

Management's Discussion & Analysis

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May 8, 2014

The following Management's Discussion and Analysis ("MD&A") of Melcor Real Estate Investment Trust's (the "REIT" or "Melcor REIT") results should be read in conjunction with the unaudited condensed interim consolidated financial statements and related notes for the quarter ended March 31, 2014 and the Management's Discussion & Analysis (MD&A) and consolidated financial statements and related notes for the year ended December 31, 2013. The discussion outlines strategies and provides analysis of the financial performance for the first quarter 2014. The analysis also provides a comparison to the REIT's forecast provided in its prospectus dated April 19, 2013. Our forecast for the three-month period ended March 31, 2014 was revised as part of our 2013 Annual Management's Discussion and Analysis, as filed on March 10, 2014.

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

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on May 8, 2014. Disclosure contained in this MD&A is current to May 8, 2014, 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, information circular and annual and quarterly reports, is available on SEDAR at www.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 2014 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.

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

As Melcor Developments Ltd. ("Melcor") retained control over the REIT, the May 1, 2013 initial public offering and acquisition of the Initial Properties was accounted for as a reorganization and recapitalization using the continuity of interests method. Financial information for the pre-acquisition period as included in the March 31, 2013 comparative period are presented based on historical combined financial information for the Initial Properties as previously reported by Melcor.

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

Certain comparative information has been amended to reflect revised calculation of the metrics which management considers to provide better and more meaningful information.

Formation of Melcor REIT

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

We began operations on May 1, 2013 when our trust units were issued for cash pursuant to the initial public offering ("IPO"). Units of the REIT trade on the Toronto Stock Exchange under the symbol MR.UN. The REIT is externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the Property Management Agreement and Asset Management Agreement.

As at May 8, 2014, Melcor, through an affiliate, holds an approximate 51.1% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

Declaration of Trust

The investment guidelines and operating policies of the REIT are outlined in the Amended and Restated Declaration of Trust ("DOT") dated May 1, 2013. A copy of the DOT is filed on SEDAR at www.sedar.com and is available on request to all unitholders. At May 8, 2014, the REIT was in compliance with all investment guidelines and operating policies stipulated in the DOT.

Our Business: Vision, Goals & Strategy

Melcor REIT has an established and diversified portfolio focused on high-growth markets in Western Canada. We own 30 income-producing office, retail and industrial properties representing 1.76 million square feet in gross leasable area ("GLA") at March 31, 2014. These high-quality properties feature stable occupancy and a diversified mix of tenants, some of whom have been in place for over 20 years. The REIT is externally managed, administered and operated by Melcor pursuant to the asset management and property management agreements entered into in connection with the IPO.

Melcor, a real estate company founded in 1923, has a rich history of growth and performance prior to the formation of the REIT. Our objective is to continue that tradition by expanding our portfolio of income-producing properties across Western Canada to provide stable and growing monthly cash distributions to unitholders. Our growth strategy is simple: acquire and improve. Melcor has a proven track record of doing both and achieved the following in Q1-2014.

Acquire:

In Q1-2014, we continued to execute on our acquisition strategy. We completed the acquisition of a 67,610 sq. ft. industrial warehouse in Lethbridge, Alberta for the purchase price of \$5.93 million (excluding closing costs). This acquisition adds depth to our industrial property offering while adhering to our strategy of growing in the markets that we know best. With this acquisition, portfolio GLA has grown 12% since IPO.

Subsequent to the quarter, the REIT's board of trustees approved the acquisition of two multi-tenant retail properties from Melcor for a purchase price of approximately \$13.50 million (excluding closing and transaction costs). The properties include phase three (11,540 sq. ft.) of the Kingsview Market retail complex in Airdrie, Alberta completed by Melcor in early 2013 and a 42,586 sq. ft. retail community strip centre (Market Mall) located in Regina, Saskatchewan that was substantially redeveloped by Melcor in 2009. These two acquisitions represent the first transactions through our proprietary pipeline.

In conjunction with the property acquisitions, we also completed a bought deal of \$20.24 million for 1.9 million trust units at \$10.65 per unit. Partial proceeds are to be used to reduce the amount outstanding under the revolving line of credit and provide capacity to capitalize on future acquisition opportunities.

Improve:

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

In Q1-2014, our signature customer care program achieved an on-time response rate of 97% compared to 95% in Q1-2013 and 96% in Q4-2013. We use this metric as an indicator of our success in providing responsive care to our customers.

In January 2014 we received BOMA BEST certification on our Westcor property, bringing our total to 3 BOMA BEST certified Green & Responsible buildings at the end of the quarter. BOMA BEST is the leading environmental certification program for existing buildings in Canada. We continue to assess our buildings against the BOMA BEST standards.

Q1-2014 Highlights & Key Performance Indicators

Financial Highlights

(\$000s)	Three months ended March 31		
	2014	2013	△%
Non-standard KPIs			
Net operating income (NOI)	6,734	6,342	6 %
Funds from operations (FFO)	4,288	3,995	7 %
Adjusted funds from operations (AFFO)	3,777	3,387	12 %
Rental revenue	10,647	9,688	10 %
Income before fair value adjustments and taxes	2,139	3,417	(37)%
Fair value adjustment on investment properties	169	2,594	(93)%
Distributions to unitholders	1,541	n/a	
Cash flows from operations	2,296	7,036	(67)%
Per unit metrics ⁽¹⁾			
Income - diluted	0.10	0.26	(62)%
FFO	0.23	0.21	10 %
AFFO	0.20	0.18	11 %
Distributions	0.17	n/a	
	31-Mar-14	31-Dec-13	△%
Total assets (\$000s)	458,801	454,743	1%
Equity (\$000s) ⁽²⁾	186,608	186,608	—%
Debt (\$000s) ⁽³⁾	219,496	215,601	2%
Weighted average interest rate on debt	3.99%	3.98%	—%
Debt to GBV ratio	51%	51%	—%
Finance costs coverage ratio ⁽⁴⁾	2.94	2.96	(1)%
Debt service coverage ratio ⁽⁵⁾	2.85	2.72	5%

Operational Highlights

	31-Mar-14	31-Dec-13	△%
Number of properties	30	29	3 %
Gross leasable area (GLA) (sq. ft.)	1,759,761	1,691,920	4 %
Occupancy % (weighted by GLA)	90.1%	90.6%	(1)%
Retention % (weighted by GLA)	76.9%	75.5%	2 %
Weighted average remaining lease term (years)	4.52	4.75	(5)%
Weighted average base rent (per sq. ft.)	\$16.23	\$16.63	(2)%

(1) Calculated as if the trust units and Class B LP Units were outstanding during the entire current and comparative periods.

(2) Calculated as the sum of trust units and Class B LP Units at their book value of \$10.00.

(3) Calculated as the sum of total amount drawn on revolving credit facility, mortgages payable and Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units, unamortized transaction costs and unamortized discount on bankers acceptance.

(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.

Q1-2014 Highlights:

- **We continue to deliver as promised and exceeded IPO forecast with stable and sustainable growth on key indicators through Q1-2014.** We continued to execute on our growth strategy of acquiring new properties and improving our existing properties through both property management and asset enhancement. Building on the momentum of our first eight months of operations, we:
 - **Achieved strong leasing activity.** We completed 45,715 sq. ft. in new leasing during the period and have renewed 66% of the GLA expiring in 2014 as of March 31, 2014.
 - **Grew through acquisition.** We completed our third property acquisition with the purchase of LC Industrial, a 67,610 sq. ft. industrial warehouse in Lethbridge, Alberta, for \$5.93 million (excluding closing costs). GLA has grown by 12% since IPO.
- The successful execution of these strategies contributed to:
 - **Revenue growth of 10% over Q1-2013** as a result of our expanded portfolio. Weighted average base rent (per sq. ft.) and occupancy remained consistent with year end. **NOI also grew by 6% over Q1-2013.**
 - **FFO and AFFO 4% and 3% ahead of our twelve-month forecast**, respectively.
- Direct operating expenses were up by 13% over the comparative period as a result of timing differences, as well as differences in allocations in the comparative period. Higher snow removal costs in 2014 also contributed to the increase.
- **Distributions of \$0.05625 per trust unit (in line with forecast) were paid in January, February and March.** Distributions made during each of the eleven months of the REIT's operations represent a payout ratio of 88%.
- **We successfully completed a bought deal issuance of 1,900,000 trust units at \$10.65 for gross proceeds of \$20.24 million** subsequent to the quarter. The funds are to be used to fund two property acquisitions from Melcor, with the remainder intended to pay down our revolving credit facility, for future acquisitions and for general trust purposes. Refer to *Subsequent Event: Bought Deal Issuance of Trust Units and Property Acquisitions*. The two pending property acquisitions demonstrate execution on our growth strategy via our proprietary Melcor pipeline.

Property Profile

At March 31, 2014 our portfolio includes interests in 30 income-producing retail, office and industrial properties comprising 1,759,761 square feet of GLA located in Western Canada, and a land lease community.

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

Property Type	Number of Properties	GLA (sq. ft.)/ Lots	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	NOI for the three-months ended March 31, 2014 (\$000s)
Retail	9	608,234	34.6%	181,848	2,570
Office	17	1,018,944	57.9%	228,050	3,723
Industrial	3	132,583	7.5%	11,931	220
Land Lease Community	1	308 lots	n/a	14,350	221
	30	1,759,761	100.0%	436,179	6,734

Retail – our 9 retail properties include multi-building retail power centres and neighborhood shopping centres containing 608,234 sq. ft.

Office – our 17 office properties include low and medium-rise buildings located in strategic urban and suburban centres, containing 1,018,944 sq. ft.

Industrial – our Q1-2014 acquisition of LC Industrial increased our portfolio to three properties and more than doubled our industrial GLA to a total of 132,583 sq. ft.

Land Lease Community – we have one land lease community in Calgary, AB, consisting of 308 pad lots. It was 100% occupied at March 31, 2014 (December 31, 2012 – 100%).

Portfolio Occupancy - Occupancy at period end was 90.1% compared to 90.6% at the end of the 2013. Our tenants include a diversified mix of national, regional and local businesses operating in a variety of industries. This diversified tenant base helps mitigate our exposure to negative trends occurring in any one sector.

Consolidated Revenue & Net Operating Income

(\$000s)	Three months ended March 31		
	2014	2013	△%
Base rent	6,806	6,264	9 %
Recoveries	3,955	3,585	10 %
Other	318	335	(5)%
Amortization of tenant incentives	(541)	(578)	(6)%
Straight-line rent adjustment	109	82	33 %
Rental revenue	10,647	9,688	10 %
Operating expenses	2,271	1,877	21 %
Utilities and property taxes	2,074	1,965	6 %
Direct operating expenses	4,345	3,842	13 %
Net rental income	6,302	5,846	8 %
NOI	6,734	6,342	6 %
Same asset NOI	5,716	5,846	(2)%
Operating margin	59%	60%	(2)%

Revenue

Rental revenue for the period increased by \$0.96 million or 10% over Q1-2013 as a result of GLA growth of 12% over Q1-2013. Q1-2014 rental revenue includes \$0.78 million related to the three newly acquired properties (Coast Home Centre in Q3-2013, Liberty Crossing in Q4-2013 and LC Industrial in Q1-2014).

Weighted average base rent decreased by 2% compared to year-end due to the increase in our industrial GLA which grew to 7.5% of the total portfolio compared to 3.8% at year-end. Industrial properties typically have lower average base rent (per sq. ft.) when compared to our office and retail properties. Occupancy was down slightly compared to year-end at 90.1% and retention improved to 76.9%.

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

	31-Mar-14	31-Dec-13	△%
Average base rent (per sq. ft.)	\$16.23	\$16.63	(2)%
Weighted average remaining lease term	4.52	4.75	(5)%
GLA	1,759,761	1,691,920	4 %
Occupancy %	90.1%	90.6%	(1)%
Retention %	76.9%	75.5%	2 %

Recoveries are amounts recovered from tenants for direct operating expenses incurred during the period and include a nominal administrative charge. Direct operating expenses increased by 13% over Q1-2013, while recoveries increased by 10%. The variance is the result of timing of expenses incurred. We expect our direct operating expenses for the year to be on budget and the variance to diminish over the course of the year.

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

Changes in non-cash adjustments related to amortization of tenant incentives and straight-line rent adjustment had a net positive impact on rental revenue during the period. Lower amortization of tenant incentives reflects the timing difference between when payments are made and amortization of the expenditure against rental revenue. Straight-line rent adjustments relate to new leases entered into during the period which have escalating rent rates and/or rent-free periods. Straight-line rent adjustments fluctuate from period to period due to the timing of leases signed.

Direct operating expenses

Direct operating expenses increased by \$0.50 million or 13% over Q1-2013. Excluding the impact of the newly acquired properties, direct operating expenses increased by \$0.31 million. Timing of operating expenditures and differences in allocations in the comparative period

drove the increase over Q1-2013 on a same asset basis. In addition, heavy snow fall in Alberta during Q1-2014 also resulted in an increase in operating expenses when compared to Q1-2013. On a same asset basis, utilities and property taxes increased by \$0.02 million or 1% due to higher appraised property values compared to 2013. This was partially offset by lower utility costs as a result of reduced power rates on certain properties.

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.

The property acquisitions completed in 2013 and Q1-2014 drove the increase in NOI with 6% growth over Q1-2013. On a same asset basis, NOI was steady over Q1-2013, with timing of operating expenses negatively affecting margins during Q1-2014. The calculation of same asset NOI is as follows (refer to *Non-standard Measures* for calculation of NOI and reconciliation to net income):

(\$000s)	Three months ended March 31		
	2014	2013	△%
Same asset NOI	5,716	5,846	(2)%
Acquisitions	586	—	
NOI before adjustments	6,302	5,846	8 %
Amortization of tenant incentives	541	578	
Straight-line rent adjustment	(109)	(82)	
NOI	6,734	6,342	6 %

Regional Analysis

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

Geographic Region	Number of Properties	GLA (sq. ft.)	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	NOI for the three-months ended March 31, 2014 (\$000s)
Northern Alberta	18	1,184,147	67.3%	290,748	4,382
Southern Alberta	7	292,975	16.6%	99,610	1,591
Saskatchewan & British Columbia	5	282,639	16.1%	45,821	761
	30	1,759,761	100.0%	436,179	6,734

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

	Northern Alberta		Southern Alberta		Saskatchewan & British Columbia	
	2014	2013	2014	2013	2014	2013
<u>Three months ended March 31 (\$000s)</u>						
Rental revenue	7,042	6,256	2,194	2,006	1,411	1,426
NOI	4,382	4,196	1,591	1,383	761	763
<u>As at March 31</u>						
Weighted average base rent (per sq. ft.)	\$16.53	\$16.64	\$17.89	\$21.00	\$12.95	\$12.99
Occupancy %	89.5%	89.7%	97.4%	96.8%	84.9%	91.0%

Higher rental revenue in Northern Alberta was primarily driven by the two property acquisitions in the region since Q1-2013, which contributed \$0.63 million in revenues in the current period. Variances in non-cash adjustments related to tenant incentives and straight-line rent adjustment made up the remaining increase over Q1-2013. The acquisition of LC Industrial in Q1-2014 drove the increase in rental revenue in Southern Alberta, contributing \$0.14 million in revenues for Q1-2014. Rental revenue in Saskatchewan and BC remained steady and reflects consistent average base rent and occupancy percentage.

General & Administrative Expense

	Three months ended March 31		
(\$000s)	2014	2013	△%
Asset management fee	269	—	100 %
Salaries and benefits	—	237	(100%)
Professional fees	110	21	424 %
Public company costs	48	—	100 %
Other	(64)	136	(147)%
	363	394	(8%)

The analysis of the components of general & administrative expense period over period is not meaningful due to the formation of the REIT on May 1, 2013 and resulting change in cost structure. Higher professional fees during Q1-2014 reflect the higher costs associated with the REIT being a stand-alone publicly traded entity. Other expense is presented net of recoveries from tenants for the costs associated with administering the REIT. Refer to note 16 of the condensed interim consolidated financial statements for additional discussion on the management fee structure.

Finance Costs

	Three months ended March 31		
(\$000s)	2014	2013	△%
Interest on mortgages payable and revolving credit facility	1,270	2,041	(38%)
Interest on Class C LP Units	1,005	—	100 %
Amortization of fair value adjustments on Class C LP Units	(110)	—	(100%)
Amortization of deferred financing costs	45	—	100 %
Finance costs before distributions	2,210	2,041	8%
Distributions on Class B LP Units	1,608	—	100 %
Finance costs	3,818	2,041	87 %

Finance costs for the three-months ended March 31, 2014 were \$1.78 million or 87% higher compared to the same period in the prior year. Analysis of the components of finance costs is not meaningful due to the formation of the REIT and resulting conversion of certain mortgages into Class C LP Units. Distributions made on Class B LP Units are classified as finance costs, as the units are accounted for as a financial liability measured at fair value through profit and loss.

Finance costs before distributions on Class B LP Units were 8% higher during the three-months ended March 31, 2014 compared to Q1-2013. The increase reflects higher average indebtedness during the period as a result of property acquisitions completed in Q1-2014 and during 2013. Lower weighted average interest rates on the Class C LP Units and revolving credit facility partially offset the increase in finance costs during the period. As at March 31, 2014 the weighted average interest rate on our revolving credit facility, mortgages payable and Class C LP Units was 3.99% based on period end balances.

Income Taxes

As at March 31, 2014, the REIT qualifies as a mutual fund trust within the meaning of the *Income Tax Act* (Canada) and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through (SIFT) rules; accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT. The comparative Q1-2013 period includes income tax expense recognized prior to the IPO and qualification for the REIT Exception.

Funds from Operations & Adjusted Funds from Operations

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

	Three months ended March 31		
<i>(\$000s, except per unit amounts)</i>	2014	2013	△%
Net income for the period	878	4,816	
Add / (deduct)			
Fair value adjustment on investment properties	(169)	(2,594)	
Fair value adjustment on Class B LP Units	1,430	—	
Amortization of tenant incentives	541	578	
Distributions on Class B LP Units	1,608	—	
Non-recurring current income taxes on formation of the REIT	—	871	
Deferred income taxes	—	324	
Funds From Operations (FFO)	4,288	3,995	7%
Add / (deduct)			
Straight-line rent adjustment	(109)	(82)	
Amortization of deferred financing costs	45	—	
Accretion on decommissioning obligation	14	15	
Net impact of amortization of fair value adjustment and interest subsidy ⁽¹⁾	143	—	
Normalized capital expenditures ⁽²⁾	(201)	(180)	
Normalized tenant incentives and leasing commissions ⁽²⁾	(403)	(361)	
Adjusted Funds from Operations (AFFO)	3,777	3,387	12%
FFO/Unit	0.23	0.21	10%
AFFO/Unit	0.20	0.18	11%

(1) Adjustment includes the following: amortization of the fair value adjustment recognized on the Class C LP Unit liability; and usage of the interest rate subsidy provided by Melcor as part of the transfer of the Initial Properties.

(2) Represents 3% and 6% of annual NOI for capital expenditures and tenant incentives and leasing commissions respectively. Amounts are net of usage of the capital expenditure subsidy provided by Melcor as part of the transfer of Initial Properties. Amounts presented in the comparative and pre-acquisition periods are based on the respective percentages of annual NOI for comparative purposes.

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. Our initial distribution rate represents approximately 93% of AFFO for the 12 months ended March 31, 2014 based on our financial forecast. Distributions to unitholders for the period were \$1.54 million (year-ended December 31, 2013 - \$4.11 million).

Fair Value of Investment Properties

We carry our investment properties at fair value in accordance with IAS 40, *Investment property*. The following table summarizes key metrics of our investment properties and components of the fair value calculation:

	31-Mar-14	31-Dec-13
Number of properties	30	29
Total GLA (sq. ft)	1,854,057	1,786,447
GLA (REIT owned %) (sq. ft.)	1,759,761	1,691,920
Fair value of portfolio (\$000s)	447,815	440,349
Weighted average capitalization rate	6.41%	6.41%
Weighted average discount rate	7.33%	7.57%
Weighted average terminal capitalization rate	6.48%	6.69%

Investment properties were valued by qualified independent external valuation professionals as at December 31, 2013. 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, 2014. This resulted in fair value gains of \$169 (year-ended December 31, 2013 - \$16,953) on investment properties recorded to income during the period. Refer to note 17 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:

(<i>\$000s</i>)	Three months ended March 31, 2014	Year ended December 31, 2013
Northern Alberta	1,143	7,969
Southern Alberta	(765)	7,683
Saskatchewan & British Columbia	(209)	1,301
	169	16,953

Fair value gains in Northern Alberta were primarily driven by a 25 and 50 basis point decrease in capitalization rates on our newly acquired properties Liberty Crossing and Coast Home Centre respectively. Net fair value losses in Southern Alberta were primarily driven by a decrease in occupancy on one of our retail CRUs and reflects vacancy during the lease-up period and the costs associated with securing a new tenant.

Fair values are most sensitive to changes in capitalization rates.

	March 31, 2014			December 31, 2013		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	9.00%	6.41%	5.50%	9.00%	6.41%
Terminal capitalization rate	5.75%	9.25%	6.48%	5.75%	9.25%	6.69%
Discount rate	6.50%	10.00%	7.33%	6.50%	10.00%	7.57%

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by \$32.42 million (December 31, 2013 - \$31.88 million) while a 50 basis points decrease (-0.5%) would increase it by \$37.91 million (December 31, 2013 - \$37.28 million).

Liquidity & Capital Resources

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

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

Cash Flows

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

	Three-months ended March 31		
(\$000s)	2014	2013	\$△
Cash from operating activities	2,296	7,036	(4,740)
Cash used in investing activities	(7,261)	(843)	(6,418)
Cash from (used in) financing activities	2,608	(6,024)	8,632
Increase (decrease) in cash and cash equivalents	(2,357)	169	(2,526)
Cash and cash equivalents, beginning of the period	5,932	689	5,243
Cash and cash equivalents, end of the period	3,575	858	2,717

Operating activities

Cash from operating activities was \$4.74 million lower than Q1-2013. Higher net working capital in Q1-2014 negatively affected cash flow from operating activities by \$4.20 million when compared to the same period in the prior year. Distributions on Class B LP Units, which are included in finance costs, reduced cash from operations by an additional \$1.61 million. The decrease in cash flows was partially offset by higher NOI over Q1-2013 as a result of the property acquisitions completed during Q1-2014 and 2013.

Investing activities

We expanded our industrial portfolio with the acquisition of LC Industrial for \$6.03 million in Q1-2014. We also commenced our capital asset program for 2014 with \$0.61 million invested in strategic value-adding asset enhancement projects.

In addition, strong leasing activity during the period resulted in \$0.26 million in leasing fees paid to Melcor under the Property Management Agreement. Leasing activity on both new and renewed leases contributed to higher payments of tenant incentives during the period, with an increase of \$0.25 million over Q1-2013. We used \$0.47 million of restricted cash during Q1-2014 to partially fund our investment activities.

Financing activities

During Q1-2014 we received proceeds of \$10.90 million by taking out mortgages on two previously unencumbered properties. Part of these proceeds were used to repay \$5.50 million of amounts drawn under the revolving credit facility. We made \$1.51 million in regular principal repayments on mortgages payable and Class C LP Units during Q1-2014. Comparatively, we recognized \$26.63 million in proceeds during Q1-2013 on the renewal and refinancing of 3 properties.

We paid \$1.54 million in distributions to unitholders during the three-months ended March 31, 2014.

During the comparative period, we recognized \$10.66 million in net distributions to Melcor. Net distributions to Melcor represent the net financing funded/received by Melcor prior to the formation of the REIT to fund operating and investing activities.

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

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

As at March 31, 2014 we had \$3.58 million in cash and cash equivalents, \$5.25 million in restricted cash and \$6.50 million in available funds under our revolving credit facility. Subsequent to period-end we completed the issuance of 1,900,000 trust units at \$10.65 through a bought deal for total proceeds of \$20.24 million (gross). The funds are intended to be used to fund two property acquisitions from Melcor, to reduce

the indebtedness under our revolving credit facility, for future acquisitions and for general trust purposes. Refer to *Subsequent Event: Bought Deal Issuance of Trust Units and Property Acquisitions*.

Capital Structure

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

Pursuant to the DOT, the REIT may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, the total indebtedness of the REIT would be more than 60% of Gross Book Value ("GBV") ("Degree of Leverage Ratio") (65% including any convertible debentures).

At March 31, 2014, and throughout the period, we were in compliance with the Degree of Leverage Ratio and had a ratio of 51% as at period end. As at March 31, 2014, the REIT's total capitalization was \$406.10 million and is comprised as follows:

(\$000s)	31-Mar-14
Revolving credit facility ⁽¹⁾	18,500
Mortgages payable ⁽¹⁾	109,171
Class C LP Units ⁽²⁾	91,825
Indebtedness	219,496
Class B LP Units ⁽³⁾	95,308
Trust units ⁽⁴⁾	91,300
Equity	186,608
Total capitalization	406,104
Gross book value (GBV)⁽⁵⁾	431,094
Debt to GBV	51 %
Maximum threshold ⁽⁶⁾	60 %

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

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

(3) Class B LP Units are classified as equity for purposes of this calculation and are included at their book value of \$10.00 per unit.

(4) Trust units are included at their book value of \$10.00 per unit.

(5) GBV is calculated as the cost of the total assets acquired in the Initial Properties and on the purchase of Coast Home Centre, Liberty Crossing and LC Industrial.

(6) As prescribed by the operating policies in the DOT (65% including any convertible debentures).

We are also subject to financial covenants on our \$25.00 million revolving credit facility. The covenants include a maximum debt to total capital ratio of 60%, a minimum interest coverage ratio of 1.50, and a minimum net book value of unitholders' equity of \$140.00 million. As at March 31, 2014, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 51%, interest coverage ratio of 1.76, and a net book value of unitholders' equity of \$223.28 million. We also have financial covenants on certain mortgages for investment properties. At March 31, 2014, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

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	2014	2015	2016	2017	2018	Thereafter
Revolving credit facility	18,500	—	18,500	—	—	—	—
Mortgages payable	109,171	19,393	22,433	14,139	1,847	34,510	16,849
Class C LP Units	91,825	2,306	25,825	11,180	4,584	13,108	34,822
Total	219,496	21,699	66,758	25,319	6,431	47,618	51,671
% of portfolio	100%	10%	30%	12%	3%	22%	23%

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.

Debt Analysis – our mortgages payable and Class C LP Units bear interest at fixed 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	3.90%	1.08
Mortgages payable	109,171	109,171	—	4.13%	2.93
Class C LP Units	91,825	91,825	—	3.84%	4.65
Total	219,496	200,996	18,500	3.99%	3.51

The weighted average interest rate on our debts remained steady during Q1-2014. During the first quarter we obtained mortgage financing on two previously unencumbered properties for \$10.90 million. Part of these proceeds were used to repay \$5.50 million of amounts drawn under the revolving credit facility. The weighted average interest rate on new financings obtained during the period was 3.49%.

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

(\$000s)	31-Mar-14
FFO	4,288
Principal repayments on Mortgages payable	752
Principle repayments on Class C LP Units	753
Debt service coverage ratio	2.85
FFO plus finance costs	6,498
Finance costs ⁽¹⁾	2,210
Finance costs coverage ratio	2.94

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

Credit Facility - As at March 31, 2014 we had an available credit limit of \$25.00 million of which \$18.50 million was drawn; and posted letters of credit of \$nil. Partial proceeds from the bought deal issuance of trust units which occurred subsequent to period end are to be used to reduce our indebtedness under the facility. Refer to *Subsequent Event: Bought Deal Issuance of Trust Units and Property Acquisitions*.

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.

The following table summarizes the Units issued and the fully diluted number of Units outstanding as at March 31, 2014 and December 31, 2013:

Issued and fully paid units (\$000s)	Units	\$ Amount
Balance, December 31, 2013 and March 31, 2014	9,130,000	91,300
<i>Dilutive securities</i>		
Class B LP Units ⁽¹⁾	9,530,798	95,308
Diluted balance, December 31, 2013 and March 31, 2014	18,660,798	186,608

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

Quarterly Results

	2014	2013				2012			
<i>(\$000s except per unit amount)</i>	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	
Revenue	10,647	10,070	9,794	9,773	9,688	10,566	9,195	9,002	
Net income	878	7,466	5,945	44,492	4,816	12,822	6,731	13,362	
Income per unit ⁽¹⁾	\$ 0.10	\$ 0.51	\$ 0.65	\$ 2.38	\$ 0.26	\$ 0.68	\$ 0.36	\$ 0.72	

(1) Calculated as if the trust units were outstanding during the entire period.

Forecast

The following details our results for the three and twelve-months ended March 31, 2014 against our financial forecast covering the period from April 1, 2013 to March 31, 2014, as provided in our prospectus dated April 19, 2013. Our forecast for the three-month period ended March 31, 2014 was revised as part of our 2013 Annual Management's Discussion and Analysis, as filed on March 10, 2014. The financial forecast for the three and twelve-months ended March 31, 2014 reflects the re-forecast for Q1-2014.

(\$000s)	Three-month period ended March 31, 2014			Twelve-month period ended March 31, 2014		
	Actuals	Re-Forecast	△%	Actuals	Re-Forecast	△%
Rental revenue	10,647	10,384	3 %	40,284	38,928	3 %
Direct operating expenses	(4,345)	(4,267)	2 %	(16,433)	(16,292)	1 %
Net rental income	6,302	6,117	3 %	23,851	22,636	5 %
General and administrative expenses	(363)	(417)	(13)%	(1,697)	(1,607)	6 %
Income before finance costs	5,939	5,700	4 %	22,154	21,029	5 %
Interest income	18	9	100 %	73	33	121 %
Interest expense						
Interest expense on mortgages debt	(1,315)	(1,185)	11 %	(4,968)	(4,316)	15 %
Distribution on Class C LP Units	(895)	(893)	— %	(3,323)	(3,620)	(8)%
Distribution on Class B LP Units	(1,608)	(1,747)	(8)%	(5,897)	(6,986)	(16)%
Net finance costs	(3,800)	(3,816)	— %	(14,115)	(14,889)	(5)%
Net income and comprehensive income	2,139	1,884	14 %	8,039	6,140	31 %
Add / (deduct):						
Amortization of tenant improvements	541	670	(19)%	2,260	2,458	(8)%
Distribution on Class B LP Units	1,608	1,747	(8)%	5,897	6,986	(16)%
Funds from Operations (FFO)	4,288	4,301	— %	16,196	15,584	4 %
Add / (deduct):						
Straight-line rent adjustment	(109)	(64)	70 %	(424)	(219)	94 %
Deferred financing costs	45	19	137 %	153	76	101 %
Net impact of mark to market adjustment and interest subsidy	143	143	— %	575	630	(9)%
Normalized capital expenditures	(201)	(201)	— %	(748)	(748)	— %
Normalized tenant inducements and leasing commissions	(403)	(403)	— %	(1,499)	(1,499)	— %
Adjusted Funds from Operations (AFFO)	3,763	3,795	(1)%	14,253	13,824	3 %
FFO/unit	0.23	0.23	— %	0.87	0.84	4 %
AFFO/unit	0.20	0.20	— %	0.76	0.74	3 %
Net Operating Income (NOI)	6,734	6,723	— %	25,687	24,875	3 %

Our financial results for the twelve-month forecast period ended March 31, 2014 reflect the continued execution of our strategic objectives. We finished the forecast period ahead of our projections with stable and sustainable growth on key indicators. In our 2013 Annual Management's Discussion and Analysis, dated March 10, 2014, we re-forecast Q1-2014 to include the expected financial results from our newly acquired properties, Coast, Liberty and LC. Actual results for Q1-2014 were in-line with our revised financial forecast.

Net rental income for the three and twelve-months ended March 31, 2014 was 3% and 5% ahead of forecast respectively. Improved leasing conditions and strong lease renewals led to higher rental revenues during the period. Non-cash adjustments related to amortization of tenant improvements and straight-line rent also had a positive impact on revenues and net rental income compared to forecast. Direct operating expenses for the twelve-month period are consistent with forecast. Direct operating expenses in Q1-2014 were 2% higher than the revised forecast due to timing of expenditures on our 2014 maintenance program.

For the twelve-months ended March 31, 2014, general & administrative expense was \$0.09 million higher than forecast. The variation from forecast is due to annual fees for audit, tax and property appraisal services being expensed in post-formation earnings (eight-month period) versus the forecast twelve-month period. The twelve-month period increase is partially offset by higher overhead transfers to properties in Q1-2014 as a result of an increase in the fee allocated (per square foot) to the properties for recovery from tenants.

Net finance costs were in-line with the revised forecast for Q1-2014 and 5% lower than forecast for the twelve-month period. Distributions on Class B LP Units are lower than forecast due to the conversion of 830,000 units to fulfill the underwriters' over-allotment option. Interest on mortgages payable and Class C LP Units was 15% higher during the twelve-month period due to the forecast period including conversion of the mortgages to Class C LP Units at April 1, 2013, compared to the actual conversion which occurred on May 1, 2013. Higher interest expense on mortgage debt reflects the higher average indebtedness under the revolving credit facility and new mortgages, which was used to fund property acquisitions during the forecast period.

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

There are no material changes to the above titled sections at March 31, 2014 in comparison to the December 31, 2013 annual MD&A.

Subsequent Event: Bought Deal Issuance of Trust Units and Property Acquisitions

On April 16, 2014 the REIT entered into an agreement to sell to a syndicate of underwriters, on a bought deal basis, 1,900,000 trust units at \$10.65 per unit for gross proceeds of \$20.24 million ("the Offering"). The issuance was qualified under a short form prospectus filed April 30, 2014. The total proceeds received by the REIT, net of underwriters' fee was \$19.43 million. Pursuant to the underwriters agreement, the underwriters have an over-allotment option which grants them the option to purchase an additional 285,000 trust units at \$10.65 per unit. The over-allotment option expires 30 days from closing. The funds are intended to be used to fund two property acquisitions from Melcor, with the remainder to be applied against the revolving credit facility, for future acquisitions and for general trust purposes. The Offering closed on May 7, 2014.

On April 15, 2014 the REIT's board of trustees also approved the acquisition of two multi-tenant retail properties (the "Acquisitions") for a purchase price of approximately \$13.50 million (excluding closing and transaction costs). The properties include phase three (11,540 sq. ft.) of the Kingsview Market retail complex in Airdrie, Alberta completed by Melcor in early 2013 and a 42,586 sq. ft. retail community strip centre (Market Mall) located in Regina, Saskatchewan that was substantially redeveloped by Melcor in 2009. These two acquisitions represent the first transactions through our proprietary pipeline.

The REIT intends to satisfy approximately \$7.40 million of the purchase price of the Acquisitions by issuing 694,836 Class B LP Units at \$10.65 per unit to Melcor. On closing of the Acquisitions it is expected that Melcor will hold an approximate 48.1% effective interest in the REIT through ownership of 10,225,634 Class B LP Units of the Partnership (or an approximate 47.5% effective interest in the REIT if the over-allotment option is exercised in full). The Acquisitions are expected to close on May 9, 2014.

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, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. No such changes were identified.

Non-standard Measures

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

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

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

Calculations

We use the following calculations in measuring our performance.

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

(\$000s)	Three months ended March 31			Financial Forecast	
	2014	2013	△%	Q1-2014	△%
Net income for the period	878	4,816			
Income tax expense	—	1,195			
Net finance costs	3,800	2,035			
Fair value adjustment on Class B LP Units	1,430	—			
Fair value adjustment on investment properties	(169)	(2,594)			
General and administrative expenses	363	394			
Amortization of tenant incentives	541	578			
Straight-line rent adjustment	(109)	(82)			
NOI	6,734	6,342	6%	6,723	—%

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 to 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; (vi) deferred income tax expense; and (vii) non-recurring current income taxes on formation of the REIT, 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) amortization of deferred financing and leasing costs; (iv) accretion on decommissioning obligation; (v) adjusting for any differences resulting from recognizing property revenues on a straight-line basis; (vi) deducting a reserve for normalized maintenance capital expenditures, tenant inducements and leasing costs, as determined by us. Other adjustments may be made to AFFO as determined by the Board in its discretion.

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

Debt to Gross Book Value: is calculated as the sum of mortgages payable and Class C LP Units, less unamortized fair value adjustment; divided by the total asset value assumed on acquisition of the Initial Properties plus total assets acquired from third parties subsequently.

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

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



MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three-months ended March 31, 2014

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2014

(Unaudited)

(\$000s)	March 31, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	3,575	5,932
Accounts receivable	1,494	1,478
Other assets (note 6)	670	1,015
	5,739	8,425
Non-Current Assets		
Restricted cash	5,247	5,969
Investment properties (note 5 and 17)	436,179	429,117
Other assets (note 6)	11,636	11,232
	453,062	446,318
TOTAL ASSETS	458,801	454,743
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 7)	18,335	23,748
Accounts payable	1,406	1,989
Distribution payable	1,050	1,050
Accrued liabilities and other payables (note 8)	3,718	3,690
Class C LP Units (note 10)	3,088	3,059
Mortgages payable (note 9)	20,367	19,911
	47,964	53,447
Non-Current Liabilities		
Accrued liabilities and other payables (note 8)	1,473	1,459
Class B LP Units (note 11 and 17)	100,550	99,120
Class C LP Units (note 10)	90,296	91,188
Mortgages payable (note 9)	88,563	78,911
TOTAL LIABILITIES	328,846	324,125
UNITHOLDERS' EQUITY	129,955	130,618
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	458,801	454,743

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Income and Comprehensive Income

For the three-months ended March 31

(Unaudited)

(\$000s)	2014	2013
Rental revenue (note 13 and 16)	10,647	9,688
Direct operating expenses (note 16)	(4,345)	(3,842)
Net rental income	6,302	5,846
General and administrative expenses (note 16)	(363)	(394)
Fair value adjustment on investment properties (note 5 and 17)	169	2,594
Fair value adjustment on Class B LP Units (note 11 and 17)	(1,430)	—
Income before finance costs and income taxes	4,678	8,046
Interest income	18	6
Finance costs (note 14 and 16)	(3,818)	(2,041)
Net finance costs	(3,800)	(2,035)
Net income before income taxes	878	6,011
Current income tax expense	—	(871)
Deferred income tax expense	—	(324)
Income tax expense	—	(1,195)
Net income and comprehensive income	878	4,816
<i>See note 15 for basic and diluted earnings per trust unit.</i>		

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at March 31, 2014

(Unaudited)

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Divisional Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2013	9,130,000	82,709	36,823	—	11,086	130,618
Net income for the period	—	—	—	—	878	878
Distributions to unitholders	—	—	—	—	(1,541)	(1,541)
Balance at March 31, 2014	9,130,000	82,709	36,823	—	10,423	129,955

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Divisional Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2012	—	—	—	168,331	—	168,331
Net income for the period	—	—	—	4,816	—	4,816
Net distributions to Melcor Developments Ltd.	—	—	—	(10,655)	—	(10,655)
Balance at March 31, 2013	—	—	—	162,492	—	162,492

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)	2014	2013
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income for the period	878	4,816
Non cash items:		
Amortization of tenant incentives (note 13)	541	578
Straight-line rent adjustments (note 13)	(109)	(82)
Fair value adjustment on investment properties (note 5 and 17)	(169)	(2,594)
Fair value adjustment on Class B LP Units (note 11 and 17)	1,430	—
Amortization of fair value adjustment on Class C LP Units (note 14)	(110)	—
Amortization of deferred financing costs (note 14)	45	—
Accretion on decommissioning obligation	14	15
Deferred income tax expense	—	324
	2,520	3,057
Changes in operating assets and liabilities	(224)	3,979
	2,296	7,036
INVESTING ACTIVITIES		
Additions to investment properties (note 4 and 5)	(6,027)	—
Payment of tenant incentives (note 6)	(836)	(584)
Investment property improvements and direct leasing costs	(866)	(259)
Change in restricted cash	468	—
	(7,261)	(843)
FINANCING ACTIVITIES		
Revolving credit facility	(5,500)	—
Proceeds from mortgages payable	10,900	26,625
Repayment of mortgages payable	(752)	(21,994)
Repayment on Class C LP Units	(753)	—
Change in restricted cash	254	—
Net distributions to Melcor Developments Ltd.	—	(10,655)
Distributions to unitholders	(1,541)	—
	2,608	(6,024)
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE PERIOD	(2,357)	169
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	5,932	689
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	3,575	858

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.

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

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

As at May 8, 2014, Melcor, through an affiliate, holds an approximate 51.1% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

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

2. BASIS OF PRESENTATION

These 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*.

As Melcor retained control over the REIT, the May 1, 2013 IPO and acquisition of the Initial Properties was accounted for as a reorganization and recapitalization using the continuity of interests method. Financial information for the pre-acquisition period as included in the March 31, 2013 comparative period are presented based on historical combined financial information for the Initial Properties as previously reported by Melcor.

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2013, 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 8, 2014.

3. SIGNIFICANT ACCOUNTING POLICIES

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

Changes in accounting policies

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

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

The adoption of IFRIC 21 did not result in a change in the recognition or timing of recognition of levies imposed on the REIT.

4. INVESTMENT PROPERTY ACQUISITION

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

The acquisition was funded through the REIT's line of credit and available cash.

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

5. INVESTMENT PROPERTIES

(\$000s)	Three months ended March 31, 2014	Year ended December 31, 2013
Balance - beginning of period	429,117	382,381
Additions		
Direct acquisition (note 4)	6,027	25,851
Property improvements	608	3,035
Direct leasing costs	258	788
Fair value adjustment on investment property (note 17)	169	16,953
Change in provision	—	109
Balance - end of period	436,179	429,117

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 17.

The cost of investment properties as at March 31, 2014 totalled \$212,885 (December 31, 2013 - \$205,992).

Presented separately from investment properties is \$10,681 (December 31, 2013 - \$10,386) in tenant incentives and \$955 (December 31, 2013 - \$846) in straight-line rent adjustments (note 6). The fair value of investment properties has been reduced by these amounts.

6. OTHER ASSETS

(\$000s)	March 31, 2014	December 31, 2013
Current Assets		
Prepaid expense, and other	670	1,015
Non-Current Assets		
Straight-line rent adjustments	955	846
Tenant incentives	10,681	10,386
	11,636	11,232
	12,306	12,247

During the three-month period we provided tenant incentives of \$836 (2013 - \$584) and recorded \$541 (2013 - \$578) 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.

7. REVOLVING CREDIT FACILITY

As at March 31, 2014 we had an available credit limit of \$25,000, of which \$18,500 (December 31, 2013 - \$24,000) was drawn; and posted letters of credit of \$nil.

(\$000s)	March 31, 2014	December 31, 2013
Amount drawn on facility	18,500	24,000
Unamortized transaction fees	(138)	(170)
Unamortized discount on bankers acceptance	(27)	(82)
	18,335	23,748

8. ACCRUED LIABILITIES AND OTHER PAYABLES

	March 31, 2014	December 31, 2013
Current Liabilities		
Accrued liabilities and other payables	3,536	3,508
Decommissioning obligation	182	182
	3,718	3,690
Non-Current Liabilities		
Decommissioning obligation	1,473	1,459
	5,191	5,149

9. MORTGAGES PAYABLE

(\$000s)	March 31, 2014	December 31, 2013
Mortgages amortized over 15-25 years at fixed interest rates	109,171	99,023
Unamortized deferred financing fees	(241)	(201)
	108,930	98,822
Current portion of mortgages payable	(20,367)	(19,911)
	88,563	78,911
Interest rate ranges	(3.01%-5.86%)	(3.01%-5.86%)

10. CLASS C LP UNITS

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

(\$000s)	March 31, 2014	December 31, 2013
Class C LP Units amortized over 2-6 years at fixed interest rates	91,825	92,578
Unamortized fair value adjustment	1,559	1,669
	93,384	94,247
Current portion of Class C LP Units	(3,088)	(3,059)
	90,296	91,188
Effective interest rate	3.84%	3.84%

At March 31, 2014 there were 9,182,597 Class C LP Units issued and outstanding (December 31, 2013 - 9,257,820).

11. CLASS B LP UNITS

Class B LP Units are held by Melcor in partial consideration for the initial properties sold to the REIT. The Class B LP Units are exchangeable at the option of the holder for one trust unit of the REIT 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 entitle 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, 2014 and recognized a fair value loss of \$1,430 during the three-month period. Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 17.

At March 31, 2014 there were 9,530,798 Class B LP Units issued and outstanding at a fair value of \$10.55 per unit or \$100,550 (December 31, 2013 - 9,530,798 at \$10.40 per unit or \$99,120).

12. UNITHOLDERS' EQUITY

Issued and outstanding trust units at March 31, 2014 are 9,130,000 (December 31, 2013 - 9,130,000).

13. RENTAL REVENUE

The components of rental revenue are as follows:

For the three months ended March 31 (\$000s)	2014	2013
Rental revenue	11,079	10,184
Amortization of tenant incentives	(541)	(578)
Straight-line adjustment	109	82
	10,647	9,688

14. FINANCE COSTS

The components of finance costs are as follows:

For the three months ended March 31 (\$000s)	2014	2013
Interest on mortgages payable and revolving credit facility	1,270	2,041
Interest on Class C LP Units	1,005	—
Amortization of fair value adjustments on Class C LP Units	(110)	—
Distributions on Class B LP Units (note 16)	1,608	—
Amortization of deferred financing costs	45	—
	3,818	2,041

Total finance costs paid during the three month period were \$3,883 (2013 - \$2,041).

15. INCOME PER UNIT

Basic and diluted earnings per trust unit for the three-months ended March 31, 2014 are calculated as follows:

For the three months ended March 31 (\$000s)	2014
Income and comprehensive income - basic and diluted (\$000s)	878
Basic and diluted weighted average trust units outstanding during the period	9,130,000
Basic and diluted earnings per trust unit	\$0.10

16. RELATED PARTY TRANSACTIONS

The condensed interim consolidated financial statements of the REIT include the following related party transactions with Melcor, and its affiliates, as the controlling Unitholder of the REIT:

a) *Property and Asset Management Agreements*

Pursuant to the terms of the Property and Asset Management Agreements the REIT incurred the following fees during the three-month period:

For the three month period ended March 31 (\$000s)	2014
<i>Asset Management Agreement</i>	
Base Annual Management Fee	269
Capital Expenditure Fee	—
Acquisition Fee	59
Financing Fee	—
<i>Property Management Agreement</i>	
Monthly Fee	287
Lease Fee	258
	873

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, 2014 there was \$392 (December 31, 2013 - \$447) 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, 2014, \$1,608 in distributions were recorded on Class B LP Units held by Melcor. These distributions were recorded as finance costs. As at March 31, 2014 there was \$536 payable to Melcor for the March distribution (December 31, 2013 - \$536 for the December distribution).

Also during the three-month period ended March 31, 2014, Melcor, as holder of all Class C LP Units, was paid \$1,758 to fund principal and interest payments on the Retained Debt. These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs.

c) *Rental Revenue*

From the three-month period ended March 31, 2014 the REIT collected \$170 in rental revenue from Melcor and an affiliate for use of office space. This amount is 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.

17. FAIR VALUE MEASUREMENT

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

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

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.

- fair values of mortgages payable and Class C LP Units are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units (Level 1).

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

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

(\$000s)	March 31, 2014				December 31, 2013	
	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
Non-financial assets						
Investment properties	436,179	—	436,179	436,179	429,117	429,117
Financial liabilities						
Mortgages payable	—	109,171	109,171	114,641	99,023	105,165
Class B LP Units	100,550	—	100,550	100,550	99,120	99,120
Class C LP Units	—	93,384	93,384	93,384	94,247	94,247

The table below analyzes assets and liabilities carried at fair value in the condensed interim consolidated statement of financial position, by the levels in the fair value hierarchy. The fair 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	—	—	436,179	436,179
Financial liabilities				
Class B LP Units	100,550	—	—	100,550

Investment properties

Investment properties are remeasured to fair value on a recurring basis and categorized as Level 3 in the fair value hierarchy. Investment properties were valued by qualified independent external valuation professionals as at December 31, 2013. We obtained updated market data at March 31, 2014 and considered whether changes to any valuation model variables resulted in significant changes to any of the investment property fair values at March 31, 2014. Fair values of investment properties were revised based on the updated data and model variables resulting in fair value gains of \$169 (2013 - \$2,594) recorded as fair value adjustment on investment properties in the income statement. Fair values are primarily determined by discounting the expected future cash flows over ten years plus a terminal value determined by applying a discount rate to estimated year eleven cash flows, or by applying a capitalization rate to the estimated future net operating income under the direct capitalization approach. The significant unobservable inputs in the Level 3 valuations are as follows:

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items;
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;

- Terminal rate - taking into account assumptions regarding vacancy rates and market rents; and
- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

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

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

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

Weighted average stabilized net operating income for investment properties is \$1,166 (December 31, 2013 - \$1,176). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	March 31, 2014			December 31, 2013		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	9.00%	6.41%	5.50%	9.00%	6.41%
Terminal capitalization rate	5.75%	9.25%	6.48%	5.75%	9.25%	6.69%
Discount rate	6.50%	10.00%	7.33%	6.50%	10.00%	7.57%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by \$32,417 (December 31, 2013 - \$31,881). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by \$37,905 (December 31, 2013 - \$37,278).

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, 2014 the fair value of the Class B LP Units was \$100,550, resulting in a fair value loss of \$1,430 for the period.

18. SUBSEQUENT EVENTS

Distributions declared

On April 15, 2014 we declared a distribution of \$0.05625 per unit for the months of April, May and June 2014. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
April 2014	April 30, 2014	May 15, 2014	\$0.05625 per unit
May 2014	May 30, 2014	June 16, 2014	\$0.05625 per unit
June 2014	June 30, 2014	July 15, 2014	\$0.05625 per unit

Trust unit offering

On April 16, 2014 the REIT entered into an agreement to sell to a syndicate of underwriters, on a bought deal basis, 1,900,000 trust units at \$10.65 per unit for gross proceeds of \$20,235 ("Offering"). The issuance was qualified under a short form prospectus filed April 30, 2014. The total proceeds received by the REIT, net of underwriters' fee was \$19,426. Pursuant to the underwriters agreement, the underwriters have an over-allotment option which grants them the option to purchase an additional 285,000 trust units at \$10.65 per unit. The over-allotment option expires 30 days from closing. Proceeds from the Offering are to be used to purchase two investment properties from Melcor, and reduce the amount outstanding under the revolving credit facility, for future acquisitions and for general trust purposes. The Offering closed on May 7, 2014.

Purchase of properties from Melcor

On April 15, 2014 the REIT's board of trustees approved the acquisition of two multi-tenant retail properties (the "Acquisitions") for a purchase price of approximately \$13,500 (excluding closing and transaction costs) from Melcor. The REIT intends to satisfy approximately \$7,400 of the purchase price of the Acquisitions by issuing 694,836 Class B LP Units at \$10.65 per unit. On closing of the Acquisitions it is expected that Melcor will hold an approximate 48.1% effective interest in the REIT through ownership of 10,225,634 Class B LP Units of the Partnership (or an approximate 47.5% effective interest in the REIT if the over-allotment option is exercised in full). The Acquisitions are expected to close on May 9, 2014.