MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three-months ended March 31, 2017

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2017

(Unaudited)

($000s)	March 31, 2017	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	**988**	1,630
Accounts receivable	**2,211**	1,364
Other assets (note 5)	**878**	1,009
Asset held for sale (note 3)	**7,760**	—
	11,837	4,003
Non-Current Assets		
Investment properties (note 4 and 14)	**617,621**	641,365
Other assets (note 5)	**18,221**	18,246
Derivative financial asset (note 14)	**84**	110
	635,926	659,721
TOTAL ASSETS	**647,763**	663,724
LIABILITIES		
Current Liabilities		
Revolving credit facility	**18,507**	17,324
Accounts payable	**1,001**	1,516
Distribution payable	**1,449**	1,449
Accrued liabilities and other payables (note 6)	**6,344**	5,820
Class C LP Units (note 8)	**13,325**	6,074
Mortgages payable (note 7)	**15,677**	6,821
Liability held for sale (note 3)	**2,653**	—
	58,956	39,004
Non-Current Liabilities		
Accrued liabilities and other payables (note 6)	**1,489**	1,475
Class B LP Units (note 9 and 14)	**124,235**	123,650
Class C LP Units (note 8)	**66,314**	74,494
Mortgages payable (note 7)	**198,952**	212,045
Convertible debenture	**32,882**	32,749
Derivative financial liability (note 14)	**61**	61
TOTAL LIABILITIES	**482,889**	483,478
UNITHOLDERS' EQUITY	**164,874**	180,246
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	**647,763**	663,724

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

For the three-months ended March 31

(Unaudited)

($000s)	2017	2016
Rental revenue (note 11 and 13)	**17,000**	16,626
Direct operating expenses (note 13)	**(6,817)**	(6,493)
Net rental income	**10,183**	10,133
General and administrative expenses (note 13)	**(689)**	(741)
Fair value adjustment on investment properties (note 4 and 14)	**(16,459)**	(1,825)
Fair value adjustment on Class B LP Units (note 9 and 14)	**(585)**	(11,547)
Loss before finance costs	**(7,550)**	(3,980)
Interest income	**6**	9
Finance costs (note 12 and 13)	**(5,946)**	(5,995)
Net finance costs	**(5,940)**	(5,986)
Net loss and comprehensive loss	**(13,490)**	(9,966)
Basic loss per trust unit	**($1.21)**	($0.89)
Diluted loss per trust unit	**($1.21)**	($0.89)

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at March 31, 2017

(Unaudited)

($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	—	—	—	(13,490)	(13,490)
Distributions to unitholders	—	—	—	(1,882)	(1,882)
Balance at March 31, 2017	11,151,297	102,707	40,448	21,719	164,874

($000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2015	11,151,297	102,707	40,448	55,794	198,949
Net loss for the period	—	—	—	(9,966)	(9,966)
Distributions to unitholders	—	—	—	(1,881)	(1,881)
Balance at March 31, 2016	11,151,297	102,707	40,448	43,947	187,102

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Cash Flows

For the three-months ended March 31

(Unaudited)

($000s)	2017	2016
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net loss for the period	**(13,490)**	(9,966)
Non cash items:		
Amortization of tenant incentives (note 5 and 11)	**769**	825
Straight-line rent adjustments (note 11)	**(215)**	(345)
Fair value adjustment on investment properties (note 4 and 14)	**16,459**	1,825
Fair value adjustment on Class B LP Units (note 9 and 14)	**585**	11,547
Amortization of fair value adjustment on Class C LP Units (note 12)	**(57)**	(57)
Fair value adjustment on derivative instruments (note 14)	**26**	—
Non-cash finance costs (note 12)	**251**	147
	4,328	3,976
Payment of tenant incentives and direct leasing costs	**(791)**	(634)
Changes in operating assets and liabilities	**(710)**	(733)
	2,827	2,609
INVESTING ACTIVITIES		
Investment property improvements and development (note 4)	**(213)**	(1,481)
	(213)	(1,481)
FINANCING ACTIVITIES		
Change in revolving credit facility	**1,171**	(801)
Proceeds from mortgages payable	**—**	21,300
Repayment of mortgages payable	**(1,673)**	(16,129)
Repayment on Class C LP Units	**(872)**	(827)
Change in restricted cash	**—**	101
Distributions to unitholders	**(1,882)**	(1,881)
	(3,256)	1,763
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE PERIOD	**(642)**	2,891
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	**1,630**	—
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	**988**	2,891

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. We are externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the Property Management Agreement and Asset Management Agreement (note 13).

As at May 4, 2017, Melcor, through an affiliate, holds an approximate 56.7% effective interest in the REIT through ownership of all Class B LP Units of Melcor REIT Limited Partnership (the "Partnership") and is the ultimate controlling party.

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, 2016, 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 May 4, 2017.

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, 2016. We have adopted amended standards IAS 7, Statement of cash flows and IAS 12, Income taxes, effective January 1, 2017. Adoption of these amended standards did not require any adjustment to the presentation or disclosure within these condensed interim consolidated financial statements.

3. ASSET HELD FOR SALE

As at March 31, 2017, we classified an industrial property as an asset held for sale with a fair value of $7,760 (including investment property of $7,723, tenant incentives of $20 and straight line rent of $17) and associated liabilities of $2,653 (including a mortgage payable of $2,640 and security deposits of $13). As at March 31, 2017 management has committed to a plan of sale of the property, with a contract in place. Subsequent to the quarter the property was sold to a third party for a purchase price of $7,760 (net of transaction costs) (note 15).

4. INVESTMENT PROPERTIES

($000s)	**Three months ended March 31, 2017**	Year ended December 31, 2016
Balance - beginning of period	**641,365**	643,421
Additions		
Property improvements	**213**	2,228
Property development activities	**—**	1,641
Direct leasing costs	**225**	621
Fair value adjustment on investment property (note 14)	**(16,459)**	(6,546)
Investment property classified as held for sale during the period (note 3)	**(7,723)**	—
Balance - end of period	**617,621**	641,365

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 14.

The cost of investment properties as at March 31, 2017 totalled $424,049 (December 31, 2016 - $429,730).

Presented separately from investment properties is $13,798 (December 31, 2016 - $14,021) in tenant incentives and $4,423 (December 31, 2016 - $4,225) in straight-line rent adjustments (note 5). The fair value of investment properties has been reduced by these amounts.

5. OTHER ASSETS

($000s)	March 31, 2017	December 31, 2016
Current Assets		
Prepaid expense, and other	**878**	1,009
Non-Current Assets		
Straight-line rent adjustments	**4,423**	4,225
Tenant incentives	**13,798**	14,021
	18,221	18,246

During the three-month period, we recorded tenant incentives of $546 (2016 - $1,248) and recorded $769 (2016 - $825) of amortization expense respectively. During the period we also re-classified $20 in tenant incentives and $17 in straight line rent adjustments to asset held for sale (note 3).

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.

6. ACCRUED LIABILITIES AND OTHER PAYABLES

($000s)	March 31, 2017	December 31, 2016
Current Liabilities		
Tenant security deposits and pre-payments	**2,702**	2,404
Accrued finance costs	**962**	488
Other accrued liabilities and payables	**2,680**	2,928
	6,344	5,820
Non-Current Liabilities		
Decommissioning obligation	**1,489**	1,475

7. MORTGAGES PAYABLE

($000s)	March 31, 2017	December 31, 2016
Mortgages amortized over 15-25 years at fixed interest rates	**200,360**	201,926
Mortgage amortized over 25 years at a variable interest rate (via a fixed for floating interest rate swap)	**18,029**	18,136
Unamortized deferred financing fees	**(1,120)**	(1,196)
	217,269	218,866
Mortgage held for sale (note 4)	**(2,640)**	—
Current portion of mortgages payable	**(15,677)**	(6,821)
	198,952	212,045
Interest rate ranges	**(2.48%-4.91%)**	(2.48%-4.91%)

8. 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)	March 31, 2017	December 31, 2016
Class C LP Units amortized over 2-6 years at fixed interest rates	**79,033**	79,905
Unamortized fair value adjustment	**606**	663
	79,639	80,568
Current portion of Class C LP Units	**(13,325)**	(6,074)
	66,314	74,494
Effective interest rate	**3.34%**	3.34%

As at March 31, 2017 we had 9,454,411 Class C LP Units issued and outstanding (December 31, 2016 - 9,454,411).

9. 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 March 31, 2017 and recognized a fair value loss of $585 during the three-month period (2016 - fair value loss of $11,547). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 14.

At March 31, 2017 there were 14,615,878 Class B LP Units issued and outstanding at a fair value of $8.50 per unit or $124,235 (December 31, 2016 - 14,615,878 at $8.46 per unit or $123,650).

10. UNITHOLDERS' EQUITY

At March 31, 2017, our issued and outstanding trust units were 11,151,297 (December 31, 2016 - 11,151,297).

11. RENTAL REVENUE

The components of rental revenue are as follows:

For the three-months ended March 31 ($000s)	2017	2016
Rental revenue	**17,554**	17,106
Amortization of tenant incentives (note 5)	**(769)**	(825)
Straight-line adjustments	**215**	345
	17,000	16,626

12. FINANCE COSTS

The components of finance costs are as follows:

For the three-months ended March 31 ($000s)	2017	2016
Interest on mortgages payable and revolving credit facility	**2,064**	2,174
Interest on Class C LP Units	**722**	791
Amortization of fair value adjustment on Class C LP Units	**(57)**	(57)
Distributions on Class B LP Units (note 13)	**2,466**	2,466
Interest on convertible debenture	**474**	474
Fair value adjustment on derivative instruments (note 14)	**26**	—
Non-cash finance costs	**251**	147
	5,946	5,995

Total finance costs paid during the three-month period were $5,195 (2016 - $5,356).

13. 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 three-month period:

For the three-months ended March 31 ($000s)	2017	2016
Asset Management Agreement		
Base Annual Management Fee	**398**	397
Capital Expenditure Fee	**—**	38
Property Management Agreement		
Monthly Fee	**464**	477
Lease Fee	**225**	123
	1,087	1,035

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. Acquisition Fees and Lease Fees are capitalized to investment properties. As at March 31, 2017 there was $302 (December 31, 2016 - $583) payable to Melcor related to these fees.

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

During the three-month period ended March 31, 2017, $2,466 in distributions were recorded on Class B LP Units held by Melcor (2016 - $2,466). These distributions were recorded as finance costs (note 12). As at March 31, 2017 there was $822 payable to Melcor for the March distribution (December 31, 2016 - $822 for the December distribution).

Also during the three-month period ended March 31, 2017, Melcor, as holder of all Class C LP Units, was paid $1,601 to fund principal and interest payments on the retained debt (2016 - $1,618).

c) Rental Revenue

For the three-month period ended March 31, 2017 we collected $240 in rental revenue from Melcor and an affiliate for use of office space (2016 - $237). In addition, pursuant to certain Head and Bridge Lease Agreements, we collected $91 in rental revenue from Melcor as compensation for certain vacant spaces at properties acquired from Melcor in 2014 (2016 - $41). 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.

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

14. FAIR VALUE MEASUREMENT

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

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

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

		March 31, 2017				December 31, 2016	
($000s)		**Fair Value**	**Amortized Cost**	**Total Carrying Value**	**Total Fair Value**	Total Carrying Value	Total Fair Value
Non-financial assets							
Investment properties	Level 3	**617,621**	**—**	**617,621**	**617,621**	641,365	641,365
Asset held for sale	Level 3	**7,760**	**—**	**7,760**	**7,760**	—	—
Financial liabilities							
Mortgages payable	Level 3	**—**	**215,749**	**215,749**	**215,907**	220,062	222,116
Class B LP Units	Level 1	**124,235**	**—**	**124,235**	**124,235**	123,650	123,650
Class C LP Units	Level 3	**—**	**79,639**	**79,639**	**79,639**	80,568	80,568
Convertible debenture	Level 1	**—**	**32,882**	**32,882**	**35,241**	32,749	35,017
Liability held for sale	Level 3	**—**	**2,653**	**2,653**	**2,653**	—	—
Derivative financial instruments							
Interest rate swap	Level 3	**84**	**—**	**84**	**84**	110	110
Conversion feature on convertible debenture	Level 3	**61**	**—**	**61**	**61**	61	61

Investment properties

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

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

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

The significant unobservable inputs in the Level 3 valuations are as follows:

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

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

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

The REIT's management company, Melcor, lead by Melcor's executive management team, is responsible for determining fair value measurements on a quarterly basis, including verifying all major inputs included in the valuation and reviewing the results. Melcor's management, along with Melcor REIT Limited Partnership's Audit Committee, discuss the valuation process and key inputs on a quarterly basis. At least once every two years, the valuations are performed by qualified external valuators

who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued.

Investment properties were valued by Melcor's internal valuation team as at March 31, 2017 of which 6 investment properties (of 47 legal phases) with a fair value of $73,400 were valued by qualified independent external valuation professionals during the period. Valuations performed during the period resulted in fair value losses of $16,459. As at December 31, 2016 Melcor's internal valuation team valued investment properties of which 22 investment properties (of 47 legal phases valued) with a fair value of $287,000 were valued by qualified independent external valuation professionals during the year. Valuations performed during the year resulted in fair value losses of $6,546.

Weighted average stabilized net operating income for investment properties is $1,486 (December 31, 2016 - $1,503). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	March 31, 2017			December 31, 2016		
	Min	**Max**	**Weighted Average**	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.71%	5.50%	8.75%	6.63%
Terminal capitalization rate	5.75%	9.00%	6.83%	5.75%	9.00%	6.83%
Discount rate	6.50%	9.75%	7.79%	6.50%	9.75%	7.70%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $44,624 (December 31, 2016 - $46,366). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $51,809 (December 31, 2016 - $53,936).

Derivative financial liability

Our financial derivative liability is comprised of the conversion feature on our convertible debenture and is categorized as level 3 in the fair value hierarchy.

The significant unobservable inputs used in the fair value measurement of the conversion feature on the convertible debenture as at March 31, 2017 are as follows:

- Volatility - expected volatility as at March 31, 2017 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 March 31, 2017. Volatility was 16.73% (December 31, 2016 - 16.73%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at March 31, 2017. The credit spread used was 3.71% (December 31, 2016 - 3.71%).

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 March 31, 2017 the fair value of the Class B LP Units was $124,235, resulting in a fair value loss of $585 for the three-month period (December 31, 2016 - fair value loss of $18,270).

15. SUBSEQUENT EVENTS

On April 17, 2017 we declared a distribution of $0.05625 per unit for the months of April, May and June 2017. The distributions will be payable as follows:

Month	**Record Date**	**Distribution Date**	**Distribution Amount**
April 2017	April 28, 2017	May 15, 2017	$0.05625 per unit
May 2017	May 31, 2017	June 15, 2017	$0.05625 per unit
June 2017	June 30, 2017	July 17, 2017	$0.05625 per unit

On April 28, 2017 we sold an investment property for gross proceeds of $8,000. The purchase price was settled through mortgage assumption of $2,647 (including accrued interest), issuance of a vendor take back mortgage of $900, and cash of $4,453 (excluding working capital adjustments). The vendor take-back mortgage bears interest at an annual rate of 6.00%,

with interest only payments payable monthly over a 36 month term. As a condition of the sale the REIT is required to head lease one unit should the current tenant vacate at the end of their lease. The head lease has a one year term, representing a maximum obligation of $48.