

Management's Discussion & Analysis

Table of Contents

Other Information	1
Non-standard Measures	1
Forward-looking Statements	1
Financial Reporting	1
Our Business: Vision, Goals & Strategy	2
Q2-2018 Highlights & Key Performance Indicators	3
Consolidated Revenue & Net Operating Income	4
Property Analysis	7
Regional Analysis	8
General & Administrative Expenses	9
Finance Costs	9
Income Taxes	10
Funds from Operations, Adjusted Funds from Operations & Adjusted Cash Flow from Operations	10
Investment Properties	13
Liquidity & Capital Resources	14
Quarterly Results	19
Off Balance Sheet Arrangements, Contractual Obligations, Business Environment & Risks, Related Party Transactions, Critical Accounting Estimates, Changes in Accounting Policies	19
Internal Control over Financial Reporting and Disclosure Controls	19
Non-standard Measures	20

July 31, 2018

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 unaudited condensed interim consolidated financial statements and related notes for the quarter ended June 30, 2018 and the MD&A and consolidated financial statements and related notes for the year ended December 31, 2017. The discussion outlines strategies and provides analysis of our financial performance for the second quarter of 2018.

The underlying financial statements in this MD&A, including 2017 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standard Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*, unless otherwise noted.

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on July 31, 2018. Disclosure contained in this MD&A is current to July 31, 2018, unless otherwise indicated.

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

Other Information

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.

Non-standard Measures

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

Non-standard measures included in this MD&A are defined on page 20 "Non-standard Measures."

Forward-looking Statements

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

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

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent the REIT's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Forward-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2018 and beyond, future leasing, acquisition and financing plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

By their nature, forward-looking statements require assumptions and involve risks and uncertainties related to the business and general economic environment, many beyond our control. There is significant risk that the predictions, forecasts, valuations, conclusions or projections we make will not prove to be accurate and that our actual results will be materially different from targets, expectations, estimates or intentions expressed in forward-looking statements. We caution readers of this document not to place undue reliance on forward-looking statements. Assumptions about the performance of the 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 on pages 24-29 of the 2017 annual report.

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.

Financial Reporting

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

Our Business: Vision, Goals & Strategy

Melcor REIT has an established and diversified portfolio in western Canada. We currently own 36 income-producing office, retail and industrial properties representing 2.83 million square feet (sf) in gross leasable area (GLA). These high-quality properties feature stable occupancy and a diversified mix of tenants, some of whom have been in place for over 25 years. We are externally managed, administered and operated by Melcor pursuant to the asset management and property management agreements entered into at our IPO.

As at July 31, 2018, Melcor, through an affiliate, holds an approximate 53.0% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and 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 expanding our portfolio of income-producing properties across western Canada to provide 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/Divest:

On January 12, 2018 the REIT acquired 172,629 sf of GLA from Melcor (the Melcor Acquisition). These properties include additional phases at four existing properties and one new property. These recently constructed, high-quality properties were acquired for a purchase price of \$80.88 million and represent our fourth acquisition from Melcor since IPO. The acquired properties add 128,301 sf to our retail and 44,328 sf to our industrial portfolios, both of which are targeted for growth in our overall portfolio mix.

We divested two retail assets to date in 2018 in the greater Edmonton area as part of our capital recycling strategy. On January 31, 2018 we sold a 23,179 sf retail property in Leduc, Alberta for gross proceeds of \$6.85 million. The property was acquired by the REIT as part of its purchase of the initial properties from Melcor in 2013 and had previously been owned by Melcor since 1974. On April 16, 2018 we sold a 27,336 sf retail property in Edmonton, Alberta for gross proceeds of \$13.80 million. The property was acquired by the REIT as part of its purchase of the initial properties from Melcor in 2013 and was developed by Melcor in 2009.

Proceeds from these sales were used to repay amounts drawn under the revolving credit facility, providing the REIT with additional capacity for future asset acquisitions.

We continue to actively seek strategic third-party and proprietary property acquisitions that meet our investment criteria.

Improve:

We continue to improve our existing assets through both property management and asset enhancement programs.

Asset Enhancement:

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.

Property Management:

We responded to 99% of calls to our signature customer care line within 30 minutes in Q2-2018, exceeding our target of a 95% on time response rate. We use this metric as an indicator of our success in providing responsive care to our customers.

Q2-2018 Highlights & Key Performance Indicators

Financial Highlights

(\$000s except unit amounts)	Three months ended June 30			Six months ended June 30		
	2018	2017	△%	2018	2017	△%
Net operating income (NOI)	11,057	10,570	5 %	22,132	21,307	4 %
Funds from operations (FFO)	6,723	6,835	(2)%	13,425	13,650	(2)%
Adjusted funds from operations (AFFO)	4,973	5,219	(5)%	9,866	10,469	(6)%
Adjusted Cash Flow from Operations (ACFO) ⁽⁷⁾	4,917	5,163	(5)%	9,754	10,356	(6)%
Rental revenue	17,537	16,559	6 %	35,554	33,559	6 %
Income before fair value adjustments	3,451	3,566	(3)%	6,871	7,146	(4)%
Fair value adjustment on investment properties ⁽⁵⁾	(3,414)	(249)	nm	(3,415)	(16,708)	nm
Distributions to unitholders	2,130	1,882	13 %	4,451	3,764	18 %
Cash flows from operations	1,679	2,701	(38)%	5,376	5,528	(3)%
Same-asset NOI	9,833	10,255	(4)%	19,599	20,588	(5)%
Per unit metrics						
Income (loss) - diluted	(\$0.13)	(\$0.16)		\$0.30	(\$1.37)	
FFO	\$0.24	\$0.27		\$0.48	\$0.53	
AFFO	\$0.18	\$0.20		\$0.35	\$0.41	
Distributions ⁽⁶⁾	\$0.17	\$0.17		\$0.34	\$0.34	
Payout ratio	95%	83%		96%	83%	
Weighted average number of units:						
Trust Units	13,186,797	11,151,297		13,051,847	11,151,297	
Class B LP Units	14,899,325	14,615,878		14,880,533	14,615,878	
Total	28,086,122	25,767,175		27,932,380	25,767,175	

	30-June-18	31-Dec-17	△%
Total assets (\$000s)	711,545	676,237	5 %
Equity (\$000s) ⁽¹⁾	280,401	260,600	8 %
Debt (\$000s) ⁽²⁾	386,858	353,340	9 %
Weighted average interest rate on debt	3.71%	3.75%	(1)%
Debt to GBV, excluding convertible debentures (maximum threshold - 60%)	48%	47%	1%
Debt to GBV (maximum threshold - 65%)	56%	56%	—%
Finance costs coverage ratio ⁽³⁾	2.68	2.93	(9)%
Debt service coverage ratio ⁽⁴⁾	2.37	2.60	(9)%

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, liability held for sale (as applicable) and convertible debentures, excluding unamortized discount and transaction costs.
3. 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.
4. 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.
5. The abbreviation nm is shorthand for not meaningful and is used through this MD&A where appropriate.
6. Distributions for the current and comparative periods have been paid out at a rate of \$0.05625 per unit per month.
7. In Q3-2017 we amended our definition of ACFO retroactive, comparative period ACFO has been restated to reflect the amended definition.

Operational Highlights

	30-June-18	31-Dec-17	△%
Number of properties	36	37	(3)%
Gross leasable area (GLA) (sf)	2,834,133	2,710,862	5 %
Occupancy (weighted by GLA)	90.1%	91.8%	(2)%
Retention (weighted by GLA)	72.5%	80.6%	(10)%
Weighted average remaining lease term (years)	4.91	4.66	5 %
Weighted average base rent (per sf)	\$16.53	\$15.88	4 %

Q2-2018 Highlights:

Our portfolio grew following the Melcor Acquisition in Q1-2018, which added 172,629 sf offset by the sale of two assets in the first and second quarters. Growth across key indicators was tempered by a decline in same-asset performance over 2017; particularly in our Edmonton office assets where market fundamentals remain challenging. Our proactive engagement on renewing existing tenants and pursuing new tenants resulted in a healthy retention rate of 72.5% at quarter end and overall occupancy of 90.1%. The stability and diversity of our portfolio with respect to both tenant profile and asset class enable the REIT to continue navigating through economic cycles. We are focused on the real estate fundamentals of asset enhancement and property management while conservatively managing our debt.

Highlights of our performance in the second quarter include:

- Revenue and NOI growth of 6% and 5% respectively over Q2-2017 as a result of the Melcor Acquisition completed on January 12, 2018, which added 172,629 sf to our portfolio.
- We continued to execute on our proactive leasing strategy to both retain existing and attract new tenants. We completed lease renewals representing 201,972 sf (including holdovers) for a retention rate of 72.5% at June 30, 2018. New leasing has been strong across the portfolio with 35,958 in new deals in the first half of 2018 and an additional 44,000 sf in committed leasing for future occupancy.
- Same-asset NOI was down 4% over Q2-2017, trending with a decline in same-asset occupancy. The decline in our Northern Alberta office assets was partially offset by same-asset income and occupancy growth in retail and office assets in Southern Alberta and British Columbia. Second quarter same-asset NOI was up 1% from Q1-2018 due to stable occupancy.
- Net income (loss) in the current and comparative periods is significantly impacted by non-cash fair value losses on investment properties due to changes in capitalization rates/NOI and Class B LP Units due to changes in the REIT's unit price. Management believes adjusted funds from operations (AFFO) is a better reflection of our true operating performance.
- AFFO was \$4.97 million or \$0.18 per share, down 5% from Q2-2017. Second quarter AFFO was up 2% over Q1-2018.
- We sold an Edmonton area retail property for gross proceeds of \$13.80 million as part of our capital recycling strategy.
- We paid distributions of \$0.05625 per trust unit in April, May and June for a quarterly payout ratio of 95%.
- We completed \$21.89 million in re-financings year to date at an average interest rate of 3.94%. Subsequent to the quarter we early re-financed our largest mortgage, securing gross proceeds of \$39.00 million at an interest rate of 3.84%. Early re-financing is a strategy employed to mitigate and re-balance our risk in the near term.
- We extended our \$35.00 million revolving credit facility to June 1, 2021 with our existing lender syndicate. The facility includes an accordion feature, which provides for up to \$10.00 million in additional borrowing capacity, subject to lender approval.
- As at June 30, 2018 we have \$3.24 million in cash and additional capacity under our revolving credit facility. We conservatively manage our debt, with a debt to GBV on the low end of our target range.

Consolidated Revenue & Net Operating Income

	Three months ended June 30			Six months ended June 30		
(\$000s)	2018	2017	△%	2018	2017	△%
Base rent	10,975	10,246	7 %	22,002	20,628	7 %
Recoveries	6,413	6,261	2 %	13,208	12,803	3 %
Other	593	589	1 %	1,184	1,219	(3)%
Amortization of tenant incentives	(757)	(802)	(6)%	(1,525)	(1,571)	(3)%
Straight-line rent adjustment	313	265	18 %	685	480	43 %
Rental revenue	17,537	16,559	6 %	35,554	33,559	6 %
Operating expenses	3,225	3,048	6 %	6,667	6,445	3 %
Utilities and property taxes	3,699	3,478	6 %	7,595	6,898	10 %
Direct operating expenses	6,924	6,526	6 %	14,262	13,343	7 %
Net rental income	10,613	10,033	6 %	21,292	20,216	5 %
NOI	11,057	10,570	5 %	22,132	21,307	4 %
Same-asset NOI	9,833	10,255	(4)%	19,599	20,588	(5)%
Operating margin	61%	61%	— %	60%	60%	— %

Revenue

Rental revenue for the period increased by \$0.98 million or 6% over Q2-2017. The increase in revenue was a result of the Melcor Acquisition completed on January 12, 2018, partially offset by the sale of two properties over the past twelve months and lower same-asset revenue. Q2-2018 rental revenue from the Melcor Acquisition properties was \$1.84 million and \$3.42 million year to date. During the three and six-month period we also recognized \$0.06 million and \$0.38 million of rental revenue from properties sold within the last twelve months (2017 - \$0.41 million and \$0.93 million). Same-asset revenues were down in the quarter and year to date due to lower same-asset occupancy and lower base rents on new and renewed deals.

Year to date we completed 201,972 sf of lease renewals (including holdovers) and had 35,958 sf in new leases commence for steady occupancy at 90.1%. In 2018, 91 leases representing 437,397 sf or 15.2% of our portfolio are up for renewal. We have retained 72.5% of expiring leases (representing 278,697 sf) as at June 30, 2018 in spite of challenging market conditions in many of our operating regions. We remain committed to our proactive leasing program to both retain tenants and attract new tenants.

The table below summarizes the leasing activity for 2018 year to date:

	Square feet	Weighted average base rent (per sf)	Occupancy %
Opening occupancy	2,487,574	\$15.88	91.8%
Expiring leases	(278,697)	\$13.31	
Early terminations	(18,780)	\$9.54	
Renewals/holdovers	201,972	\$11.76	
New leasing	35,958	\$12.27	
Lease amendments	(1,595)	\$—	
Investment properties acquired	172,629	\$28.08	
Investment properties sold	(46,524)	\$22.28	
Closing occupancy	2,552,537	\$16.53	90.1%

Weighted average base rent was \$16.53, up \$0.65 compared to December 31, 2017 and \$0.84 over Q2-2017 due to the Melcor Acquisition, which had a weighted average base rate of \$28.08. This increase was partially offset by lower rates on new leasing completed during the period and the sale of Corinthia Plaza and Miller Crossing in the first half of 2018.

The following table summarizes our average base rent, GLA, occupancy and retention:

	30-Jun-18	30-Jun-17	△%	31-Dec-17	△%
Weighted average base rent (per sf)	\$16.53	\$15.69	5 %	\$15.88	4 %
Weighted average remaining lease term (years)	4.91	4.70	4 %	4.66	5 %
Gross leasable area (GLA) (sf)	2,834,133	2,711,847	5 %	2,710,862	5 %
Occupancy (weighted by GLA)	90.1%	92.7%	(3)%	91.8%	(2)%
Retention (weighted by GLA)	72.5%	78.6%	(8)%	80.6%	(10)%

Recoveries are amounts recovered from tenants for direct operating expenses incurred and include a nominal administrative charge. We typically expect recovery revenue to correlate with changes in recoverable operating expenses. Recovery revenue was up 2% in the quarter and 3% year to date while direct operating expenses increased 6% and 7% respectively. Our recovery ratio was down over 2017 as a result of lower occupancy. Comparative period recoveries were also elevated as a result of truing up 2016 year-end estimates.

Other revenue includes parking and other miscellaneous revenue that is ancillary to our business and fluctuates from period to period.

Amortization of tenant incentives can fluctuate based on the timing of lease rollovers and leasing incentives. Straight-line rent adjustments relate to new leases which have escalating rent rates and/or rent-free periods. The increase in straight-line rent adjustments in the quarter and year to date is primarily due to leases assumed as part of the Melcor Acquisition, which had primarily long-term leases with multiple rent escalations. Straight-line rent adjustments fluctuate due to the timing of signed leases.

Direct operating expenses

Direct operating expenses were up 7% year to date in 2018. Excluding the impact of properties acquired and disposed of over the past twelve months, direct operating expenses increased by 1%. On a same-asset basis, property taxes and utilities increased by 3% due to higher mill rates and increased utility consumption on account of colder weather and increases to levies and taxes in Alberta. The timing of maintenance projects and lower non-recoverable costs led to a 2% decrease in same-asset operating expenses in the first half of 2018. As a cornerstone of our property management strategy, we are committed to efficient and cost effective maintenance of our buildings to ensure maximum value to our tenants and unitholders.

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.

Portfolio growth over the past twelve months contributed to a 5% increase in NOI over Q2-2017. On a same-asset basis, second quarter NOI was down 4% as a result of lower occupancy and weighted average base rates. Same-asset NOI compared to Q1-2018 was up 1%.

The calculation of same-asset NOI is as follows (refer to *Non-standard Measures* for calculation of NOI and reconciliation to net income):

(\$000s)	Three months ended June 30			Six months ended June 30		
	2018	2017	△%	2018	2017	△%
Same-asset NOI	9,833	10,255	(4)%	19,599	20,588	(5)%
Acquisitions	1,178	—		2,252	—	
Disposals	46	315		281	719	
NOI	11,057	10,570	5 %	22,132	21,307	4 %
Amortization of tenant incentives	(757)	(802)		(1,525)	(1,571)	
Straight-line rent adjustment	313	265		685	480	
Net rental income per financial statements	10,613	10,033	6 %	21,292	20,216	5 %

Property Analysis

At June 30, 2018 our portfolio included interests in 36 retail, office and industrial income-producing properties located in western Canada for a total of 2,834,133 sf of GLA, and a land lease community.

The following table summarizes the composition of our properties at June 30, 2018 by property type:

Property Type	Number of Properties	GLA (sf)/ Lots	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	Net rental income for the six months ended June 30, 2018 (\$000s)
Retail	12	1,055,835	37.3%	356,304	10,586
Office	20	1,570,207	55.4%	287,418	8,797
Industrial	3	208,091	7.3%	43,200	1,436
Land Lease Community	1	308 lots	n/a	16,050	473
	36	2,834,133	100.0%	702,972	21,292

The following table details key financial and operational metrics for each of our asset classes for the three and six-months ended June 30, 2018:

	Retail		Office		Industrial		Land Lease Community	
	2018	2017	2018	2017	2018	2017	2018	2017
<u>Three months ended June 30 (\$000s)</u>								
Rental revenue	7,821	6,691	8,465	8,990	919	553	332	325
Net rental income	5,262	4,507	4,388	4,898	736	394	227	234
Same-asset NOI	4,226	4,293	4,916	5,293	464	435	227	234
<u>Six months ended June 30 (\$000s)</u>								
Rental revenue	15,693	13,295	17,395	18,340	1,804	1,272	662	652
Net rental income	10,586	8,949	8,797	9,813	1,436	967	473	487
Same-asset NOI	8,401	8,626	9,801	10,614	924	861	473	487
<u>As at June 30</u>								
Weighted average base rent (sf)	\$19.89	\$18.85	\$14.27	\$14.15	\$14.12	\$10.31	n/a	n/a
Occupancy	95.0%	95.0%	85.5%	90.5%	100.0%	100.0%	100.0%	100.0%

Retail – our 12 retail properties include 5 multi-building regional power centres and 7 neighborhood shopping centres. During the six months ended June 30, 2018 we completed the Melcor Acquisition, increasing owned retail GLA by 128,301 sf. Rental revenue from these assets was \$1.51 million in the quarter and \$2.80 million year to date. During the first half of 2018, we sold two retail assets (50,515 sf). Rental revenue recognized from these assets was \$0.07 million in Q2-2018 and \$0.39 million year to date (2017 - \$0.40 million and \$0.78 million respectively). Occupancy was steady over Q2-2017 and Q1-2018. Weighted average base rent was up 6% over Q2-2017 and down 2% from Q1-2018. Newly acquired GLA contributed to higher

rent and occupancy and offset the decline in same-asset rent and occupancy due to tenant rollover. Same-asset NOI was down 3% over Q2-2017 due to lower occupancy and more tenants on rent-free periods. Compared to Q1-2018, same-asset NOI was up 1%, with lower non-recoverable costs and positive true-ups of 2017 recoveries.

Office – our 20 office properties include low and medium-rise buildings located in strategic urban and suburban centres. Our office portfolio is our most geographically diverse asset class, with properties across Alberta, in Regina, SK and Kelowna, BC. Occupancy declined 6% over Q2-2017 and was down 1% from Q1-2018. Continued competition for downtown Edmonton office tenants and its impact on the suburban market resulted in an increase in vacancy and a 6% decrease in rental revenue over Q2-2017. NOI declined 7% compared to Q2-2017 and was stable over Q1-2018, a direct result of lower rent and recovery ratio.

Industrial – our 3 industrial properties include single and multi-tenant buildings. We acquired a 44,328 sf building in our Telford Industrial Park in Q1-2018 as part of the Melcor Acquisition. In Q2-2017 we divested LC Industrial, a 67,610 sf property. Rental revenues from these assets were \$0.33 million in the quarter and \$0.62 million year to date (2017 - \$0.01 million and \$0.16 million respectively). Our assets remained fully occupied through the first quarter of 2018. Weighted average base rents were stable over Q1-2018 and up \$3.81 over Q2-2017 as a result of the acquisition and disposition completed over the past year. On a same-asset basis rental revenue and NOI were up over Q2-2017 as a result of rent escalations on leases with stepped rent rates. Compared to Q1-2018, same-asset NOI was steady.

Land Lease Community – we have one land lease community in Calgary, AB, consisting of 308 pad lots. It was 100% occupied at June 30, 2018 (December 31, 2017 – 100%). Revenue on our land lease community was up 2% over Q2-2017 due to increased pad rates. NOI declined 3% over Q2-2017 as a result of higher property taxes and utilities.

Regional Analysis

The following table summarizes the composition of our properties at June 30, 2018 by geographic region:

Geographic Region	Number of Properties	GLA (sf)	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	Net rental income for the six months ended June 30, 2018 (\$000s)
Northern Alberta	22	1,669,324	58.9%	409,524	11,916
Southern Alberta	7	798,020	28.2%	223,058	7,390
Saskatchewan & British Columbia	7	366,789	12.9%	70,390	1,986
	36	2,834,133	100.0%	702,972	21,292

The following table details key financial and operational metrics for each of our geographic regions for the three and six-months ended June 30, 2018:

	Northern Alberta		Southern Alberta		Saskatchewan & British Columbia	
	2018	2017	2018	2017	2018	2017
<u>Three-months ended June 30 (\$000s)</u>						
Rental revenue	10,122	10,038	5,683	4,622	1,732	1,899
Net rental income	5,869	5,995	3,804	2,984	940	1,054
Same-asset NOI	5,504	6,012	3,278	3,093	1,051	1,150
<u>Six-months ended June 30 (\$000s)</u>						
Rental revenue	20,588	20,246	11,327	9,565	3,639	3,748
Net rental income	11,916	11,883	7,390	6,273	1,986	2,060
Same-asset NOI	11,045	12,108	6,367	6,254	2,187	2,226
<u>As at June 30</u>						
Weighted average base rent (per sf)	\$16.76	\$16.41	\$17.35	\$15.14	\$13.63	\$13.55
Occupancy	87.9%	91.8%	94.7%	96.2%	90.1%	89.8%

Northern Alberta - our Northern Alberta assets are located throughout the greater Edmonton area, including Leduc and Spruce Grove, and in Red Deer. Rental revenue and net rental income were up due to the addition of 86,470 sf through the Melcor Acquisition. Same-asset NOI was stable over Q1-2018 and down 8% over Q2-2017 due to continued pressure on our Edmonton office properties rent and occupancy.

Southern Alberta - our Southern Alberta assets are located throughout the greater Calgary area, including Chestermere and Airdrie, and in Lethbridge. The addition of 86,159 sf of retail GLA through the Melcor Acquisition contributed to the increase in rental revenue and net rental income. Same-asset NOI was up 6% over Q2-2017 and Q1-2018 due to the timing of operating costs and fluctuations in the recovery ratio.

Saskatchewan and British Columbia - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue and NOI were down 9% over Q2-2017 as a result of higher tenant incentive amortization and non-recoverable costs. Second quarter results were significantly impacted by a 12,374 sf Regina, SK office tenant that vacated at the end of their term. To date we have secured future new leasing at the building for approximately one third of the space.

General & Administrative Expenses

(\$000s)	Three months ended June 30			Six months ended June 30		
	2018	2017	△%	2018	2017	△%
Asset management fee	434	396	10 %	871	794	10 %
Professional fees	117	69	70 %	194	151	28 %
Public company costs	66	83	(20)%	203	205	(1)%
Other	91	76	20 %	186	163	14 %
General & administrative expenses	708	624	13%	1,454	1,313	11%

General & administrative expenses (G&A) were \$0.71 million or 4% of rental revenue in Q2-2018 and \$1.45 million or 4% of rental revenue year to date. Asset management fees were up 10% over 2017 due to the net increase in properties following acquisitions and dispositions completed over the past twelve months. The asset management fee is charged at an annual rate of 0.25% of gross book value. Higher professional fees and other expenses are due to timing of expenses incurred and increased market activity. We are committed to prudent financial stewardship, including careful monitoring of discretionary G&A expenses to ensure maximum value to our unitholders. We expect G&A to be approximately 5% of rental revenue.

Finance Costs

(\$000s)	Three months ended June 30			Six months ended June 30		
	2018	2017	△%	2018	2017	△%
Interest on mortgages payable and revolving credit facility	2,146	2,004	7%	4,298	4,068	6 %
Interest on Class C LP Units	738	715	3%	1,513	1,437	5 %
Amortization of fair value adjustment on Class C LP Units	(56)	(56)	—%	(112)	(113)	(1)%
Interest on convertible debentures	772	475	63%	1,548	949	63 %
Fair value adjustment on derivative instruments	18	(153)	nm	1	(127)	nm
Amortization of deferred financing fees	367	252	46%	755	503	50 %
Finance costs before distributions	3,985	3,237	23%	8,003	6,717	19 %
Distributions on Class B LP Units	2,515	2,467	2%	5,029	4,933	2 %
Finance costs	6,500	5,704	14%	13,032	11,650	12 %

Finance costs were up over 2017 due to the Melcor Acquisition, which closed on January 12, 2018. As part of the transaction we assumed \$31.04 million in mortgages payable, issued 1,331,202 Class C LP Units representing \$13.31 million, and issued

283,447 Class B LP Units representing \$2.50 million. Cash to close the transaction was partially funded through the public offering of \$23.00 million in convertible debentures (2017 Debentures), which closed on December 21, 2017.

Higher interest on mortgages payable and Class C LP units were partially offset by lower amounts drawn on our revolving credit facility during the current period and settlement of the indebtedness on two investment properties disposed of in 2018.

The 2017 Debentures pay a coupon of 5.25% annually. The \$34.50 million 2014 Debentures pay a coupon of 5.50% annually.

Distributions on Class B LP Units increased 2% over 2017 as a result of new units issued during the period. Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units (\$0.17 per unit during the quarter).

Non-cash finance costs increased over 2017 as a result of amortization of discount and transaction costs on the 2017 Debentures.

As at June 30, 2018 the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debentures was 3.71%.

Income Taxes

As at June 30, 2018, 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 & Adjusted Cash Flow From Operations

Funds From Operations (FFO), Adjusted Funds From Operations (AFFO) and Adjusted Cash Flow From Operations (ACFO) are non-standard measures used in the real estate industry to measure the operating and cash flow performance of investment properties.

Funds from operations & adjusted funds from operations

REALpac defines Funds From Operations (FFO) as net income (calculated in accordance with IFRS), adjusted for, among other things, fair value adjustments, amortization of tenant incentives and effects of puttable instruments classified as financial liabilities (distributions on Class B LP Units). The REIT calculates FFO in accordance with REALpac.

We believe that FFO is an important measure of operating performance and the performance of real estate properties, while AFFO is an important cash flow measure. AFFO is not a substitute for cash flow from operations as it does not include changes in operating assets and liabilities.

FFO and AFFO are not a substitute for net income established in accordance with IFRS when measuring the REIT's performance. While our methods of calculating FFO and AFFO comply with REALpac recommendations, they may differ from and not be comparable to those used by other entities.

	Three months ended June 30			Six months ended June 30		
<i>(\$000s, except per unit amounts)</i>	2018	2017	△%	2018	2017	△%
Net income (loss) for the period	(1,768)	(1,792)		7,776	(15,282)	
Add / (deduct)						
Fair value adjustment on investment properties	3,414	249		3,415	16,708	
Fair value adjustment on Class B LP Units	1,787	5,262		(4,321)	5,847	
Amortization of tenant incentives	757	802		1,525	1,571	
Distributions on Class B LP Units	2,515	2,467		5,029	4,933	
Fair value adjustment on derivative instruments	18	(153)		1	(127)	
Funds From Operations (FFO)	6,723	6,835	(2)%	13,425	13,650	(2)%
Deduct						
Straight-line rent adjustments	(313)	(265)		(685)	(480)	
Normalized capital expenditures	(606)	(566)		(1,212)	(1,156)	
Normalized tenant incentives and leasing commissions	(831)	(785)		(1,662)	(1,545)	
Adjusted Funds from Operations (AFFO)	4,973	5,219	(5)%	9,866	10,469	(6)%
FFO/Unit	\$0.24	\$0.27		\$0.48	\$0.53	
AFFO/Unit	\$0.18	\$0.20		\$0.35	\$0.41	

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

	Three months ended June 30			Six months ended June 30		
<i>(\$000s, except per unit amounts)</i>	2018	2017	△%	2018	2017	△%
Funds From Operations (FFO)	6,723	6,835	(2)%	13,425	13,650	(2)%
Interest on convertible debentures	772	475		1,548	949	
Amortization of deferred financing fees on convertible debentures	238	133		479	266	
Funds From Operations - Diluted (FFO - Diluted)	7,733	7,443	4 %	15,452	14,865	4 %
FFO - Diluted/Unit	\$0.24	\$0.26		\$0.47	\$0.52	

Capital Expenditures

We continually invest in our assets with value-adding investments that enhance property quality, which contributes to higher occupancy and rental rates. These upgrades typically focus on increasing operating efficiency, property attractiveness, functionality and desirability. Asset enhancement and preservation investments fluctuate based on the nature and timing of projects undertaken, and are impacted by many factors including, but not limited to, the age and location of the property, and the leasing profile and strategy. The majority of building improvement expenditures are recoverable from tenants over 5-25 years. As actual expenditures can vary from one period to another, the REIT uses a normalized capital expenditure in determining AFFO and sustainable, economic cash flow of investment properties.

Normalized expenditures exclude new property development initiatives such as densification and non-recoverable capital as these are discretionary in nature. Normalized capital expenditures are calculated based on a trailing 5 year historical actual spend plus 5 year projected spend (historical results are limited to May 1, 2013 onward).

The following summarizes our actual expenditures compared to normalized amounts.

<i>(\$000s)</i>	Six months ended June 30, 2018	Year ended December 31, 2017
Actual capital expenditures	1,320	2,315
Normalized capital expenditures	1,212	2,312
Variance	108	3

Tenant Incentive & Direct Leasing Expenditures

We continually invest in tenant incentives and direct leasing expenditures as part of our leasing strategy. Tenant incentives are directly correlated with base rent achieved on leasing deals, with higher tenant incentives carrying higher base rent. Expenditures on any particular building are impacted by many factors including, but not limited to, the lease maturity profile and strategy, market conditions and the property's location and asset class. As actual expenditures can vary from one period to another, the REIT uses a normalized capital expenditure in determining AFFO and sustainable, economic cash flow of investment properties. Normalized tenant incentives are calculated based on a trailing 5 year actual spend plus 5 year projected spend (historical results are limited to May 1, 2013 onward).

The following summarizes our actual expenditures compared to normalized amounts.

<i>(\$000s)</i>	Six months ended June 30, 2018	Year ended December 31, 2017
Actual tenant incentives and direct leasing expenditures	2,241	3,385
Normalized tenant incentives and direct leasing expenditures	1,662	3,090
Variance	579	295

Adjusted cash flow from operations

REALpac defines Adjusted Cash Flow from Operations (ACFO) as cash flow from operations adjusted for, among other things, changes in operating assets and liabilities, payments of tenant incentives and direct leasing costs, non-cash finance costs, normalized capital expenditures and normalized tenant incentives and direct leasing costs. We calculate ACFO substantially in accordance with the guidelines set out by REALpac; however, the adjustment for the effects of puttable instruments classified as financial liabilities (distributions on Class B LP Units) is not a specific adjustment defined therein and therefore represents a departure from REALpac guidance. We consider the current presentation to be more meaningful as we do not consider distributions on Class B LP Units to represent a true borrowing cost as the amounts are payable only to the extent of those declared on trust units, both of which are at the discretion of the REIT's Board of Trustees. In Q3-2017 we amended our definition of ACFO retroactive, comparative period ACFO has been restated to reflect the amended definition.

<i>(\$000s)</i>	Three months ended June 30			Six months ended June 30		
	2018	2017	△%	2018	2017	△%
Cash flows from operations	1,679	2,701	(38)%	5,376	5,528	(3)%
Distributions on Class B LP Units	2,515	2,467		5,029	4,933	
Actual payment of tenant incentives and direct leasing costs	836	852		1,419	1,643	
Changes in operating assets and liabilities	1,691	746		1,559	1,456	
Amortization of deferred financing fees	(367)	(252)		(755)	(503)	
Normalized capital expenditures	(606)	(566)		(1,212)	(1,156)	
Normalized tenant incentives and leasing commissions	(831)	(785)		(1,662)	(1,545)	
Adjusted Cash flow from Operations (ACFO)	4,917	5,163	(5)%	9,754	10,356	(6)%

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 six-month period were \$4.45 million (2017 - \$3.76 million).

Distributions made during the three and six-months ended June 30, 2018 represent a payout ratio of approximately 95% and 96% of AFFO (2017 - 83% and 83%). We generate sufficient cash flows from operations to sustain our current distribution rate for the foreseeable future. We use ACFO in evaluating our ability to continue to fund distributions. The most similar IFRS measure is cash flows from operations. Cash flow from operations, which includes Class B LP Unit distributions as a financing charge, exceeded distributions by \$0.93 million for the six-months ended June 30, 2018 (2017 - \$1.76 million) as illustrated below. Distributions in Q2-2018 exceeded cash flow from operations before Class B LP Units due to the timing of capital projects undertaken.

	Three months ended June 30			Six months ended June 30		
(\$000s)	2018	2017	△%	2018	2017	△%
Cash flows from operations	1,679	2,701	(38)%	5,376	5,528	(3)%
Distributions on Class B LP Units	2,515	2,467	2 %	5,029	4,933	2 %
Cash flow from operations before Class B LP Unit Distributions	4,194	5,168	(19)%	10,405	10,461	(1)%
Distributions on unitholders	(2,130)	(1,882)	13 %	(4,451)	(3,764)	18 %
Distributions on Class B LP Units	(2,515)	(2,467)	2 %	(5,029)	(4,933)	2 %
Total distributions	(4,645)	(4,349)	7 %	(9,480)	(8,697)	9 %
Cash flow from operations before Class B LP Unit distributions less total distributions	(451)	819	(155)%	925	1,764	(48)%
Total distributions as a % of cash flow from operations before Class B LP Unit distributions	111%	84%	32 %	91%	83%	10 %

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:

	Six months ended June 30, 2018	Year ended December 31, 2017
Number of properties	36	37
Total GLA (sf)	2,964,170	2,830,368
GLA (REIT owned %) (sf)	2,834,133	2,710,862
Fair value of portfolio (\$000s)	702,972	642,763
Value per square foot	\$248	\$237
NOI (\$000s)	22,132	42,101
Weighted average capitalization rate	6.64%	6.68%
Weighted average discount rate	6.72%	6.79%
Weighted average terminal capitalization rate	7.70%	7.75%

For the quarter ended June 30, 2018, Melcor's internal valuation team performed the valuation assessment. Year to date, 13 phases (of 47 legal phases) with a fair value of \$189.75 million were valued by qualified independent external valuation professionals, resulting in a net \$3.42 million change in fair value. For the year ended December 31, 2017, 27 phases (of 46 legal phases) with a fair value of \$392.70 million were valued by qualified independent external valuation professionals, resulting in fair value losses of \$12.80 million.

Phases are a result of the property development process when a larger project is developed over an extended period of time and subdivided into legal phases for increased flexibility.

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

<i>(\$000s)</i>	Six months ended June 30, 2018	Year ended December 31, 2017
Northern Alberta	(6,420)	(16,959)
Southern Alberta	491	4,710
Saskatchewan & British Columbia	2,514	(551)
	(3,415)	(12,800)

Fair value losses in Northern Alberta were due to increased vacancy on certain suburban area Edmonton properties in conjunction with spending on tenant incentives. Fair value gains in Southern Alberta were realized on Calgary area retail properties and our office property in Lethbridge where market fundamentals remain strong. Our retail portfolio in Saskatchewan & British Columbia drove fair value gains in the region with higher NOI and a 25 to 50 basis point decrease in capitalization rates. The remainder of fair value losses across the portfolio were due to capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. Fair value adjustments represent a change of less than 1% in the fair value of our portfolio.

Fair values are most sensitive to changes in capitalization rates.

	June 30, 2018			December 31, 2017		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.64%	5.50%	8.75%	6.68%
Terminal capitalization rate	5.75%	9.00%	6.72%	5.75%	9.00%	6.79%
Discount rate	6.50%	9.75%	7.70%	6.50%	9.75%	7.75%

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by \$49.42 million (December 31, 2017 - \$44.31 million) while a 50 basis points decrease (-0.5%) would increase it by \$57.47 million (December 31, 2017 - \$51.48 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:

	Three months ended June 30			Six months ended June 30		
<i>(\$000s)</i>	2018	2017	△\$	2018	2017	△\$
Cash from operating activities	1,679	2,701	(1,022)	5,376	5,528	(152)
Cash used in investing activities	12,252	3,411	8,841	(19,036)	3,198	(22,234)
Cash from (used in) financing activities	(11,952)	(4,928)	(7,024)	4,708	(8,184)	12,892
Increase (decrease) in cash and cash equivalents	1,979	1,184	795	(8,952)	542	(9,494)
Cash and cash equivalents, beginning of the period	1,258	988	270	12,189	1,630	10,559
Cash and cash equivalents, end of the period	3,237	2,172	1,065	3,237	2,172	1,065

Operating activities

Cash from operating activities decreased compared to the prior periods as a result of fluctuations in adjustments for working capital and expenditures on tenant incentives and direct leasing costs. Our tenant incentives and direct leasing cost investments were \$0.84 million in the quarter and \$1.42 million year to date (2017 - \$0.85 million and \$1.64 million) as we completed 237,930 sf of new and renewed leasing, resulting in period-end occupancy of 90.1%. The timing of lease expiries impacts the level of spending on tenant incentives and direct leasing costs and will fluctuate from period to period. Cash flows before adjustments for working capital and payment of tenant incentives and direct leasing costs were down \$0.09 million in the quarter and \$0.27 million year to date. The decrease is due to lower same-asset NOI, which offset the positive operating cash flow impact of the Melcor Acquisition.

Investing activities

On January 12, 2018 we completed the acquisition of five commercial properties via our right of first offer on Melcor properties. The \$80.88 million purchase price was partially settled through \$34.18 million in cash, with the balance being satisfied through mortgage assumption and the issuance of Class C and B LP Units.

We commenced our 2018 capital program with \$1.32 million invested year to date (2017 - \$1.02 million). 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. Asset enhancement investments fluctuate based on the nature and timing of projects undertaken.

On January 31, 2018, we disposed of Corinthia Plaza in Leduc, Alberta for a sale price of \$6.37 million (net of transaction costs). The sale was settled through mortgage assumption of \$3.66 million and cash of \$3.07 million. Proceeds were used to repay amounts drawn under our revolving credit facility.

On April 16, 2018, we disposed of Miller Crossing in Edmonton, Alberta for a sale price of \$13.39 million (net of transaction costs). Proceeds were used to retire the \$6.95 million outstanding Class C LP unit liability, with remaining proceeds used to repay amounts drawn under our revolving credit facility.

Financing activities

On January 12, 2018 we received \$16.11 million from the issuance of 2,035,500 trust units, net of transaction costs. Proceeds were used to fund the Melcor Acquisition.

During Q2-2018 we repaid \$5.48 million net on our revolving credit facility from proceeds on the sale of Miller Crossing (2017 - net repayment of \$2.15 million and \$0.98 million year to date).

We continued our monthly distribution of \$0.05625 per unit for quarterly distributions of \$2.13 million; \$4.24 million year to date (2017 - \$1.88 million and \$3.76 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 June 30, 2018 we had \$3.24 million in cash and cash equivalents in addition to funds available under our revolving credit facility.

Capital Structure

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

Pursuant to the DOT Degree of Leverage Ratio, we may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, our total indebtedness would be more than 60% (65% including any convertible debentures) of Gross Book Value (GBV). Throughout the period we were in compliance with the Degree of Leverage Ratio and had a ratio of 56% as at June 30, 2018 (48% excluding convertible debentures).

As at June 30, 2018, our total capitalization was \$667.26 million and is comprised of:

(\$000s)	30-Jun-18
Revolving credit facility ⁽¹⁾	—
Mortgages payable ⁽¹⁾	251,031
Class C LP Units ⁽²⁾	78,327
Indebtedness, excluding convertible debentures	329,358
Convertible debentures ⁽³⁾	57,500
Indebtedness	386,858
Class B LP Units ⁽⁴⁾	150,207
Trust units	130,194
Equity	280,401
Total capitalization	667,259
Gross Book Value (GBV)⁽⁵⁾	692,956
Debt to GBV, excluding convertible debentures (maximum threshold - 60%)	48%
Debt to GBV (maximum threshold - 65%)	56%

(1) Debts are presented excluding unamortized transaction costs and discount on bankers acceptance.

(2) Class C LP Units excluding unamortized fair value adjustment on Class C LP Units.

(3) Convertible debentures are 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 less dispositions.

We are also 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 June 30, 2018, and throughout the period, we were in compliance with our financial covenants. We also have financial covenants on certain mortgages for investment properties. At June 30, 2018, and throughout the period, we were in compliance with the financial covenants on our mortgages. We prepare financial forecasts to monitor changes to our debt and capital levels and manage 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:

	<i>as at June 30</i>						
(\$000s)	Total	2018	2019	2020	2021	2022	Thereafter
Revolving credit facility	—	—	—	—	—	—	—
Mortgages payable	251,031	12,325	68,286	20,232	35,737	30,247	84,204
Class C LP Units	78,327	5,980	3,628	27,092	14,675	1,095	25,857
Convertible debentures	57,500	—	34,500	—	—	23,000	—
Total	386,858	18,305	106,414	47,324	50,412	54,342	110,061
% of portfolio	100%	5%	28%	12%	13%	14%	27%

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.

On June 1, 2018 we entered into the first amendment to our revolving credit facility agreement with two western Canadian financial institutions. Under the terms of the amending agreement the REIT maintains an available credit limit based upon the

carrying value of specific investment properties to a maximum of \$35.00 million for general corporate purposes and acquisitions, including a \$5.00 million swingline sub-facility. An additional \$10.00 million is available by way of an accordion feature, subject to lender approval. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.25% or bankers acceptance plus 2.25% stamping fee. The facility matures June 1, 2021.

During the quarter we re-financed the mortgage on a Regina, SK retail property for \$12.24 million in gross proceeds (net \$5.46 million) at an interest rate of 4.15% (previously 3.41%). Year to date we also renewed the mortgage on another Regina, SK retail property for \$2.44 million in gross proceeds (net \$nil) at an interest rate of 3.99% (previously 3.73%). Subsequent to the quarter we re-financed the mortgage on a Lethbridge, AB mixed use property, scheduled to mature in 2019, securing \$39.00 million in gross proceeds (net \$13.38 million) at an interest rate of 3.84% (previously 3.38%). We re-financed this mortgage early to reduce our risk of financing at less favourable rates and terms.

During the second quarter we extended the maturity of a \$7.21 million mortgage that secures Retained Debt related to one of the Initial Properties to April 1, 2021, at an interest rate of 3.58% (previously 3.33%). On April 16, 2018 we repaid Class C LP Units held by Melcor (821,477 units) with a carrying value of \$6.95 million from proceeds of the sale of the associated property.

Over the next 12 months, six mortgages are up for renewal. These mortgages had an outstanding principal balance of \$24.26 million and a weighted average interest rate of 3.33% at June 30, 2018. In addition, we have one property encumbered by Class C LP Units where the underlying mortgages - held by Melcor - are up for renewal in the next 12 months. These Class C LP Units have an outstanding principal balance of \$4.20 million and a weighted average interest rate of 6.16% (4.00% including interest rate subsidy). We expect to be able to re-finance these debts at market competitive terms.

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

Debt Analysis – our mortgages payable, Class C LP Units and convertible debenture bear interest at fixed rates (including one variable rate mortgage fixed via a floating for fixed interest rate swap contract); our revolving credit facility bears interest at variable rates. The following table summarizes the interest rates and terms to maturity:

<i>(\$000s)</i>	Total	Fixed	Variable	Weighted average interest rate	Weighted average term to maturity
Revolving credit facility	—	—	—	—%	2.92
Mortgages payable	251,031	233,692	17,339	3.41%	4.14
Class C LP Units	78,327	78,327	—	3.43%	3.83
Convertible debentures	57,500	57,500	—	5.40%	2.71
Total	386,858	369,519	17,339	3.71%	3.86

The weighted average interest rate on our debts was 3.71% (December 31, 2017 - 3.75%).

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 market competitive 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 period. 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 debt. These metrics are not calculated for purposes of covenant compliance on any of our debt facilities.

<i>(\$000s)</i>	Six months ended June 30, 2018	Year ended December 31, 2017
FFO	13,425	26,670
Principal repayments on Mortgages payable	3,799	6,751
Principal repayments on Class C LP Units	1,876	3,489
Debt service coverage ratio	2.37	2.60
FFO plus finance costs	21,427	40,519
Finance costs ⁽¹⁾	8,002	13,849
Finance costs coverage ratio	2.68	2.93

(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 the unitholders and to receive any distributions by the REIT. Special voting units have no economic entitlement in the REIT but entitle the holder to one vote per special voting unit. Special voting units may only be issued in connection with securities exchangeable into trust units (including Class B LP Units).

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

On January 12, 2018 the REIT issued 2,035,500 trust units in exchange for subscription receipts previously issued at a price of \$8.50 per unit for gross proceeds of \$17.30 million. The issuance was qualified under a short form prospectus dated December 14, 2017.

On January 12, 2018 the REIT issued 283,447 Class B LP Units at a price of \$8.82, or \$2.50 million, to Melcor as partial consideration for the Melcor Acquisition.

The following table summarizes the trust units issued and the fully diluted number of units outstanding as at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
	Units	\$ Amount	Units	\$ Amount
Issued and fully paid units (\$000s)				
Balance, beginning of period	11,151,297	112,892	11,151,297	112,892
Issuance of trust units	2,035,500	17,302	—	—
Balance, end of period	13,186,797	130,194	11,151,297	112,892
<i>Dilutive securities</i>				
Class B LP Units ⁽¹⁾	14,899,325	150,207	14,615,878	147,708
Convertible debentures	4,727,273	57,500	4,727,273	57,500
Diluted balance, end of period	32,813,395	337,901	30,494,448	318,100

(1) A corresponding number of special voting units are held by Melcor through an affiliate.

Quarterly Results

	2018		2017				2016	
(\$000s except per unit amount)	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	17,537	18,017	16,263	16,791	16,559	17,000	16,170	16,439
Net income (loss) ⁽¹⁾	(1,768)	9,544	11,723	4,291	(1,792)	(13,490)	2,790	153
Funds from operations (FFO)	6,723	6,702	5,991	7,029	6,835	6,815	6,306	6,843
Adjusted funds from operations (AFFO) ⁽²⁾	4,973	4,893	4,567	5,158	5,219	5,250	4,723	5,174
Per unit metrics								
Basic earnings (loss) per unit	\$ (0.13)	\$ 0.74	\$ 0.35	\$ 0.25	\$ (0.16)	\$ (1.21)	\$ 0.10	\$ 0.01
FFO	\$ 0.24	\$ 0.24	\$ 0.23	\$ 0.27	\$ 0.27	\$ 0.26	\$ 0.24	\$ 0.27
AFFO ⁽²⁾	\$ 0.18	\$ 0.18	\$ 0.18	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.18	\$ 0.20
Annualized distribution rate	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675
Payout Ratio	95%	96%	95%	84%	83%	83%	92%	84%
Period-end closing unit price	\$8.22	\$8.10	\$8.51	\$8.85	\$8.86	\$8.50	\$8.46	\$8.67
Annualized distribution yield on closing unit price (%) ⁽³⁾	8.21%	8.33%	7.93%	7.63%	7.62%	7.94%	7.98%	7.79%

(1) Net income (loss) is significantly impacted by the results of non-cash fair value adjustments on assets and liabilities carried at fair value. Management believes that FFO is a better measure of operating performance and that AFFO is a better measure of cash flows.

(2) We adopted REALpac's new guidance on AFFO in Q2-2017 retroactively. See Adjusted Funds From Operations for details.

(3) Annualized distribution yield is calculated as the annualized distribution rate divided by the period-end closing price.

Off Balance Sheet Arrangements, Contractual Obligations, Business Environment & Risks, Related Party Transactions, Critical Accounting Estimates, Changes in Accounting Policies

We adopted IFRS 15, Revenue from Contracts with Customers and IFRS 9, Financial Instruments effective January 1, 2018. Refer to note 3 of the interim financial statements for further discussion on the impact of adoption and an overview of our policy. There were no other material changes to the above titled sections at June 30, 2018 in comparison to the December 31, 2017 annual MD&A.

Internal Control over Financial Reporting and Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer have evaluated whether there were material changes to internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. No such changes were identified.

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 July 31, 2018, 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 these non-standard measures will assist 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:

(\$000s)	Three months ended					Six months ended		
	30-Jun-18	30-Jun-17	△%	31-Mar-18	△%	30-Jun-18	30-Jun-17	△%
Net income (loss) for the period	(1,768)	(1,792)		9,544		7,776	(15,282)	
Net finance costs	6,472	5,690		6,496		12,968	11,630	
Fair value adjustment on Class B LP Units	1,787	5,262		(6,108)		(4,321)	5,847	
Fair value adjustment on investment properties	3,414	249		1		3,415	16,708	
General and administrative expenses	708	624		746		1,454	1,313	
Amortization of tenant incentives	757	802		768		1,525	1,571	
Straight-line rent adjustment	(313)	(265)		(372)		(685)	(480)	
NOI	11,057	10,570	5%	11,075	— %	22,132	21,307	4%

Same-asset NOI: this measure compares the NOI on assets that have been owned for the entire current and comparative period and are classified for continuing use.

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 instrument, after adjustments for equity accounted entities, joint ventures and non-controlling interests calculated to reflect FFO on the same basis as consolidated properties.

FFO per unit: FFO per unit is defined as FFO divided by weighted average trust units and weighted average Class B LP Units outstanding.

Adjusted funds from operations (AFFO): AFFO is defined as FFO subject to certain adjustments, including: (i) adjusting for any differences resulting from recognizing property revenues on a straight-line basis; (ii) 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.

AFFO per unit: AFFO per unit is defined as AFFO divided by weighted average trust units and weighted average Class B LP Units outstanding.

Adjusted cash flows from operations (ACFO): ACFO is defined as cash flows from operations subject to certain adjustments, including: (i) fair value adjustments and other effects of redeemable units classified as liabilities; (ii) payments of tenant incentives and direct leasing costs; (iii) changes in operating assets and liabilities which are not indicative of sustainable cash available for distribution; (iv) amortization of deferred financing fees; and (v) deducting a reserve for normalized maintenance capital expenditures, tenant inducements and leasing costs, as determined by us. Other adjustments may be made to ACFO 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, liability held for sale (as applicable) and convertible debenture, excluding unamortized discount and transaction costs divided by Gross Book Value (GBV). GBV is calculated as the total assets acquired in the Initial Properties, subsequent asset purchases and development costs less dispositions.

Cash finance costs: is calculated as finance costs less amortization of deferred financing fees, fair value adjustment on derivative instruments and amortization of fair value adjustment on Class C LP Units.



MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three and six-months ended June 30, 2018

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at June 30, 2018

(Unaudited)

(\$000s)	June 30, 2018	December 31, 2017
ASSETS		
Current Assets		
Cash and cash equivalents	3,237	12,189
Restricted cash	—	16,956
Accounts receivable	1,226	1,764
Other assets (note 6)	2,707	1,161
Assets held for sale (note 4)	—	6,732
	7,170	38,802
Non-Current Assets		
Investment properties (note 5 and 16)	683,766	617,278
Other assets (note 6)	19,206	18,753
Loan receivable	900	900
Derivative financial asset (note 16)	503	504
	704,375	637,435
TOTAL ASSETS	711,545	676,237
LIABILITIES		
Current Liabilities		
Accounts payable	1,355	1,649
Distribution payable	1,580	1,453
Accrued liabilities and other payables (note 8)	8,095	7,195
Subscription receipts (note 12)	—	16,623
Class C LP Units (note 10)	7,808	14,637
Mortgages payable (note 9)	31,616	24,348
Liability held for sale (note 4)	—	3,670
	50,454	69,575
Non-Current Liabilities		
Accrued liabilities and other payables (note 8)	1,550	1,524
Class B LP Units (note 11 and 16)	122,472	124,381
Class C LP Units (note 10)	70,845	59,639
Mortgages payable (note 9)	217,994	192,892
Convertible debentures	54,525	54,046
Derivative financial liabilities (note 16)	729	729
TOTAL LIABILITIES	518,569	502,786
UNITHOLDERS' EQUITY	192,976	173,451
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	711,545	676,237

See accompanying notes to the condensed interim consolidated financial statements.

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

For the three and six-months ended June 30

(Unaudited)

	Three months ended June 30		Six months ended June 30	
(\$000s)	2018	2017	2018	2017
Rental revenue (note 13 and 15)	17,537	16,559	35,554	33,559
Direct operating expenses (note 15)	(6,924)	(6,526)	(14,262)	(13,343)
Net rental income	10,613	10,033	21,292	20,216
General and administrative expenses (note 15)	(708)	(624)	(1,454)	(1,313)
Fair value adjustment on investment properties (note 5 and 16)	(3,414)	(249)	(3,415)	(16,708)
Fair value adjustment on Class B LP Units (note 11 and 16)	(1,787)	(5,262)	4,321	(5,847)
Income (loss) before finance costs	4,704	3,898	20,744	(3,652)
Interest income	28	14	64	20
Finance costs (note 14 and 15)	(6,500)	(5,704)	(13,032)	(11,650)
Net finance costs	(6,472)	(5,690)	(12,968)	(11,630)
Net income (loss) and comprehensive income (loss)	(1,768)	(1,792)	7,776	(15,282)
Basic income (loss) per trust unit	(\$0.13)	(\$0.16)	\$0.60	(\$1.37)
Diluted income (loss) per trust unit	(\$0.13)	(\$0.16)	\$0.30	(\$1.37)

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at June 30, 2018

(Unaudited)

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2017	11,151,297	102,707	40,448	30,296	173,451
Issuance of trust units (note 12)	2,035,500	16,112	—	—	16,112
Property purchase from Melcor Developments Ltd. (note 4 and 11)	—	—	88	—	88
Net income for the period	—	—	—	7,776	7,776
Distributions to unitholders	—	—	—	(4,451)	(4,451)
Balance at June 30, 2018	13,186,797	118,819	40,536	33,621	192,976

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2016	11,151,297	102,707	40,448	37,091	180,246
Net loss for the period	—	—	—	(15,282)	(15,282)
Distributions to unitholders	—	—	—	(3,764)	(3,764)
Balance at June 30, 2017	11,151,297	102,707	40,448	18,045	161,200

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Cash Flows

For the three and six-months ended June 30

(Unaudited)

	Three months ended June 30		Six months ended June 30	
(\$000s)	2018	2017	2018	2017
CASH FLOWS FROM (USED IN)				
OPERATING ACTIVITIES				
Net income (loss) for the period	(1,768)	(1,792)	7,776	(15,282)
Non cash items:				
Amortization of tenant incentives (note 6 and 13)	757	802	1,525	1,571
Straight-line rent adjustments (note 13)	(313)	(265)	(685)	(480)
Fair value adjustment on investment properties (note 5 and 16)	3,414	249	3,415	16,708
Fair value adjustment on Class B LP Units (note 11 and 16)	1,787	5,262	(4,321)	5,847
Amortization of fair value adjustment on Class C LP Units (note 14)	(56)	(56)	(112)	(113)
Fair value adjustment on derivative instruments (note 14 and 16)	18	(153)	1	(127)
Amortization of deferred financing fees (note 14)	367	252	755	503
	4,206	4,299	8,354	8,627
Payment of tenant incentives and direct leasing costs	(836)	(852)	(1,419)	(1,643)
Changes in operating assets and liabilities	(1,691)	(746)	(1,559)	(1,456)
	1,679	2,701	5,376	5,528
INVESTING ACTIVITIES				
Additions to investment properties (note 4)	—	—	(34,175)	—
Net proceeds from disposal of investment properties (note 4)	13,389	4,220	16,459	4,220
Investment in property improvements (note 5)	(1,137)	(809)	(1,320)	(1,022)
	12,252	3,411	(19,036)	3,198
FINANCING ACTIVITIES				
Proceeds from issuing trust units net of costs (note 12)	—	—	16,112	—
Change in revolving credit facility	(5,481)	(2,151)	—	(980)
Proceeds from mortgages payable (note 9)	12,240	7,200	12,240	7,200
Repayment of mortgages payable	(8,697)	(7,213)	(10,578)	(8,886)
Repayment on Class C LP Units (note 10)	(7,884)	(882)	(8,823)	(1,754)
Distributions to unitholders	(2,130)	(1,882)	(4,243)	(3,764)
	(11,952)	(4,928)	4,708	(8,184)
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE PERIOD	1,979	1,184	(8,952)	542
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	1,258	988	12,189	1,630
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	3,237	2,172	3,237	2,172

See accompanying notes to the condensed interim consolidated financial statements.

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. We began operations on May 1, 2013.

Our principal business is to acquire, own and manage office, retail and industrial properties in select markets across Western Canada. The properties are externally managed, administered and operated by Melcor Developments Ltd. (“Melcor”) pursuant to the Property Management Agreement and Asset Management Agreement (note 15).

As at July 31, 2018, Melcor, through an affiliate, holds an approximate 53.0% 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.

We are governed under the laws of the Province of Alberta. Our registered office 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 condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standard Board (“IASB”) applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*.

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS as issued by the IASB. These condensed interim consolidated financial statements were authorized for issue by the Board of Trustees on July 31, 2018.

The condensed interim consolidated financial statements have been prepared using the same significant accounting policies and methods as those used in our annual consolidated financial statements for the year ended December 31, 2017. We have adopted new standards IFRS 9, Financial instruments, and IFRS 15, Revenue from contracts with customers. Adoption of these amended standards requires additional disclosure within these condensed interim consolidated financial statements (note 3). Beginning January 1, 2019 IFRS 16, Leases, will be in effect. We are in the process of assessing the impact of this new standard and do not expect the adoption to have a material impact on our financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES AND NEW STANDARDS ADOPTED

The accounting policies followed in these condensed interim consolidated financial statements are consistent with those of the previous financial year, except as described below.

We have adopted the following new IFRS standards effective January 1, 2018:

- a) **IFRS 15, Revenue from Contracts with Customers** supersedes IAS 18, 'Revenue', IAS 11, 'Construction Contracts' and other interpretive guidance associated with revenue recognition. 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.

Impact of Adoption

The adoption of IFRS 15 did not result in any adjustments upon transition, change in recognition, or timing of recognition of revenues in the REIT. Adoption does require additional disclosures to the interim financial statements to distinguish between those revenues related to lease components or service revenues (note 13).

Accounting Policies Adopted From January 1 2018

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.

Rental revenues include both lease and service revenue component. Lease revenues from investment properties include base rents, recoveries of operating expenses including property taxes, parking revenue, incidental income and sign and storage lease revenue. 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 the 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 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.

Service revenues are amounts outlined separately in the lease agreement for distinct services provided including utilities, maintenance and security recoveries from tenants which are recognized on a monthly basis in the period in which the corresponding costs are incurred and performance obligations are completed.

- b) IFRS 9, Financial Instruments** replaces IAS 39 and introduces a new classification and measurement model with three classification categories, 'amortized cost', 'fair value' and '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 and a new hedge accounting model.

Impact of Adoption

The adoption of IFRS 9 did not result in any adjustments upon transition. Financial assets which include cash and cash equivalents, restricted cash, accounts receivable and loan receivable were previously classified as Loans and Receivables are now classified as amortized cost. This change in classification did not result in any changes in measurement of financial assets in the REIT.

The REIT was required to revise its impairment methodology under IFRS 9 for its financial assets, to account for expected credit losses. To measure the expected credit loss, financial assets have been grouped based on shared credit risk characteristics and the days past due. While our financial assets are subject to the expected credit loss requirements, the identified loss was immaterial.

There was no impact to the measurement, recognition or disclosures of financial liabilities.

Accounting Policies Adopted From January 1, 2018

Financial assets

Financial assets that are held for collection of contractual cash flows represent solely payments of principal and interest are measured at amortized cost. This includes cash and cash equivalents, restricted cash, accounts receivable and loan receivable. Financial assets are initially recognized at fair value plus transaction costs, adjusted for an expected credit loss. Subsequently, receivables are measured at amortized cost using the effective interest rate method adjusted for expected credit losses.

For financial assets, the REIT applies the simplified expected credit loss approach, which requires expected lifetime losses to be recognized from initial recognition.

4. ACQUISITIONS & DISPOSITIONS

Acquisitions

On January 12, 2018 the REIT closed on the previously announced acquisition of five commercial properties from Melcor Developments Ltd. ("Melcor Acquisition") for a total purchase price of \$80,875.

(\$000s)	
Investment properties	80,875
Assumed mortgages (note 9)	(31,037)
	49,838
Consideration to Melcor	
Class C LP units issued (note 10)	13,312
Class B LP units issued (note 11)	2,500
Cash paid to Melcor	34,026
	49,838

An additional \$149 in transaction costs were incurred for a net cash investment of \$34,175. The purchase price approximates fair market value and in accordance with our policy, has been accounted for as an asset purchase.

Dispositions

On April 16, 2018 we sold an investment property for a sales price of \$13,389 (net of transaction costs and including tenant incentives of \$434 and straight line rent of \$80). Concurrent with the sale we repaid the associated Class C LP Unit liability which had a balance of \$6,947 (note 10).

On January 31, 2018, we disposed of an industrial property previously classified as held for sale for a sales price of \$6,732 (net of transaction costs) (note 5). The sale price was settled through mortgage assumption of \$3,662, and cash of \$3,070.

5. INVESTMENT PROPERTIES

(\$000s)	Six months ended June 30, 2018	Year ended December 31, 2017
Balance - beginning of period	617,278	641,365
Additions		
Direct acquisition (note 4)	81,024	—
Property improvements	1,320	2,315
Direct leasing costs	434	800
Fair value adjustment on investment properties (note 16)	(3,415)	(12,800)
Investment property classified as held for sale during the period (note 4)	—	(6,642)
Investment property disposed of during the period (note 4)	(12,875)	(7,760)
Balance - end of period	683,766	617,278

In accordance with our policy 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 16.

Presented separately from investment properties is \$13,326 (December 31, 2017 - \$13,478) in tenant incentives and \$5,880 (December 31, 2017 - \$5,275) in straight-line rent adjustments (note 6). The fair value of investment properties has been reduced by these amounts.

6. OTHER ASSETS

(\$000s)	June 30, 2018	December 31, 2017
Current Assets		
Prepaid expense, and other	2,707	1,161
Non-Current Assets		
Straight-line rent adjustments	5,880	5,275
Tenant incentives	13,326	13,478
	19,206	18,753

During the six-month period, we recorded tenant incentives of \$1,807 (2017 - \$1,222) and recorded \$1,525 (2017 - \$1,571) of amortization expense respectively. We also disposed of a property which included tenant incentives of \$434 and straight line rent of \$80 (note 4).

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.

7. REVOLVING CREDIT FACILITY

On June 1, 2018 we entered into the first amendment to our revolving credit facility agreement with our existing lenders. Under the terms of the amending agreement the REIT maintains an available credit limit based upon the carrying value of specific investment properties to a maximum of \$35,000 million for general corporate purposes and acquisitions, including a \$5,000 million swingline sub-facility. An additional \$10,000 million is available by way of an accordion feature, subject to lender approval. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.25% or bankers acceptance plus 2.25% stamping fee. The agreement also provides the REIT with \$5,000 in available letters of credit which bear interest at 2.25%. 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 revolving facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the new facility. The facility matures June 1, 2021.

As of June 30, 2018, the carrying value of the pledged properties was \$55,300 (December 31, 2017 - \$56,258).

As at June 30, 2018 we had \$nil (December 31, 2017 - \$nil) drawn from the facility; and posted letters of credit of \$150 (December 31, 2017 - \$nil).

8. ACCRUED LIABILITIES AND OTHER PAYABLES

(\$000s)	June 30, 2018	December 31, 2017
Current Liabilities		
Tenant security deposits and pre-payments	2,954	2,488
Accrued finance costs	572	533
Other accrued liabilities and payables	4,569	4,174
	8,095	7,195
Non-Current Liabilities		
Decommissioning obligation	1,550	1,524

9. MORTGAGES PAYABLE

(\$000s)	June 30, 2018	December 31, 2017
Mortgages amortized over 15-25 years at fixed interest rates	233,692	200,728
Mortgage amortized over 25 years at a variable interest rate (via a fixed for floating interest rate swap)	17,339	17,604
Unamortized deferred financing fees	(1,421)	(1,092)
	249,610	217,240
Current portion of mortgages payable	(31,616)	(24,348)
	217,994	192,892
Interest rate ranges	(2.48%-4.91%)	(2.48%-4.91%)

The change in mortgages payable during the period is summarized as follows:

(\$000s)	
Balance at December 31, 2017	217,240
Principal repayments:	
Scheduled amortization on mortgages	(3,799)
Mortgage repayments	(6,779)
New mortgages	12,240
Mortgages assumed (note 4)	31,037
Deferred financing fees capitalized	(539)
Amortization of deferred financing fees	210
Balance at June 30, 2018	249,610

10. CLASS C LP UNITS

Class C LP Units are held by Melcor in consideration of debt retained on certain properties sold to the REIT. Distributions are made on the units in order to permit Melcor to satisfy required principal and interest payments. The Class C LP Units are classified as debt and a portion of the distributions are recognized as interest expense.

(\$000s)	June 30, 2018	December 31, 2017
Class C LP Units amortized over 15-25 years at fixed interest rates	78,327	73,838
Unamortized fair value adjustment	326	438
	78,653	74,276
Current portion of Class C LP Units	(7,808)	(14,637)
	70,845	59,639
Effective interest rate	3.43%	3.39%

On April 16, 2018 Melcor retired the mortgage that secures retained debt relating to a property sold by the REIT to a third party. Concurrent with the retirement of the mortgage we repaid the outstanding Class C LP Unit liability, representing a balance of \$6,947 or 821,477 of Class C LP Units. The units were to mature September 1, 2019. During the quarter Melcor also extended the mortgage that secures retained debt relating to two of the initial properties from April 1, 2018 to April 1, 2021 at an interest rate of 3.58% (previously 3.33%). Concurrent with the extended mortgage we extended the maturity of 894,692 Class C Units with a balance of \$7,211 from April 1, 2018 to April 1, 2021 at an interest rate of 3.58%.

During the six-months ended June 30, 2018 the REIT issued 1,331,202 Class C LP units as partial consideration for the Melcor Acquisitions (note 4). As at June 30, 2018 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2017 - 9,454,411).

The change in Class C LP units during the period is summarized as follows:

(\$000s)	
Balance at December 31, 2017	74,276
Principal repayments:	
Scheduled amortization on Class C LP units	(1,876)
Class C LP Units repaid (note 4)	(6,947)
Class C LP Units issued (note 4)	13,312
Amortization of fair value adjustment on Class C LP Units (note 14)	(112)
Balance at June 30, 2018	78,653

11. CLASS B LP UNITS

Class B LP Units are held by Melcor as partial consideration for certain properties sold to the REIT. The Class B LP Units are exchangeable at the option of the holder for one trust unit and, therefore, are considered a puttable instrument and are required to be accounted for as a financial liability. Each unit is accompanied by one special voting unit which entitles the

holder to one vote at any meeting of the unitholders. Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units and are included in finance costs.

In accordance with our policy, we record Class B LP units at fair value. We remeasured the Class B LP Units at June 30, 2018 and recognized a fair value gain of \$4,321 during the six-month period (2017 - fair value loss of \$5,847). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 16.

On January 12, 2018 the REIT issued 283,447 Class B LP units at \$8.82 or \$2,500 as partial consideration for the Melcor Acquisition (note 4). As at the adjustment date the fair value of the units issued was \$8.51 per unit, or \$2,412; the \$88 difference between book value and fair value was recorded to contributed surplus.

At June 30, 2018 there were 14,899,325 Class B LP Units issued and outstanding at a fair value of \$8.22 per unit or \$122,472 (December 31, 2017 - 14,615,878 at \$8.51 per unit or \$124,381).

The following table summarizes the change in Class B LP Units for the period:

<i>(\$000s except unit amounts)</i>	June 30, 2018		December 31, 2017	
Balance - beginning of period	14,615,878	124,381	14,615,878	123,650
Issuance of Class B LP units - Melcor Acquisition	283,447	2,412	—	—
Fair value adjustment on Class B LP Units	—	(4,321)	—	731
Balance - end of period	14,899,325	122,472	14,615,878	124,381

12. UNITHOLDERS' EQUITY

On January 12, 2018 the REIT issued 2,035,500 trust units in exchange for subscription receipts previously issued and outstanding as of December 31, 2017 at a price of \$8.50 per subscription receipt for gross proceeds of \$17,302 (transaction costs of \$1,190 were incurred for net proceeds of \$16,112). At June 30, 2018, our issued and outstanding trust units were 13,186,797 (December 31, 2017 - 11,151,297).

13. RENTAL REVENUE

The components of rental revenue are as follows:

(\$000's)	Three months ended June 30		Six months ended June 30	
	2018	2017	2018	2017
Lease revenue	14,942	14,024	29,823	28,098
Service revenue	3,039	3,072	6,571	6,552
Amortization of tenant incentives (note 6)	(757)	(802)	(1,525)	(1,571)
Straight-line adjustments	313	265	685	480
	17,537	16,559	35,554	33,559

14. FINANCE COSTS

The components of finance costs are as follows:

	Three months ended June 30		Six months ended June 30	
(\$000's)	2018	2017	2018	2017
Interest on mortgages payable and revolving credit facility	2,146	2,004	4,298	4,068
Interest on Class C LP Units	738	715	1,513	1,437
Amortization of fair value adjustment on Class C LP Units	(56)	(56)	(112)	(113)
Distributions on Class B LP Units	2,515	2,467	5,029	4,933
Interest on convertible debentures	772	475	1,548	949
Fair value adjustment on derivative instruments	18	(153)	1	(127)
Amortization of deferred financing fees	367	252	755	503
	6,500	5,704	13,032	11,650

Total finance costs paid during the three and six-month period were \$6,952 and \$12,258 (2017 - \$6,101 and \$11,296).

15. RELATED PARTY TRANSACTIONS

Our condensed interim consolidated financial statements include the following related party transactions with Melcor, and its affiliates, as our controlling unitholder:

a) Property and Asset Management Agreements

Pursuant to the terms of the Property and Asset Management Agreements, we incurred the following fees during the period:

	Three months ended June 30		Six months ended June 30	
(\$000's)	2018	2017	2018	2017
Asset Management Agreement				
Base Annual Management Fee	434	396	871	794
Property Management Agreement				
Monthly Fee	502	487	1,014	951
Lease Fee	338	174	433	399
	1,274	1,057	2,318	2,144

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. Acquisition Fees, Capital Expenditure Fees and Lease Fees are capitalized to investment properties. As at June 30, 2018 there was a \$629 (December 31, 2017 - \$579) payable to Melcor related to these fees.

b) Distributions on Class B LP Units and Redemptions of Class C LP Units

During the three and six-month period ended June 30, 2018, \$2,515 and \$5,029 in distributions were recorded on Class B LP Units held by Melcor (2017 - \$2,467 and \$4,933). These distributions were recorded as finance costs (note 14). As at June 30, 2018 there was a \$838 payable to Melcor for the June distribution (December 31, 2017 - \$822 for the December distribution).

Also during the three and six-month period ended June 30, 2018, Melcor, as holder of all Class C LP Units, was paid \$1,747 and \$3,440 to fund principal and interest payments on the retained debt (2017 - \$1,601 and \$3,202). In addition, during the period we repaid the outstanding balance on 821,477 of Class C LP Units with a carrying value of \$6,947 (note 4).

c) Rental Revenue

For the three and six-month period ended June 30, 2018 we collected \$256 and \$491 in rental revenue from Melcor and an affiliate for use of office space (2017 - \$241 and \$481). In addition, pursuant to certain Head and Bridge Lease Agreements, we

collected \$41 and \$87 in rental revenue from Melcor as compensation for certain vacant spaces at properties acquired from Melcor in 2014 (2017 - \$92 and \$183). These amounts are included in rental revenue.

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

During the first quarter the REIT purchased five commercial properties from Melcor (note 4). The total purchase price of \$80,875, and transaction costs of \$149, were settled through issuance of 283,447 Class B LP Units at price of \$8.82 representing \$2,500; assumption of \$31,037 in mortgages payable; issuance of 1,331,202 Class C LP Units, representing \$13,312 in Retained Debt by Melcor; and cash of \$34,175.

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

16. FAIR VALUE MEASUREMENT

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

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

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables, loan receivable, 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, liability held for sale 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 liabilities, the conversion features on our convertible debentures, are 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 and the fair value of convertible debenture is estimated based on the closing trading price of the REIT's debenture (Level 1).

In addition, the REIT carries its investment properties and assets held for sale at fair value 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 period.

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.

		June 30, 2018				December 31, 2017	
(\$000s)		Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
Non-financial assets							
Investment properties	Level 3	683,766	—	683,766	683,766	617,278	617,278
Assets held for sale	Level 3	—	—	—	—	6,732	6,732
Financial liabilities							
Mortgages payable	Level 3	—	249,610	249,610	241,992	217,240	219,700
Class B LP Units	Level 1	122,472	—	122,472	122,472	124,381	124,381
Class C LP Units	Level 3	—	78,653	78,653	78,653	74,276	74,276
Convertible debentures	Level 1	—	54,525	54,525	57,500	54,046	58,018
Liability held for sale	Level 3	—	—	—	—	3,670	3,670
Derivative financial instruments							
Interest rate swap	Level 3	503	—	503	503	504	504
Conversion feature on convertible debentures	Level 3	729	—	729	729	729	729

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 valuers 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 June 30, 2018 of which 13 investment properties (of 47 legal phases) with a fair value of \$189,750 were valued by qualified independent external valuation professionals during the period. Valuations performed during the six-month period resulted in fair value losses of \$3,415. During the year ended December 31, 2017 Melcor's internal valuation team valued investment properties of which 27 investment properties (of 46 legal phases valued) with a fair value of \$392,700 were valued by qualified independent external valuation professionals during the year. Valuations performed during the year ended December 31, 2017 resulted in fair value losses of \$12,800.

Weighted average stabilized net operating income for investment properties is \$1,498 (December 31, 2017 - \$1,534). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	June 30, 2018			December 31, 2017		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.64%	5.50%	8.75%	6.68%
Terminal capitalization rate	5.75%	9.00%	6.72%	5.75%	9.00%	6.79%
Discount rate	6.50%	9.75%	7.70%	6.50%	9.75%	7.75%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by \$49,421 (December 31, 2017 - \$44,312). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by \$57,474 (December 31, 2017 - \$51,480).

Non-derivative financial instruments

The fair value of mortgages payable, liability held for sale and Class C LP Units 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.

Derivative financial instruments

Our derivative financial instruments are comprised of a floating for fixed interest rate swap on one of our mortgages (level 3) 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 June 30, 2018 the fair value of the interest rate swap contract is \$503 (December 31, 2017 - \$504).

The significant unobservable inputs used in the fair value measurement of the conversion feature on the convertible debenture as at June 30, 2018 are as follows:

- Volatility - expected volatility as at June 30, 2018 was derived from the historical prices of our trust units. As the REIT was formed on May 1, 2013, price history is limited and we use the entire historical data up until June 30, 2018. Volatility was 21.70% (December 31, 2017 - 21.70%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at June 30, 2018. The credit spread used was 2.81% (December 31, 2017 - 2.81%).

As at June 30, 2018, the fair value of the conversion feature on our convertible debentures was \$729 (December 31, 2017 - \$729).

Valuations performed during the six-month period resulted in fair value loss of \$1 (December 31, 2017 - fair value gains of \$521).

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 June 30, 2018 the fair value of the Class B LP Units was \$122,472, resulting in a fair value gain of \$4,321 for the six-month period (December 31, 2017 - fair value loss of \$585).

17. SUBSEQUENT EVENTS

Distributions

On July 16, 2018 we declared a distribution of \$0.05625 per unit for the months of July, August and September 2018. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
July 2018	July 31, 2018	August 15, 2018	\$0.05625 per unit
August 2018	August 31, 2018	September 17, 2018	\$0.05625 per unit
September 2018	September 28, 2018	October 15, 2018	\$0.05625 per unit