including key inputs, are reviewed by the REIT's Chief Executive Officer and Chief Financial Officer and are discussed with the REIT's Audit Committee prior to being finalized.

Changes in fair value are recognized in the consolidated statements of income and comprehensive income in the period in which they arise.

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 20), 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 consolidated 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

DDistributions 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 revolving 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, fair value adjustment on derivative financial instruments 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:

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, distribution 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 derivatives are comprised of the conversion feature on our convertible debenture and interest rate swap on one of our mortgages. 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 instruments are recorded in the consolidated statement of financial position at their fair value. Changes in fair value of derivative instruments that are not designated as hedges for accounting purposes are recognized in the consolidated statement of income and comprehensive income.

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, accrued liabilities and other payables and deferred finance costs capitalized during the year. Excluded from operating assets and liabilities are investment property additions and tenant incentive payments that are unpaid and included in accounts payable at year end.

4. SIGNIFICANT JUDGEMENTS AND CRITICAL ACCOUNTING ESTIMATES

Estimates and judgments are continually evaluated and are based on historical experience as 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. INVESTMENT PROPERTIES

Our accounting policies related to investment properties are described in note 3(e). 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'.

B. 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.

C. 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 we continue 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

The fair value of investment properties is dependent on stabilized net operating income or forecasted future cash flows and property specific capitalization or discount rates. The stabilized net operating income or forecasted future cash flows involve assumptions of future rental income, including estimated market rental rates and vacancy rates, estimated direct operating costs and estimated capital expenditures. Capitalization and discount rates take into account the location, size and quality of the property, as well as market data at the valuation date. Refer to note 7 and 26 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, 2016:

IAS 1, Presentation of financial statements was amended to clarify guidance on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies.

Adoption of this amended standard did not require any changes to the financial statements or disclosure of accounting policies.

IFRS 11, Accounting for acquisitions of interests in joint operations was amended to provide specific guidance on accounting for the acquisition of an interest in a joint operation that is a business.

Adoption of this amended standard did not require any adjustment to the method of accounting for the joint operations in the financial statements.

Other standards, amendments and interpretations that were effective for the year beginning January 1, 2016 are not material to the REIT.

Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

NEW AND AMENDED STANDARDS NOT YET ADOPTED

IAS 7, Statement of cash flows was amended to require disclosures about changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

This amendment is effective for the years beginning on or after January 1, 2017.

IAS 12, Income taxes was amended to (i) clarify what is meant by "information disclosed elsewhere in the interim financial report" and (ii) require a cross reference to the location of that information.

This amendment is effective for years beginning on or after January 1, 2016.

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 to each prior reporting period presented retrospectively or through the recognition of the cumulative effect to opening retained earnings.

An amendment was issued in September 2015 to defer the effective date of IFRS 15 to the first interim period within years beginning on or after January 1, 2018.

Amendment to IFRS 15 was issued in April 2016 to clarify the guidance on identifying performance obligations, licenses of intellectual property and principal versus agent, and to provide additional practical expedients on transition. Amendments are effective for annual reporting periods beginning on or after January 1, 2018.

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 16, Leases was issued in January 2016 by the IASB to replace IAS 17. IFRS 16 includes several changes in the method of accounting for operating leases, including:

i. All leases will be on the balance sheet of lessees, except those that meet the limited exception criteria;

ii. Rent expense for leases on the balance sheet will be recorded as depreciation and finance expenses;

iii. Timing of expenses will change as the finance lease model results in an accelerated recognition of expenses compared to a straight-line operating lease model.

IFRS 16 is required to be applied for annual periods beginning on or after January 1, 2019.

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

6. INVESTMENT PROPERTY ACQUISITIONS

On November 12, 2015, we completed the purchase of a multi-tenant retail property (held within a 50% joint venture) and a single-tenant industrial property from Melcor for a purchase price of $15,250 (an additional $77 in transaction costs were capitalized to the properties). The REIT satisfied the purchase price through the REIT's line of credit and available cash.

In accordance with our policy this acquisition has been accounted for as an asset purchase.

7. INVESTMENT PROPERTIES

($000s)	2016	2015
Balance - beginning of year	643,421	630,003
Additions		
Direct acquisition (note 6)	—	15,327
Property improvements	2,228	2,427
Property development activities	1,641	359
Direct leasing costs	621	723
Fair value adjustment on investment properties (note 26)	(6,546)	(5,418)
Balance - end of year	641,365	643,421

In accordance with our policy, as detailed in note 3(e), 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 26.

The cost of investment properties as at December 31, 2016 totaled $429,730 (December 31, 2015 - $425,240).

Presented separately from investment properties is $14,021 (December 31, 2015 - $14,448) in tenant incentives and $4,225 (December 31, 2015 - $3,066) in straight-line rent adjustments (note 8). 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. Rent is receivable from tenants monthly. Minimum lease payments under non-cancellable operating leases of investment properties are receivable as follows:

($000s)	2016	2015
Within one year	38,626	39,755
Later than one year but not later than 5 years	113,324	119,344
Later than 5 years	68,764	85,536
	220,714	244,635

8. OTHER ASSETS

($000s)	2016	2015
Current Assets		
Prepaid expense, and other	**1,009**	933
Non-Current Assets		
Straight-line rent adjustments	**4,225**	3,066
Tenant incentives	**14,021**	14,448
	18,246	17,514

During the year we recorded tenant incentives of $2,789 (December 31, 2015 - $4,673) and $3,216 (December 31, 2015 - $3,057) 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.

9. REVOLVING CREDIT FACILITY

The REIT has an available credit limit based upon the carrying values of specific investment properties up to a maximum of $35,000 for general purposes, including a $5,000 swingline sub-facility. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. The new facility matures on May 1, 2018, with an extension option of up to three years at the discretion of the lenders. Depending on the form under which the new facility is accessed, rates of interest will vary between prime plus 1.15% 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 0.45% for the unused portion of the new 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 new facility.

As at December 31, 2016, the carrying value of pledged properties was $55,647 (December 31, 2015 - $56,900). We initially capitalized $341 in transaction costs associated with the facility, of which $114 was unamortized at December 31, 2016 and is presented net of the outstanding balance (December 31, 2015 - $232).

As at December 31, 2016 we had $17,480 (December 31, 2015 - $19,301) drawn from the facility; and posted letters of credit of $nil (December 31, 2015 - $nil). The weighted average effective interest rate on borrowings, based on period end balances, is 3.48% (December 31, 2015 - 3.24%).

The following table summarizes the components of the balance:

($000s)	2016	2015
Amount drawn on facility	**17,480**	19,301
Unamortized transaction fees	**(114)**	(232)
Unamortized discount on bankers acceptance	**(42)**	(13)
Restricted cash	**—**	202
	17,324	19,258

10. ACCRUED LIABILITIES AND OTHER PAYABLES

	2016	2015
Current Liabilities		
Tenant security deposits and pre-payments	**2,404**	2,707
Accrued finance costs	**488**	494
Other accrued liabilities and payables	**2,928**	3,523
	5,820	6,724
Non-Current Liabilities		
Decommissioning obligation	**1,475**	1,408

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 $2,014 (December 31, 2015 - $2,014). At December 31, 2016, a discount rate of 4.00% (December 31, 2015 - 4.00%) and an inflation rate of 2.00% (December 31, 2015 - 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.

11. MORTGAGES PAYABLE

($000s)	2016	2015
Mortgages amortized over 15-25 years at fixed interest rates	**201,926**	216,452
Mortgage amortized over 25 years at a fixed interest rate (via a floating for fixed interest rate swap)	**18,136**	—
Unamortized fair value adjustment	**—**	109
Unamortized deferred financing fees	**(1,196)**	(1,167)
	218,866	215,394
Current portion of mortgages payable	**(6,821)**	(34,125)
	212,045	181,269
Interest rate ranges	**(2.48%-4.91%)**	(2.48%-5.59%)

During the year, we entered into a floating for fixed interest rate swap which fixes the interest rate on our variable rate mortgage at 2.97% for the term of the mortgage. As at December 31, 2016 the fair value of the interest rate swap contract is $110. This financial instrument has not been designated as a hedge for accounting purposes. Supplemental information on fair value measurement, including valuation technique and key inputs, is included in note 26.

Specific investment properties with a carrying value of $428,272 (December 31, 2015 - $425,735) 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 3.45% (December 31, 2015 – 3.68%).

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

($000s)	Principal Installment Repayments	Balance Maturing	Total
2017	6,821	—	6,821
2018	7,058	39,341	46,399
2019	5,618	62,959	68,577
2020	3,405	5,318	8,723
2021	3,294	30,497	33,791
Thereafter	7,457	48,294	55,751
	33,653	186,409	220,062

12. 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 finance costs.

As at December 31, 2016 the carrying value of the Class C LP Units, included in the consolidated statement of financial position, were as follows:

($000s)	2016	2015
Class C LP Units amortized over 2-6 years at fixed interest rates	**79,905**	83,268
Unamortized fair value adjustment	**663**	890
	80,568	84,158
Current portion of Class C LP Units	**(6,074)**	(12,301)
	74,494	71,857
Effective interest rate	**3.34%**	3.52%

During the year Melcor extended the mortgage that secures retained debt relating to one of the initial properties from August 1, 2016 to August 1, 2021. The interest rate on this mortgage of 3.854% was reduced to 2.543%. Concurrent with the extension of the mortgage we extended the maturity of 977,220 Class C LP Units with a current balance of $9,030 from August 1, 2016 to August 1, 2021 at the reduced interest rate of 2.543%.

In 2015 Melcor extended the mortgage that secures retained debt relating to one of the initial properties from August 1, 2015 to August 1, 2020, and the interest rate of such mortgage of 4.77% (4.00% after the interest rate subsidy paid by Melcor) was reduced to 2.68%. Concurrent with the extension of the mortgage the REIT extended the maturity of 2,195,911 Class C LP Units with a current balance of $19,939 from August 1, 2015 to August 1, 2020 at the reduced interest rate of 2.68%.

Specific investment properties with a carrying value of $153,868 (December 31, 2015 - $159,800) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above Class C LP Units, along with a guarantee by the Partnership.

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

($000s)	Principal Installment Repayments	Balance Maturing	Total
2017	3,496	2,578	6,074
2018	3,216	11,421	14,637
2019	3,058	6,576	9,634
2020	2,436	23,863	26,299
2021	907	7,181	8,088
Thereafter	908	14,265	15,173
	14,021	65,884	79,905

During the year $2,853 (2015 - $3,198) was recognized in finance costs (note 17) and $3,590 (2015 - $3,485) was recognized as a reduction in the Class C LP Units liability related to these distributions. In 2015 we also repaid the maturing balance on 333,100 Class C LP units with a carrying value of $3,105.

As at December 31, 2016 we had 9,454,411 Class C LP Units issued and outstanding (December 31, 2015 - 9,454,411).

13. CONVERTIBLE DEBENTURE

We issued a 5.50% extendible convertible unsecured subordinated debenture (the "convertible debenture") to the public on December 3, 2014 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 acquisition of certain properties from Melcor, 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.

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:

($000s)	Host Instrument	Conversion Feature	Total
Balance at December 31, 2014	31,780	185	31,965
Amortization of discount and transaction costs	466	—	466
Fair value adjustment on conversion feature (note 26)	—	(180)	(180)
Balance at December 31, 2015	32,246	5	32,251
Amortization of discount and transaction costs	503	—	503
Fair value adjustment on conversion feature (note 26)	—	56	56
Balance at December 31, 2016	32,749	61	32,810

During the year $1,898 of interest expense was recognized in finance costs (note 17) (2015 - $1,898).

At December 31, 2016 we remeasured the conversion feature to fair value resulting in a fair value adjustment of $56 (2015 - $180). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 26.

14. CLASS B LP UNITS

Melcor, through an affiliate, holds an approximate 56.7% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. 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 15b). Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units.

The following table summarizes the change in Class B LP Units for the year.

($000s except unit amounts)	2016		2015	
Balance, beginning of year	**14,615,878**	**105,380**	14,615,878	138,266
Fair value adjustment on Class B LP Units	**—**	**18,270**	—	(32,886)
Balance, end of year	**14,615,878**	**123,650**	14,615,878	105,380

Distributions on Class B LP Units for the year were $9,866 (2015 - $9,866), and are included in finance costs (note 17).

In accordance with our policy, as detailed in note 3(h), we record Class B LP Units at fair value. We remeasured the Class B LP Units at December 31, 2016 and recognized a fair value loss of $18,270 during the year (2015 - fair value gain of $32,886). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 26.

At December 31, 2016 there were 14,615,878 Class B LP Units issued and outstanding at a fair value of $8.46 per unit or $123,650 (December 31, 2015 - 14,615,878 Class B LP Units issued and outstanding at a fair value of $7.21 per unit or $105,380).

15. 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 June 30, 2015 we commenced a normal course issuer bid ("NCIB") which allows the REIT to purchase up to 563,750 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units. The trust units may be repurchased up to a maximum daily limit of 3,824. The price which the REIT will pay for trust units repurchased under the plan will be the market price at the time of acquisition.

In connection with commencement of the NCIB, the REIT also entered into an automatic purchase plan agreement with a broker to allow for the purchase of trust units under the NCIB at times when the REIT ordinarily would not be active in the market due to regulatory restrictions or self-imposed trading blackout periods.

In 2015, there were 123,703 trust units purchased for cancellation by the REIT pursuant to the NCIB at a cost of $1,000. Trust units were reduced by $1,252 and contributed surplus increased by $252. The NCIB ended on June 29, 2016.

Issued and outstanding trust units at December 31, 2016 are 11,151,297 (December 31, 2015 - 11,151,297).

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

($000s except unit amounts)	2016		2015	
Balance, beginning of year	**11,151,297**	**102,707**	11,275,000	103,959
Trust units repurchased	**—**	**—**	(123,703)	(1,252)
Balance, end of year	**11,151,297**	**102,707**	11,151,297	102,707

Notes to the Consolidated Financial Statements

($000s except unit and per unit amounts)

16. RENTAL REVENUE

The components of rental revenue are as follows:

For the years ended December 31 ($000s)	2016	2015
Rental revenue	**68,099**	66,926
Amortization of tenant incentives (note 8)	**(3,216)**	(3,057)
Straight-line adjustments	**1,159**	1,613
	66,042	65,482

17. FINANCE COSTS

The components of finance costs are as follows:

For the years ended December 31 ($000s)	2016	2015
Interest on mortgages payable and revolving credit facility	**8,564**	8,416
Interest on Class C LP Units	**3,080**	3,537
Amortization of fair value adjustments on Class C LP Units	**(227)**	(339)
Distributions on Class B LP Units	**9,866**	9,866
Interest on convertible debenture	**1,898**	1,898
Fair value adjustment on derivative instruments (note 26)	**(54)**	(180)
Non-cash finance costs	**887**	596
	24,014	23,794

Total finance costs paid during the year were $23,170 (2015 - $23,424).

18. INCOME TAXES

As at December 31, 2016 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.

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

For the years ended December 31 ($000s)	2016	2015
Net income (loss)	**(11,176)**	41,070
Statutory rate	**27%**	26%
	(3,018)	10,678
Non-deductible expenses	**4**	7
Non-taxable portion of capital gains and fair value adjustments	**884**	678
Allocation of taxable income (loss) to unitholders (note 3m)	**2,130**	(11,363)
	—	—

19. INCOME PER UNIT

Basic and diluted earnings per trust unit for the year ended December 31, 2016 is calculated as follows:

($000s except unit amounts)	2016	2015
Net income (loss) - basic	**(11,176)**	41,070
Impact of Class B LP Unit fair value adjustment and distributions	**28,136**	(23,020)
Impact of convertible debenture interest, fair value adjustment and amortization	**2,457**	2,184
Net income - diluted	**19,417**	20,234
Basic weighted average trust units outstanding	**11,151,297**	11,237,384
Impact of conversion of Class B LP Units	**14,615,878**	14,615,878
Impact of conversion of convertible debenture	**2,727,273**	2,727,273
Diluted weighted average trust units outstanding	**28,494,448**	28,580,535
Basic earnings (loss) per trust unit	**($1.00)**	$3.65
Diluted earnings (loss) per trust unit	**($1.00)**	$0.71

20. RELATED PARTY TRANSACTIONS

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

The REIT is externally managed, administered and operated by Melcor pursuant to the terms and conditions as set forth under the Property Management Agreement and Asset Management Agreement.

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:

For the year ended December 31 ($000s)	2016	2015
Asset Management Agreement		
Base Annual Management Fee	**1,592**	1,524
Capital Expenditure Fee	**38**	—
Property Management Agreement		
Monthly Fee	**1,905**	1,876
Lease Fee	**621**	690
	4,156	4,090

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 (note 3e), Acquisition Fees and Lease Fees are capitalized to investment properties. As at December 31, 2016 there was $583 payable to Melcor related to these fees (December 31, 2015 - $297) which is included in accrued liabilities and other payables.

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

During the year $9,866 in distributions were recorded on Class B LP Units held by Melcor (2015 - $9,866). These distributions were recorded as finance costs (note 17). As at December 31, 2016 there was $822 payable to Melcor for the December distribution (December 31, 2015 - $822) which is included in distribution payable.

Also during the year, Melcor, as holder of all Class C LP Units, was paid $6,443 to fund principal and interest payments on the Retained Debt (2015 - $6,683). These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs (note 17). In addition, during 2015 we repaid the maturing balance on 333,100 Class C LP units with a carrying value of $3,105.

C. RENTAL REVENUE

During the year the REIT collected $961 in rental revenue from Melcor and an affiliate for use of office space (2015 - $921). In addition, pursuant to the Head and Bridge Lease Agreements, the REIT collected $279 in rental revenue from Melcor as compensation for certain vacant spaces at the properties acquired (2015 - $452).

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.

E. PURCHASE OF INVESTMENT PROPERTIES

On November 12, 2015, the REIT purchased two properties from Melcor pursuant to the Development and Opportunities Agreement with Melcor. The purchase price of $15,250 was satisfied with the REIT's line of credit and available cash (note 6).

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

21. JOINT ARRANGEMENTS

The table below discloses our rights to and share of the assets, liabilities, revenues, and earnings of three joint arrangements (2015 – 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%

($000's)	Assets	Liabilities	Revenue	Earnings
For the year ended and as at December 31				
2016	**61,417**	**30,802**	**5,182**	**3,559**
2015	60,354	31,808	4,219	2,249

22. 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.

23. COMMITMENTS AND CONTINGENCIES

The REIT is contingently liable under guarantees that are issued in the normal course of business and with respect to litigation and claims that arise from time to time. In the opinion of management, any liability that may arise from such contingencies would not have a material adverse effect on the consolidated financial statements of the REIT.

In the normal course of operations we enter into lease agreements with tenants which specify tenant incentive payments upon completion of the related tenant improvements. The REIT has entered into lease agreements that may require tenant incentive payments of approximately $1,111.

24. 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, 2016, and throughout the period, we were in compliance with the Degree of Leverage Ratio and had a ratio of 55% (50% excluding convertible debenture) as at December 31, 2016.

We are also subject to financial covenants on our $35,000 revolving credit facility. The covenants include a maximum debt to gross book value ratio of 60% (excluding convertible debentures), a minimum debt service coverage ratio of 1.50, and a minimum adjusted unitholders' equity of $140,000. As at December 31, 2016, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 48%, debt service coverage ratio of 1.68, and an adjusted unitholders' equity of $291,060. We also have financial covenants on certain mortgages for investment properties. At December 31, 2016, 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.

25. 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, 2016 and has provided for $76 of outstanding receivables related to accounts where collectability is doubtful (2015 - $156). 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 on-going 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 11, 12 and 13 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, 2018. 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.

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 $175 (December 31, 2015 - $193) 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.

26. 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, 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, Class C LP Units, convertible debenture and derivative financial asset - interest rate swap are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 3)
- 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 3(e), which is determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows (Level 3).

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.

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

			December 31, 2016		
($000s)	Fair Value Hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
Non-financial assets					
Investment properties	Level 3	641,365	—	641,365	641,365
Financial liabilities					
Mortgages payable	Level 3	—	220,062	220,062	222,116
Class B LP Units	Level 1	123,650	—	123,650	123,650
Class C LP Units	Level 3	—	80,568	80,568	80,568
Convertible debenture	Level 3	—	32,749	32,749	32,749
Derivative financial instruments					
Interest rate swap	Level 3	110	—	110	110
Conversion feature on convertible debenture	Level 3	61	—	61	61

($000s)	Fair Value Hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
			December 31, 2015		
Non-financial assets					
Investment properties	Level 3	643,421	—	643,421	643,421
Financial liabilities					
Mortgages payable	Level 3	—	216,452	216,452	215,150
Class B LP Units	Level 1	105,380	—	105,380	105,380
Class C LP Units	Level 3	—	84,158	84,158	84,158
Convertible debenture	Level 3	—	32,246	32,246	32,246
Derivative financial instruments					
Interest rate swap	Level 3	—	—	—	—
Conversion feature on convertible debenture	Level 3	5	—	5	5

INVESTMENT PROPERTIES

Investment properties are remeasured to fair value on a recurring basis, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows. The application of these valuation methods results in these measurements being classified as Level 3 in the fair value hierarchy.

Under the discounted future cash flows method, fair values are determined by discounting the forecasted future cash flows over ten years plus a terminal value determined by applying a terminal capitalization rate to forecasted year eleven cash flows.

Under the direct income capitalization method, fair values are determined by dividing the stabilized net operating income of the property by a property specific capitalization rate.

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 on a quarterly basis, including verifying all major inputs included in the valuation and reviewing the results. Melcor's management, along with Melcor REIT Limited Partnership's Audit Committee, discuss the valuation process and key inputs on a quarterly basis. At least once every two years, the valuations are performed by qualified external valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued.

Investment properties were valued by Melcor's internal valuation team as at December 31, 2016 of which 22 investment properties (of 47 legal phases valued) with a fair value of $287,000 were valued by qualified independent external valuation professionals during the year, which resulted in fair value losses of $6,546 recorded as fair value adjustment on investment properties in the consolidated statements of income and comprehensive income (2015 - investment properties were valued by Melcor's internal valuation team of which 27 investment properties (of 47 legal phases valued) with a fair value of $443,750 were valued by qualified independent external valuation professionals during the year, which resulted in fair value losses of $5,418).

Weighted average stabilized net operating income for investment properties is $1,503 (2015 - $1,504). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	Min	Max	Weighted Average
		December 31, 2016	
Capitalization rate	**5.50%**	**8.75%**	**6.63%**
Terminal capitalization rate	**5.75%**	**9.00%**	**6.83%**
Discount rate	**6.50%**	**9.75%**	**7.70%**

	Min	Max	Weighted Average
		December 31, 2015	
Capitalization rate	5.50%	9.00%	6.57%
Terminal capitalization rate	5.75%	9.25%	6.81%
Discount rate	6.50%	10.00%	7.71%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $46,366 (2015 - $46,953). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $53,936 (2015 - $54,685).

NON-DERIVATIVE FINANCIAL LIABILITIES

The fair value of mortgages payable, Class C LP Units and convertible debenture have been calculated by discounting the expected cash flows of each loan using a discount rate specific to each individual loan. The discount rate is determined using the bond yield for similar instruments of similar maturity adjusted for each individual project's specific credit risk. In determining the adjustment for credit risk, we consider current market conditions and other indicators of credit worthiness.

($000s except unit and per unit amounts)

DERIVATIVE FINANCIAL INSTRUMENTS

Our derivative financial instruments are comprised of a floating for fixed interest rate swap on one of our mortgages (level 2) and the conversion feature on our convertible debenture (level 3).

The fair value of the interest rate swap is calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at December 31, 2016 the fair value of the interest rate swap contract is $110.

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

- Volatility - expected volatility as at December 31, 2016 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, 2016. Volatility was 16.73% (2015 - 15.86%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at December 31, 2016. The credit spread used was 3.71% (2015 - 4.60%).

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, 2016 the fair value of the Class B LP Units was $123,650, resulting in a fair value loss of $18,270 in income for the year (2015 - fair value gain of $32,886).

27. SUBSEQUENT EVENTS

DISTRIBUTION DECLARED

On January 16, 2017 we declared a distribution of $0.05625 per unit for the months of January, February and March 2017. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
January 2017	January 31, 2017	February 15, 2017	$0.05625 per unit
February 2017	February 28, 2017	March 15, 2017	$0.05625 per unit
March 2017	March 31, 2017	April 17, 2017	$0.05625 per unit

CORPORATE & UNITHOLDER INFORMATION

Annual General Meeting

Please join us at our annual general meeting.
We look forward to seeing you there.

Wednesday, April 26 | 10:00 AM MDT
The Westin Edmonton
Devonian Room
10135 100 Street NW
Edmonton, AB

Auditors

PricewaterhouseCoopers LLP

Investor Relations

For Investor Relations including all other unitholders inquiries and requests, contact:

Nicole Forsythe
P | 1-855-673-6937

IR@MelcorREIT.ca

Distributions

$0.05625 per month
60% of distributions to unitholders were classified as return of capital.

Legal Counsel

Bryan & Company LLP

Exchange Listing

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

Customer Service

For Customer Service including tenant services, contact:

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care.melcor.ca
service@care.melcor.ca

Unitholder Services

For unitholder services including distribution information, contact:
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