Management's Discussion & Analysis

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May 5, 2016

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 March 31, 2016 and the MD&A and consolidated financial statements and related notes for the year ended December 31, 2015. The discussion outlines strategies and provides analysis of our financial performance for the first quarter of 2016.

The underlying financial statements in this MD&A, including 2015 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted.

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on May 5, 2016. Disclosure contained in this MD&A is current to May 5, 2016, 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) and net operating income (NOI), which are key measures of performance used by real estate businesses. We believe that these measures are important in evaluating the REIT's operating performance, financial risk, economic performance, and cash flows. These non-standard measures may not be comparable to similar measures presented by other companies and real estate investment trusts and should not be used as a substitute for performance measures prepared in accordance with IFRS.

Non-standard measures included in this MD&A are defined on page 16 "*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 2016 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 22-26 of the 2015 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 own 38 income-producing office, retail and industrial properties representing 2.77 million square feet (sf) in gross leasable area (GLA) at March 31, 2016. These high-quality properties feature stable occupancy and a diversified mix of tenants, some of whom have been in place for over 20 years. 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 May 5, 2016, Melcor, through an affiliate, holds an approximate 56.7% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

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

Acquire:

We continue to actively seek strategic property acquisitions that meet our investment criteria. We have not completed any acquisitions in 2016.

Improve:

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

Asset Enhancement:

We continue to execute on opportunities to densify our portfolio. In Q1-2016 we substantially completed the construction of a 7,850 sf single tenant commercial retail unit (CRU) at a neighbourhood shopping centre in Spruce Grove, with the tenant's lease commencing May 1. This is the second densification project that we have undertaken over the past 12 months and we have identified additional opportunities to densify existing properties.

Property Management:

We responded to 99% of calls to our signature customer care line within 30 minutes in Q1-2016, 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.

Q1-2016 Highlights & Key Performance Indicators

Financial Highlights

	Three months ended March 31		
($000s)	**2016**	2015	△%
Non-Standard KPIs			
Net operating income (NOI)	**10,613**	10,205	4 %
Funds from operations (FFO)	**6,697**	6,303	6 %
Adjusted funds from operations (AFFO)	**5,477**	5,178	6 %
Rental revenue	**16,626**	16,258	2 %
Income before fair value adjustments	**3,406**	3,115	9 %
Fair value adjustment on investment properties	**(1,825)**	(1,809)	1 %
Distributions to unitholders	**1,881**	1,903	(1)%
Cash flows from operations	**2,609**	2,595	1 %
Same-asset NOI	**9,870**	9,875	— %
Per unit metrics			
Income (loss) - diluted	**($0.89)**	$0.15	nm
FFO	**$0.26**	$0.24	8 %
AFFO	**$0.21**	$0.20	5 %
Distributions	**$0.17**	$0.17	— %
Payout ratio	**80%**	84%	(5)%

	31-Mar-16	31-Dec-15	△%
Total assets ($000s)	**669,190**	666,458	— %
Equity ($000s)(1)	**260,600**	260,600	— %
Debt ($000s)(2)	**357,064**	353,521	1 %
Weighted average interest rate on debt	**3.58%**	3.80%	(6%)
Debt to GBV ratio(3)	**56%**	56%	—%
Finance costs coverage ratio(4)	**2.90**	2.87	1 %
Debt service coverage ratio(5)	**2.86**	2.76	4 %

Operational Highlights

	31-Mar-16	31-Dec-15	△%
Number of properties	**38**	38	— %
Gross leasable area (GLA) (sf)	**2,768,750**	2,768,750	— %
Occupancy (weighted by GLA)	**93.9%**	93.6%	—%
Retention (weighted by GLA)	**29.1%**	73.0%	(60)%
Weighted average remaining lease term (years)	**5.03**	5.27	(5)%
Weighted average base rent (per sf)	**$15.67**	$15.49	1 %

(1) Calculated as the sum of trust units and Class B LP Units at their book value. Class B LP Units are presented as a financial liability in the condensed interim consolidated financial statements.
(2) Calculated as the sum of total amount drawn on revolving credit facility, mortgages payable, Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units and convertible debenture, excluding unamortized discount and transaction costs.
(3) Excluding convertible debentures, Debt to GBV ratio is 51% (December 31, 2015 - 50%).
(4) Calculated as the sum of FFO and finance costs; divided by finance costs, excluding distributions on Class B LP Units.
(5) Calculated as FFO divided by sum of contractual principal repayments on mortgages payable and distributions of Class C LP Units, excluding amortization of fair value adjustment on Class C LP Units.

Q1-2016 Highlights:

Our portfolio performance remained steady throughout Q1-2016. The stability and diversity of our portfolio with respect to both tenant profile and asset class position the REIT well for managing through economic cycles. We are focused on the real estate fundamentals of asset enhancement and property management while conservatively managing our debt. At 80%, our payout ratio is a strong indicator of our overall health and our ability to sustain distributions at current rates.

Highlights of our performance in the first quarter include:

- Property acquisitions completed via the Melcor proprietary pipeline over the past 12 months coupled with densification activity on an existing property led to revenue growth of 2% and AFFO growth of 6% over Q1-2015.
- We continue to see leasing activity, with 30,336 sf in new and renewed leasing completed during the quarter. Occupancy increased slightly to 93.9%.
- We achieved an on-time response rate in our signature care program of 99% in Q1-2016. We view this metric as an important indication of our commitment to ongoing client care, which contributes to tenant satisfaction and ultimately retention.
- We reduced our weighted average interest rate by 22 basis points over December 31, 2015 as a result of mortgage financings. Reductions to our average borrowing costs translated into improvement in both our finance costs coverage ratio and debt service coverage ratio, a strong indicator of our ability to satisfy our ongoing debt servicing requirements.
- We paid distributions of $0.05625 per trust unit in January, February and March for a quarterly payout ratio of 80%.
- As at March 31, 2016 we have $2.89 million in cash, $2.19 million in restricted cash and additional capacity under our revolving credit facility. Our working capital position remains healthy and we continue to collect receivables in a timely manner to ensure near-term liquidity.

Consolidated Revenue & Net Operating Income

	Three months ended March 31		
($000s)	**2016**	2015	△%
Base rent	**10,521**	10,056	5 %
Recoveries	**6,021**	6,165	(2)%
Other	**564**	367	54 %
Amortization of tenant incentives	**(825)**	(722)	14 %
Straight-line rent adjustment	**345**	392	(12)%
Rental revenue	**16,626**	16,258	2 %
Operating expenses	**3,225**	3,116	3 %
Utilities and property taxes	**3,268**	3,267	— %
Direct operating expenses	**6,493**	6,383	2 %
Net rental income	**10,133**	9,875	3 %
NOI	**10,613**	10,205	4 %
Same-asset NOI	**9,870**	9,875	— %
Operating margin	**61%**	61%	— %

Revenue

Q1-2016 rental revenue grew by 2% or $0.37 million as a result of 35,396 sf of additional GLA brought online in 2015. We acquired additional phases at two existing properties and densified two existing retail properties with the addition of new commercial retail units (CRUs). Rental revenue from the newly acquired/constructed GLA was $0.33 million during the three-months ended March 31, 2016 (2015 - $nil). On a same-asset basis, rental revenue was steady over Q1-2015 with increases in base rent and other revenues being offset by a decline in recoveries and non-cash adjustments.

During the quarter we completed 30,336 sf of leasing, with occupancy slightly up at 93.9%. Only 13% of our 2016 expiries, representing 32,003 sf of GLA, occurred in Q1. One tenant who did not renew represented a large portion of this GLA which significantly impacted retention rate in the quarter. We continue to be proactive with our leasing programs to both retain tenants and attract new tenants.

Weighted average base rent was $15.67, up 1% compared to December 31, 2015. Increases in base rents correlated with a decrease in straight-line rent adjustments, with increased tenant incentives continuing to lead to net effective rent compression.

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

	31-Mar-16	31-Dec-15	△%
Weighted average base rent (per sf)	**$15.67**	$15.49	1 %
Weighted average remaining lease term	**5.03**	5.27	(5)%
GLA	**2,768,750**	2,768,750	— %
Occupancy	**93.9%**	93.6%	— %
Retention	**29.1%**	73.0%	(60)%

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 decreased 2% compared to Q1-2015 while direct operating expenses increased 2% over the same period. The decline in our recovery ratio was the result of truing up 2015 year-end estimates in Q1-2016 in conjunction with higher non-recoverable costs during the current quarter.

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

Amortization of tenant incentives increased over Q1-2015 as a result of lease rollovers during 2015 and leasing incentive programs designed to increase occupancy. Straight-line rent adjustments relate to new leases which have escalating rent rates and/or rent-free periods. The decrease in straight-line rent adjustments is a result of fewer leases on rent-free periods and step-ups on leases with multiple rent escalations. Straight-line rent adjustments fluctuate due to the timing of signed leases.

Direct operating expenses

Direct operating expenses increased $0.11 million or 2% over Q1-2015. Excluding the impact of newly acquired/constructed properties, direct operating expenses were steady over 2015. On a same-asset basis, operating expenses increased 3% primarily as a result of allowances for doubtful accounts made during the quarter offset by lower snow removal costs due to the mild winter. Also on a same-asset basis utility and property taxes were reduced over Q1-2015 as a result of reduced energy consumption and cost savings on utility contracts, combined with stable property taxes.

NOI and Same-Asset NOI

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

GLA added in the past twelve months via property acquisitions and the construction of a CRU in an existing property led to a 4% increase in NOI over Q1-2015. On a same-asset basis, NOI was steady.

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

	Three months ended March 31		
($000s)	**2016**	2015	**△%**
Same-asset NOI	**9,870**	9,875	— %
Acquisitions/Development	**263**	—	
NOI before adjustments	**10,133**	9,875	3 %
Amortization of tenant incentives	**825**	722	
Straight-line rent adjustment	**(345)**	(392)	
NOI	**10,613**	10,205	4 %

Property Analysis

At March 31, 2016 our portfolio included interests in 38 retail, office and industrial income-producing properties located in western Canada for a total of 2,768,750 sf of GLA, and a land lease community.

The following table summarizes the composition of our properties at March 31, 2016 by property type:

Property Type	**Number of Properties**	**GLA (sf)/ Lots**	**% of Portfolio (GLA)**	**Fair Value of Investment Properties ($000s)**	**NOI for the three months ended March 31, 2016 ($000s)**
Retail	13	970,235	34.9%	305,619	4,293
Office	20	1,567,142	56.6%	307,801	5,526
Industrial	4	231,373	8.4%	32,475	551
Land Lease Community	1	308 lots	n/a	14,850	243
	38	**2,768,750**	**100.0%**	**660,745**	**10,613**

The following table details key financial and operational metrics for each of our asset classes for the quarter ended March 31, 2016:

	Retail		Office		Industrial		Land Lease Community	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
Three months ended March 31 ($000s)								
Rental revenue	**6,299**	6,164	**9,264**	9,166	**741**	611	**322**	317
NOI	**4,293**	4,276	**5,526**	5,243	**551**	441	**243**	245
As at March 31								
Weighted average base rent (sf)	**$18.92**	$18.30	**$14.40**	$14.13	**$10.02**	$8.18	**n/a**	n/a
Occupancy	**96.7%**	96.4%	**91.2%**	90.6%	**100.0%**	97.9%	**100.0%**	100.0%

Retail – our 13 retail properties include 5 multi-building regional power centres and 8 neighborhood shopping centres. Retail GLA increased by 25,305 sf over Q1-2015 as we acquired an additional phase and built a new CRU at Chestermere Station in southern Alberta. Rental revenue from newly acquired/constructed retail properties was $0.24 million during the three-months ended March 31, 2016 (2015 - $nil). On a same-asset basis, rental revenue declined 2% as a result of negative revisions to 2015 year-end recovery estimates. Retail occupancy remained steady. The newly added GLA, with an average base rate of $29.77, contributed to the up-tick in weighted average base rent. Same-asset NOI declined 3% over Q1-2015 as a result of $0.10 million in allowances for doubtful accounts recorded during the current period.

Office – our 20 office properties include low and medium-rise buildings located in strategic urban and suburban centres. We are focused on diversifying our portfolio by increasing the retail and industrial makeup in our portfolio, thus office GLA has not changed. On a same-asset basis, Q1-2016 rental revenue was steady over the comparative period. Occupancy and weighted average base rents improved modestly over Q1-2015, which, combined with lower direct operating costs resulted in a 5% improvement in NOI.

Industrial – our 4 industrial properties include single and multi-tenant buildings. Industrial GLA increased by 10,091 sf over Q1-2015 as we acquired an additional phase at Telford Industrial Park in the greater Edmonton area. Q1-2016 Rental revenue from the new property was $0.10 million and NOI was $0.08. Same-asset rental revenue and NOI were stable over Q1-2015 with upward trends in weighted average base rents and occupancy.

Land Lease Community – we have one land lease community in Calgary, AB, consisting of 308 pad lots. It was 100% occupied at March 31, 2016 (December 31, 2015 – 100%). NOI on our land lease community was steady over Q1-2015, with increases in pad rates being offset by the introduction of a curb-side recycling program in the community.

Regional Analysis

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

Geographic Region	Number of Properties	GLA (sf)	% of Portfolio (GLA)	Fair Value of Investment Properties ($000s)	NOI for the three months ended March 31, 2016 ($000s)
Northern Alberta	24	1,625,947	58.8%	409,382	6,284
Southern Alberta	7	776,129	28.0%	183,862	3,181
Saskatchewan & British Columbia	7	366,674	13.2%	67,501	1,148
	38	**2,768,750**	**100.0%**	**660,745**	**10,613**

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

	Northern Alberta		Southern Alberta		Saskatchewan & British Columbia	
	2016	2015	**2016**	2015	**2016**	2015
Three months ended March 31 ($000s)						
Rental revenue	**10,105**	10,022	**4,734**	4,385	**1,787**	1,851
NOI	**6,284**	6,212	**3,181**	2,829	**1,148**	1,164
As at March 31						
Average base rent (per sf)	**$16.58**	$16.23	**$14.53**	$13.68	**$14.06**	$13.52
Occupancy	**93.7%**	93.4%	**95.4%**	92.9%	**91.6%**	93.2%

Northern Alberta - our Northern Alberta assets are located throughout the greater Edmonton area, including Leduc and Spruce Grove, and in Red Deer. Rental revenue grew modestly over Q1-2015 as a result of the addition of 10,091 sf in industrial GLA, purchased from Melcor in November 2015. On a same-asset basis, rental revenue was steady over the comparative period with stable average base rent and occupancy. Same-asset NOI remained unchanged.

Southern Alberta - our Southern Alberta assets are located throughout the greater Calgary area, including Chestermere and Airdrie, and in Lethbridge. GLA increased by 25,305 sf as we acquired an additional phase and built a new CRU in Chestermere. Rental revenue from the newly acquired/constructed retail properties was $0.24 million (2015 - $nil). On a same-asset basis, rental revenue was up 3% as a result of improvements in both occupancy and average base rents. This translated into a 6% increase in same-asset NOI with improved occupancy positively impacting our recovery ratio.

Saskatchewan and British Columbia - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue declined 3% over Q1-2015 as a result of lower occupancy. NOI was also impacted by bad debts expense for a Saskatchewan retail tenant that was terminated during the period.

General & Administrative Expenses

	Three months ended March 31		
($000s)	**2016**	2015	**△%**
Asset management fee	**397**	380	4 %
Professional fees	**122**	92	33 %
Public company costs	**106**	113	(6)%
Other	**116**	191	(39)%
	741	776	(5%)

General & administrative expenses (G&A) for the three-months ended March 31, 2016 were $0.74 million (4% of rental revenue). The acquisition of 31,629 sf from Melcor in November 2015 led to the increase in asset management fee, which is charged at an annual rate of 0.25% of gross book value. Higher professional fees were due to one-time changes to our valuation process over the comparative period. Other expenses fluctuate from period to period due to the timing of costs incurred. In Q1-2015 we recorded a $0.11 million provision for doubtful accounts in G&A, which was subsequently re-classified to direct operating expenses in Q2-2015. Excluding this amount, other G&A increased modestly as a result of additional fees on re-negotiation of one of our JV agreements with the manager, Melcor, to align the fee structure with other management agreements and fairly compensate Melcor for administration of the assets. 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 March 31 2016	2015	△%
Interest on mortgages payable and revolving credit facility	**2,174**	2,072	5%
Interest on Class C LP Units	**791**	956	(17)%
Amortization of fair value adjustment on Class C LP Units	**(57)**	(105)	(46)%
Interest on convertible debenture	**474**	474	— %
Non-cash finance costs	**147**	139	6 %
Finance costs before distributions	**3,529**	3,536	—%
Distributions on Class B LP Units	**2,466**	2,466	— %
Finance costs	**5,995**	6,002	— %

Finance costs for the three-months ended March 31, 2016 were steady over the prior period at $6.00 million. Interest on mortgages payable and revolving credit facility increased $0.10 million over Q1-2015 as a result of higher average mortgage indebtedness and amounts drawn under our credit facility. This was partially offset by interest rate savings on new and renewed mortgage financings which resulted in a 46 basis point decrease in our weighted average interest rate over Q1-2015. Interest on Class C LP Units decreased over the comparative period due to the repayment of the maturing balance on 333,100 Class C LP Units in February 2015 for approximately $3.10 million and the reduction of the interest rate on extension of 2,195,911 Class C LP Units in August 2015. Our $34.50 million convertible debenture pays a coupon of 5.50% annually.

Distributions on Class B LP Units were unchanged over Q1-2015 at $2.47 million. Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units which were $0.17 per unit during the quarter.

Non-cash finance costs increased over Q1-2015 as a result of higher amortization of deferred finance costs on recent re-financings, including our revolving credit facility. This was partially offset by unwinding the discount recognized on a 2014 mortgage assumption which was re-refinanced during the quarter.

As at March 31, 2016 the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debenture was 3.58%.

Income Taxes

As at March 31, 2016, the REIT qualifies as a mutual fund trust within the meaning of the *Income Tax Act* (Canada) and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through (SIFT) rules; accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT.

Funds from Operations & Adjusted Funds from Operations

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

	Three months ended March 31		
($000s, except per unit amounts)	**2016**	2015	△%
Net income (loss) for the period	**(9,966)**	13,291	(175)%
Add / (deduct)			
Fair value adjustment on investment properties	**1,825**	1,809	1 %
Fair value adjustment on Class B LP Units	**11,547**	(11,985)	(196)%
Amortization of tenant incentives	**825**	722	14 %
Distributions on Class B LP Units	**2,466**	2,466	— %
Funds From Operations (FFO)	**6,697**	6,303	6 %
Add / (deduct)			
Straight-line rent adjustments	**(345)**	(392)	(12)%
Non-cash finance costs	**147**	139	6 %
Net impact of amortization of fair value adjustment and interest subsidy(1)	**44**	88	(50)%
Normalized capital expenditures(2)	**(640)**	(321)	99 %
Normalized tenant incentives and leasing commissions(2)	**(426)**	(639)	(33)%
Adjusted Funds from Operations (AFFO)	**5,477**	5,178	6 %
FFO/Unit	**$0.26**	$0.24	8 %
AFFO/Unit	**$0.21**	$0.20	5 %

(1) Adjustment includes the following: amortization of the fair value adjustment recognized on the Class C LP Unit liability; and usage of the interest rate subsidy provided by Melcor as part of the transfer of the Initial Properties.
(2) Represents 6% and 4% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively (2015 - 3% and 6% of annual NOI respectively). Amounts are net of usage of the capital expenditure subsidy provided by Melcor as part of the transfer of Initial Properties.

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

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 March 31		
($000s, except per unit amounts)	**2016**	2015	△%
Funds From Operations (FFO)	**6,697**	6,303	6%
Interest on convertible debenture	**474**	474	
Non-cash finance costs on convertible debenture	**114**	114	
Funds From Operations - Diluted (FFO - Diluted)	**7,285**	6,891	6%
FFO - Diluted/Unit	**$0.26**	$0.24	8%

Distributions

In order to continue to qualify for the 'REIT Exception', as provided under the SIFT rules we must allocate substantially all taxable income. As such, we allocate monthly distributions to unitholders as determined and approved by the Board of Trustees. We made monthly distributions to unitholders at a rate of $0.05625 per unit, representing $0.675 per unit on an annualized basis. Distributions to unitholders during the three-month period were $1.88 million (2015 - $1.90 million).

Distributions made during the three-months ended March 31, 2016 represent a payout ratio of approximately 80% of AFFO (2015 - 84%). We generate sufficient cash flows from operations in order to sustain our current distribution rate for the foreseeable future. We use AFFO in evaluating our ability to continue to fund distributions. The most similar IFRS measure is cash flow from operations. Cash flows from operations for the quarter were $2.61 million (2015 - $2.60 million), exceeding distributions by $0.73 million (2015 - $0.69 million).

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

	Three months ended March 31		
($000s)	**2016**	2015	△%
Cash flows from operations	**2,609**	2,595	1%
Distributions on Class B LP Units	**2,466**	2,466	
Payment of tenant incentives and direct leasing costs	**634**	1,455	
Change in restricted cash	**—**	(63)	
Changes in operating assets and liabilities	**733**	(508)	
Interest subsidy	**101**	193	
Normalized capital expenditures	**(640)**	(321)	
Normalized tenant incentives and leasing commissions	**(426)**	(639)	
Adjusted Funds from Operations (AFFO)	**5,477**	5,178	6%

Fair Value of Investment Properties

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

	31-Mar-16	31-Dec-15
Number of properties	**38**	38
Total GLA (sf)	**2,888,246**	2,888,246
GLA (REIT owned %) (sf)	**2,768,750**	2,768,750
Fair value of portfolio ($000s)	**660,745**	660,935
Value per square foot	**$239**	$239
NOI ($000s)	**10,613**	41,313
Weighted average capitalization rate	**6.62%**	6.57%
Weighted average discount rate	**7.70%**	7.71%
Weighted average terminal capitalization rate	**6.83%**	6.81%

Investment properties were valued by Melcor's internal valuation team as at December 31, 2015 of which 27 (of 47 legal phases) investment properties with a fair value of $443.75 million were valued by qualified independent external valuation professionals during the year. We obtained updated market data and considered whether changes to any valuation model variables resulted in significant changes to any of the property fair values at March 31, 2016. This resulted in a fair value loss of $1.83 million (year-ended December 31, 2015 - fair value losses of $5.42 million) on investment properties recorded to income during the three-month period. Refer to note 14 of the condensed interim consolidated financial statements for additional information on the calculation of fair value adjustments.

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

($000s)	**Three months ended March 31, 2016**	**Year ended December 31, 2015**
Northern Alberta	**(3,950)**	(8,253)
Southern Alberta	**855**	1,833
Saskatchewan & British Columbia	**1,270**	1,002
	(1,825)	(5,418)

Fair value losses in Northern Alberta were primarily driven by continued pressure on Edmonton office capitalization rates, decreasing 25 basis points over Q4-2015 on certain properties. Fair value gains across our Southern Alberta and Saskatchewan & British Columbia portfolios were the result of increased stabilized NOI and stable 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 approximately 1% in the fair value of our portfolio.

Fair values are most sensitive to changes in capitalization rates.

	March 31, 2016			**December 31, 2015**		
	Min	**Max**	**Weighted Average**	**Min**	**Max**	**Weighted Average**
Capitalization rate	**5.50%**	**8.75%**	**6.62%**	5.50%	9.00%	6.57%
Terminal capitalization rate	**5.75%**	**9.00%**	**6.83%**	5.75%	9.25%	6.81%
Discount rate	**6.50%**	**9.75%**	**7.70%**	6.50%	10.00%	7.71%

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by $46.50 million (December 31, 2015 - $46.95 million) while a 50 basis points decrease (-0.5%) would increase it by $54.10 million (December 31, 2015 - $54.69 million).

Liquidity & Capital Resources

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

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

Cash Flows

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

	Three months ended March 31		
($000s)	**2016**	2015	**△$**
Cash from operating activities	**2,609**	2,595	14
Cash used in investing activities	**(1,481)**	(293)	(1,188)
Cash from (used in) financing activities	**1,763**	(8,998)	10,761
Increase (decrease) in cash and cash equivalents	**2,891**	(6,696)	9,587
Cash and cash equivalents, beginning of the period	**—**	6,712	(6,712)
Cash and cash equivalents, end of the period	**2,891**	16	2,875

Operating activities

Cash from operating activities increased $0.01 million or 1% over Q1-2015. Properties acquired from Melcor in November 2015 and construction of an additional CRU at an existing property in the prior year added $0.23 million to Q1-2016 NOI (2015 - $nil). We continued to execute strategies to maintain occupancy and invested $0.63 million on tenant incentives and direct leasing costs for new and renewed leases during the quarter (2015 - $1.46 million). As at March 31, 2016 we completed 30,336 sf in new and renewed leasing, resulting in a period-end occupancy rate of 93.9%. The timing of lease expiries impacts the level of spending on tenant incentives and direct leasing costs and will fluctuate from period to period. Changes in working capital reduced operating cash flows by $1.24 million over the comparative period.

Investing activities

During Q1-2016 we substantially completed construction on a 7,850 sf single-tenant CRU to densify an existing regional power center in Northern Alberta, investing $1.45 million in development costs during the quarter. 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. Our capital program for 2016 will commence in Q2. Asset enhancement investments fluctuate based on the nature and timing of projects undertaken.

Financing activities

During Q1-2016 we re-financed the mortgage on one property with a principal balance of $14.61 million for $3.89 million net proceeds. We also obtained mortgage financing on a recently acquired and previously unencumbered property for proceeds of $2.80 million. During the comparative period we repaid the maturing balance on 333,100 Class C LP Units with a carrying value of $3.10 million on one of our commercial properties by issuing a mortgage. Partial proceeds from mortgage financings in the current and comparative period were used to repay amounts drawn under the revolving credit facility.

We continued our monthly distribution of $0.05625 per unit for distributions of $1.88 million in Q1-2016 (2015 - $1.90 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 March 31, 2016 we had $2.89 million in cash and cash equivalents and $2.19 million in restricted cash 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 debenture 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 March 31, 2016 (51% excluding convertible debentures).

As at March 31, 2016, our total capitalization was $617.66 million and is comprised of:

($000s)	**31-Mar-16**
Revolving credit facility(1)	18,500
Mortgages payable(1)	221,623
Class C LP Units(2)	82,441
Indebtedness, excluding convertible debenture	322,564
Convertible debenture(3)	34,500
Indebtedness	357,064
Class B LP Units(4)	147,708
Trust units	112,892
Equity	260,600
Total capitalization	**617,664**
Gross Book Value (GBV)(5)	**636,764**
Debt to GBV, excluding convertible debenture (maximum threshold - 60%)	**51%**
Debt to GBV (maximum threshold - 65%)	**56%**

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

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 March 31, 2016, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 49%, debt service coverage ratio of 1.69, and an adjusted unitholders' equity of $272.36 million. We also have financial covenants on certain mortgages for investment properties. At March 31, 2016, 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 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:

		as at March 31					
($000s)	**Total**	**2016**	**2017**	**2018**	**2019**	**2020**	**Thereafter**
Revolving credit facility	**18,500**	18,500	—	—	—	—	—
Mortgages payable	**221,623**	18,385	6,255	41,492	70,992	8,189	76,310
Class C LP Units	**82,441**	11,474	5,733	14,286	9,271	25,861	15,816
Convertible debenture	**34,500**	—	—	—	34,500	—	—
Total	**357,064**	**48,359**	**11,988**	**55,778**	**114,763**	**34,050**	**92,126**
% of portfolio	100%	14%	3%	16%	32%	10%	25%

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

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

($000s)	Total	Fixed	Variable	Weighted average interest rate	Weighted average term to maturity
Revolving credit facility	**18,500**	—	18,500	3.46%	2.34
Mortgages payable	**221,623**	203,123	18,500	3.31%	4.45
Class C LP Units	**82,441**	82,441	—	3.52%	3.99
Convertible debenture	**34,500**	34,500	—	5.50%	3.75
Total	**357,064**	**320,064**	**37,000**	**3.58%**	**4.17**

The weighted average interest rate on our debts decreased to 3.58% (December 31, 2015 - 3.80%) as a result of mortgage financings.

During Q1-2016 we obtained mortgage financing of $18.50 million at a rate of 2.97% (the variable interest rate mortgage was fixed via a floating for fixed interest rate swap for the term of the mortgage). Proceeds were used to retire the existing mortgage, which was assumed as part of a third party property acquisition in 2014 and had a carrying value of $14.61 million and a fixed interest rate of 5.38%. We also placed mortgage financing on a recently acquired and previously unencumbered property for proceeds of $2.80 million at a fixed interest rate of 3.16%.

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

Debt Service Coverage Ratio and Finance Costs Coverage Ratio – we calculate debt service coverage ratio as FFO for the period divided by principal repayments on mortgages payable and Class C LP Units made during the 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.

($000s)	Three months ended Mar 31, 2016	Year ended December 31, 2015
FFO	**6,697**	**26,345**
Principal repayments on Mortgages payable	1,518	6,139
Principle repayments on Class C LP Units	827	3,416
Debt service coverage ratio	**2.86**	**2.76**
FFO plus finance costs	10,226	40,453
Finance costs(1)	3,529	14,108
Finance costs coverage ratio	**2.90**	**2.87**

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

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.

No units were repurchased under our normal course issuer bid (NCIB) during Q1-2016. As at March 31, 2016 the REIT is entitled to repurchase 467,958 trust units under the NCIB. The NCIB expires on June 29, 2016.

The following table summarizes the trust units issued and the fully diluted number of units outstanding as at March 31, 2016 and December 31, 2015:

	March 31, 2016		December 31, 2015	
Issued and fully paid units ($000s)	**Units**	**$ Amount**	Units	$ Amount
Balance, beginning of period	**11,151,297**	**112,892**	11,275,000	114,144
Repurchase of trust units	—	—	(123,703)	(1,252)
Balance, end of period	**11,151,297**	**112,892**	11,151,297	112,892
Dilutive securities				
Class B LP Units[1]	**14,615,878**	**147,708**	14,615,878	147,708
Convertible debenture	**2,727,273**	**34,500**	2,727,273	34,500
Diluted balance, end of period	**28,494,448**	**295,100**	28,494,448	295,100

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

Quarterly Results

	2016	2015				2014		
($000s except per unit amount)	**Q4**	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue ($000s)	**16,626**	16,963	15,938	16,323	16,258	11,669	11,074	11,119
Net income (loss) ($000s)	**(9,966)**	16,381	11,287	111	13,291	9,481	2,693	5,296
Basic earnings (loss) per unit	**($0.89)**	$1.46	$1.00	$0.01	$1.18	$0.88	$0.24	$0.52
Annualized distribution rate	**$0.675**	$0.675	$0.675	$0.675	$0.675	$0.675	$0.675	$0.675
Period-end closing unit price	**$8.00**	$7.21	$7.95	$8.73	$8.64	$9.46	$9.70	$10.29
Annualized distribution yield on closing unit price (%)[1]	**8.44%**	9.36%	8.49%	7.73%	7.81%	7.14%	6.96%	6.56%

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

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

There were no material changes to the above titled sections at March 31, 2016 in comparison to the December 31, 2015 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 March 31, 2016 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 May 5, 2016, the REIT was in compliance with all investment guidelines and operating policies stipulated in the DOT.

Non-standard Measures

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

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

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

Calculations

We use the following calculations in measuring our performance.

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

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

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

	Three months ended March 31		
($000s)	**2016**	2015	△%
Net income (loss) for the period	**(9,966)**	13,291	(175)%
Net finance costs	**5,986**	5,984	— %
Fair value adjustment on Class B LP Units	**11,547**	(11,985)	(196)%
Fair value adjustment on investment properties	**1,825**	1,809	1 %
General and administrative expenses	**741**	776	(5)%
Amortization of tenant incentives	**825**	722	14 %
Straight-line rent adjustment	**(345)**	(392)	(12)%
NOI	**10,613**	10,205	4 %

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

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

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

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

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

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

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

MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three-months ended March 31, 2016

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2016

(Unaudited)

($000s)	March 31, 2016	December 31, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	**2,891**	—
Accounts receivable	**2,466**	2,302
Other assets (note 5)	**901**	933
	6,258	3,235
Non-Current Assets		
Restricted cash	**2,187**	2,288
Investment properties (note 4 and 14)	**643,200**	643,421
Other assets (note 5)	**17,545**	17,514
	662,932	663,223
TOTAL ASSETS	**669,190**	666,458
LIABILITIES		
Current Liabilities		
Revolving credit facility	**18,245**	19,258
Accounts payable	**963**	1,487
Distribution payable	**1,449**	1,449
Accrued liabilities and other payables (note 6)	**7,085**	6,724
Class C LP Units (note 8)	**12,256**	12,301
Mortgages payable (note 7)	**20,035**	34,125
	60,033	75,344
Non-Current Liabilities		
Accrued liabilities and other payables (note 6)	**1,430**	1,408
Class B LP Units (note 9 and 14)	**116,927**	105,380
Class C LP Units (note 8)	**71,018**	71,857
Mortgages payable (note 7)	**200,306**	181,269
Convertible debenture	**32,369**	32,246
Derivative financial liability (note 14)	**5**	5
TOTAL LIABILITIES	**482,088**	467,509
UNITHOLDERS' EQUITY	**187,102**	198,949
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	**669,190**	666,458

See accompanying notes to the condensed interim consolidated financial statements.

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

For the three-months ended March 31

(Unaudited)

($000s)	2016	2015
Rental revenue (note 11 and 13)	**16,626**	16,258
Direct operating expenses (note 13)	**(6,493)**	(6,383)
Net rental income	**10,133**	9,875
General and administrative expenses (note 13)	**(741)**	(776)
Fair value adjustment on investment properties (note 4 and 14)	**(1,825)**	(1,809)
Fair value adjustment on Class B LP Units (note 9 and 14)	**(11,547)**	11,985
Income (loss) before finance costs	**(3,980)**	19,275
Interest income	**9**	18
Finance costs (note 12 and 13)	**(5,995)**	(6,002)
Net finance costs	**(5,986)**	(5,984)
Net income (loss) and comprehensive income (loss)	**(9,966)**	13,291
Basic earnings (loss) per trust unit	**($0.89)**	$1.18
Diluted earnings (loss) per trust unit	**($0.89)**	$0.15

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at March 31, 2016

(Unaudited)

($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

($000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2014	11,275,000	103,959	40,196	22,306	166,461
Net income for the period	—	—	—	13,291	13,291
Distributions to unitholders	—	—	—	(1,903)	(1,903)
Balance at March 31, 2015	11,275,000	103,959	40,196	33,694	177,849

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)	2016	2015
		note 16
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income (loss) for the period	**(9,966)**	13,291
Non cash items:		
Amortization of tenant incentives (note 5 and 11)	**825**	722
Straight-line rent adjustments (note 11)	**(345)**	(392)
Fair value adjustment on investment properties (note 4 and 14)	**1,825**	1,809
Fair value adjustment on Class B LP Units (note 9 and 14)	**11,547**	(11,985)
Amortization of fair value adjustment on Class C LP Units (note 12)	**(57)**	(105)
Non-cash finance costs (note 12)	**147**	139
	3,976	3,479
Payment of tenant incentives and direct leasing costs	**(634)**	(1,455)
Change in restricted cash	**—**	63
Changes in operating assets and liabilities	**(733)**	508
	2,609	2,595
INVESTING ACTIVITIES		
Investment property improvements and development	**(1,481)**	(293)
	(1,481)	(293)
FINANCING ACTIVITIES		
Change in revolving credit facility	**(801)**	(5,000)
Proceeds from mortgages payable	**21,300**	3,095
Repayment of mortgages payable	**(16,129)**	(1,502)
Repayment on Class C LP Units	**(827)**	(3,881)
Change in restricted cash	**101**	193
Distributions to unitholders	**(1,881)**	(1,903)
	1,763	(8,998)
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE PERIOD	**2,891**	(6,696)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	**—**	6,712
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	**2,891**	16

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 5, 2016, 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, 2015, 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 5, 2016.

3. ACCOUNTING POLICIES

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, 2015. We have adopted amended standards IAS 1, Presentation of financial statements and IAS 34, Interim financial reporting, effective January 1, 2016. Adoption of these amended standards did not require any adjustment to the presentation or disclosures within these condensed interim consolidated financial statements.

4. INVESTMENT PROPERTIES

($000s)	Three months ended March 31, 2016	Year ended December 31, 2015
Balance - beginning of period	**643,421**	630,003
Additions		
Direct acquisition	**—**	15,327
Property improvements	**28**	2,427
Property development activities	**1,453**	359
Direct leasing costs	**123**	723
Fair value adjustment on investment property (note 14)	**(1,825)**	(5,418)
Balance - end of period	**643,200**	643,421

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, 2016 totalled $426,844 (December 31, 2015 - $425,240).

Presented separately from investment properties is $14,134 (December 31, 2015 - $14,448) in tenant incentives and $3,411 (December 31, 2015 - $3,066) 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, 2016	December 31, 2015
Current Assets		
Prepaid expense, and other	**901**	933
Non-Current Assets		
Straight-line rent adjustments	**3,411**	3,066
Tenant incentives	**14,134**	14,448
	17,545	17,514

During the three-month period, we recorded tenant incentives of $511 (2015 - $1,248) and recorded $825 (2015 - $722) of amortization expense respectively. In accordance with SIC 15, *Operating leases - incentives*, amortization of tenant incentives is recorded on a straight-line basis over the term of the lease against rental revenue.

6. ACCRUED LIABILITIES AND OTHER PAYABLES

($000s)	March 31, 2016	December 31, 2015
Current Liabilities		
Tenant security deposits and pre-payments	**2,635**	2,707
Accrued finance costs	**986**	494
Other accrued liabilities and payables	**3,464**	3,523
	7,085	6,724
Non-Current Liabilities		
Decommissioning obligation	**1,430**	1,408

7. MORTGAGES PAYABLE

($000s)	March 31, 2016	December 31, 2015
Mortgages amortized over 15-25 years at fixed interest rates	**203,123**	216,452
Mortgage amortized over 25 years at a variable interest rate	**18,500**	—
Unamortized fair value adjustment	**—**	109
Unamortized deferred financing fees	**(1,282)**	(1,167)
	220,341	215,394
Current portion of mortgages payable	**(20,035)**	(34,125)
	200,306	181,269
Interest rate ranges	**(2.48%-5.59%)**	(2.48%-5.59%)

During the period, we entered into a floating for fixed interest rate swap which fixes the interest rate on our variable rate mortgage at 2.97% for the term of the mortgage. As at March 31, 2016 the fair value of the interest rate swap contract is $nil. This financial instrument has not been designated as a hedge for accounting purposes.

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, 2016	December 31, 2015
Class C LP Units amortized over 2-6 years at fixed interest rates	**82,441**	83,268
Unamortized fair value adjustment	**833**	890
	83,274	84,158
Current portion of Class C LP Units	**(12,256)**	(12,301)
	71,018	71,857
Effective interest rate	**3.52%**	3.52%

As at March 31, 2016 we had 9,454,411 Class C LP Units issued and outstanding (December 31, 2015 - 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, 2016 and recognized a fair value loss of $11,547 during the three-month period (2015 - fair value gain of $11,985). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 14.

At March 31, 2016 there were 14,615,878 Class B LP Units issued and outstanding at a fair value of $8.00 per unit or $116,927 (December 31, 2015 - 14,615,878 at $7.21 per unit or $105,380).

10. UNITHOLDERS' EQUITY

At March 31, 2016, our issued and outstanding trust units were 11,151,297 (December 31, 2015 - 11,151,297).

11. RENTAL REVENUE

The components of rental revenue are as follows:

For the three-months ended March 31 ($000s)	2016	2015
Rental revenue	**17,106**	16,588
Amortization of tenant incentives (note 5)	**(825)**	(722)
Straight-line adjustments	**345**	392
	16,626	16,258

12. FINANCE COSTS

The components of finance costs are as follows:

For the three-months ended March 31 ($000s)	2016	2015
Interest on mortgages payable and revolving credit facility	**2,174**	2,072
Interest on Class C LP Units	**791**	956
Amortization of fair value adjustment on Class C LP Units	**(57)**	(105)
Distributions on Class B LP Units (note 13)	**2,466**	2,466
Interest on convertible debenture	**474**	474
Non-cash finance costs	**147**	139
	5,995	6,002

Total finance costs paid during the three-month period were $5,814 (2015 - $5,863).

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)	2016	2015
Asset Management Agreement		
Base Annual Management Fee	**397**	380
Capital Expenditure Fee	**38**	—
Property Management Agreement		
Monthly Fee	**477**	482
Lease Fee	**123**	207
	1,035	1,069

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, 2016 there was $303 (December 31, 2015 - $297) 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, 2016, $2,466 in distributions were recorded on Class B LP Units held by Melcor (2015 - $2,466). These distributions were recorded as finance costs (note 12). As at March 31, 2016 there was $822 payable to Melcor for the March distribution (December 31, 2015 - $822 for the December distribution).

Also during the three-month period ended March 31, 2016, Melcor, as holder of all Class C LP Units, was paid $1,618 to fund principal and interest payments on the retained debt (2015 - $1,732). During the comparative period we also repaid the maturing balance on 333,100 Class C LP Units with a carrying value of $3,105. These payments were recorded as a reduction of the Class C LP Unit liability and as finance costs.

c) Rental Revenue

For the three-month period ended March 31, 2016 we collected $237 in rental revenue from Melcor and an affiliate for use of office space (2015 - $189). In addition, pursuant to certain Head and Bridge Lease Agreements, we collected $41 in rental revenue from Melcor as compensation for certain vacant spaces at properties acquired from Melcor in 2014 (2015 - $326). 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 our financial instruments were determined as follows:

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.
- fair values of mortgages payable, Class C LP Units and convertible debenture are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of derivative financial liability, the conversion feature on our convertible debenture, and our floating for fixed interest rate swap 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 our trust units (Level 1).

In addition, we carry our 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 following table summarizes our assets and liabilities carried at fair value and our financial assets and liabilities where carrying value may not approximate fair value.

	March 31, 2016				December 31, 2015	
($000s)	**Fair Value**	**Amortized Cost**	**Total Carrying Value**	**Total Fair Value**	Total Carrying Value	Total Fair Value
Non-financial assets						
Investment properties	**643,200**	—	**643,200**	**643,200**	643,421	643,421
Financial liabilities						
Mortgages payable	—	**221,623**	**221,623**	**219,264**	216,452	215,150
Class B LP Units	**116,927**	—	**116,927**	**116,927**	105,380	105,380
Class C LP Units	—	**83,274**	**83,274**	**83,274**	84,158	84,158
Convertible debenture	—	**32,369**	**32,369**	**32,369**	32,246	32,246
Derivative financial liability	**5**	—	**5**	**5**	5	5

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

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

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

($000s)	Level 1	Level 2	Level 3	Total
Non-financial assets				
Investment properties	—	—	643,200	643,200
Financial liabilities				
Derivative financial liability	—	—	5	5
Class B LP Units	116,927	—	—	116,927

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 the 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’.

Melcor - as our management company - 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 three 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 qualified external valuators at March 31, 2016, which resulted in fair value losses of $1,825 (December 31, 2015 - Melcor Development Ltd.'s internal valuation team performed the valuations of which 27 investment properties (of 47 legal phases valued) with a fair value of $443,750 were valued by qualified independent external valuation professionals during the year, which resulted in fair value losses of $5,418) recorded as fair value adjustment on investment properties in the interim condensed consolidated statements of income and comprehensive income.

Weighted average stabilized net operating income for investment properties is $1,509 (December 31, 2015 - $1,504). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

(Unaudited - in $000s except unit and per unit amounts)

	March 31, 2016			December 31, 2015		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.62%	5.50%	9.00%	6.57%
Terminal capitalization rate	5.75%	9.00%	6.83%	5.75%	9.25%	6.81%
Discount rate	6.50%	9.75%	7.70%	6.50%	10.00%	7.71%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $46,502 (December 31, 2015 - $46,953). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $54,098 (December 31, 2015 - $54,685).

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, 2016 are as follows:

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

Class B LP Units

Class B LP Units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the trust units at the period end date. At March 31, 2016 the fair value of the Class B LP Units was $116,927, resulting in a fair value loss of $11,547 for the three-month period (December 31, 2015 - fair value gain of $32,886).

15. SUBSEQUENT EVENTS

On April 15, 2016 we declared a distribution of $0.05625 per unit for the months of April, May and June 2016. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
April 2016	April 29, 2016	May 16, 2016	$0.05625 per unit
May 2016	May 31, 2016	June 15, 2016	$0.05625 per unit
June 2016	June 30, 2016	July 15, 2016	$0.05625 per unit

16. COMPARATIVE FIGURES

The 2015 comparative balances of payment of tenant incentives and direct leasing costs of $1,455 and change in restricted cash of $63 have been reclassified from investing activities to operating activities in the consolidated statement of cash flows to reflect better presentation of the underlying nature of the cash flows.