# MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2024

(Unaudited)

## Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2024

(Unaudited)

| ($000s) | March 31, 2024 | December 31, 2023 | January 1, 2023 |
|---|---|---|---|
| | | Restated (note 3) | Restated (note 3) |
| **ASSETS** | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | **3,861** | 3,289 | 3,304 |
| Restricted cash (note 6) | **—** | — | 1,000 |
| Accounts receivable | **2,310** | 2,133 | 2,079 |
| Other assets (note 5) | **1,011** | 1,024 | 956 |
| Assets held for sale (note 6) | **41,577** | 33,774 | 19,500 |
| | **48,759** | 40,220 | 26,839 |
| **Non-Current Assets** | | | |
| Investment properties (note 4, 15 and 17) | **614,038** | 629,993 | 672,010 |
| Other assets (note 5) | **27,341** | 28,015 | 28,172 |
| Derivative financial assets (note 17) | **3,180** | 2,770 | 3,748 |
| | **644,559** | 660,778 | 703,930 |
| **TOTAL ASSETS** | **693,318** | 700,998 | 730,769 |
| | | | |
| **LIABILITIES** | | | |
| **Current Liabilities** | | | |
| Revolving credit facility (note 7) | **37,607** | 37,860 | 31,634 |
| Accounts payable | **1,704** | 1,902 | 2,216 |
| Distribution payable | **—** | 1,163 | 1,163 |
| Accrued liabilities and other payables (note 8) | **11,440** | 11,316 | 9,673 |
| Class C LP Units (note 10) | **1,672** | 1,648 | 26,657 |
| Class B LP Units (note 3, 11 and 17) | **51,923** | 66,919 | 89,172 |
| Mortgages payable (note 9) | **53,317** | 53,698 | 56,339 |
| Convertible debentures (note 3 and 17) | **45,244** | 44,997 | 44,056 |
| | **202,907** | 219,503 | 260,910 |
| **Non-Current Liabilities** | | | |
| Accrued liabilities and other payables (note 8) | **3,694** | 1,871 | 1,809 |
| Class C LP Units (note 10) | **19,554** | 19,982 | 11,141 |
| Mortgages payable (note 9) | **257,518** | 259,620 | 267,300 |
| Derivative financial liabilities (note 17) | **524** | 734 | 412 |
| **TOTAL LIABILITIES** | **484,197** | 501,710 | 541,572 |
| | | | |
| **UNITHOLDERS' EQUITY** | **209,121** | 199,288 | 189,197 |
| **TOTAL LIABILITIES AND UNITHOLDERS' EQUITY** | **693,318** | 700,998 | 730,769 |

*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)

| | Three months ended March 31 | |
|---|---|---|
| ($000s) | **2024** | 2023 |
| Rental revenue (note 13 and 15) | **18,905** | 18,990 |
| Direct operating expenses (note 15) | **(8,334)** | (8,352) |
| Net rental income | **10,571** | 10,638 |
| General and administrative expenses (note 15) | **(1,020)** | (779) |
| Fair value adjustment on investment properties (note 4 and 17) | **(9,056)** | (1,586) |
| Fair value adjustment on Class B LP Units (note 11 and 17) | **14,996** | 2,903 |
| Income before finance costs | **15,491** | 11,176 |
| Interest income | **14** | 19 |
| Finance costs (note 14 and 15) | **(5,153)** | (7,539) |
| Net finance costs | **(5,139)** | (7,520) |
| Net income and comprehensive income | **10,352** | 3,656 |
| Basic income per trust unit (note 12) | **$0.80** | $0.28 |
| Diluted (loss) income per trust unit (note 12) | **($0.14)** | $0.09 |

*See accompanying notes to the condensed interim consolidated financial statements.*

## Condensed Interim Consolidated Statements of Changes in Unitholders’ Equity

For the three months ended March 31

(Unaudited)

| ($000s except unit amounts) | Number of Trust Units | Trust Units | Contributed Surplus | Retained Earnings | Total Unitholders' Equity |
|---|---|---|---|---|---|
| **Balance at December 31, 2023** | 12,963,169 | 116,614 | 41,601 | 41,073 | 199,288 |
| Net income for the period | — | — | — | 10,352 | 10,352 |
| Distributions to unitholders | — | — | — | (519) | (519) |
| **Balance at March 31, 2024** | 12,963,169 | 116,614 | 41,601 | 50,906 | 209,121 |

| ($000s except unit amounts) | Number of Trust Units | Trust Units | Contributed Surplus | Retained Earnings | Total Unitholders' Equity |
|---|---|---|---|---|---|
| **Balance at December 31, 2022** | 12,963,169 | 116,614 | 41,601 | 30,982 | 189,197 |
| Net income for the period | — | — | — | 3,656 | 3,656 |
| Distributions to unitholders | — | — | — | (1,556) | (1,556) |
| **Balance at March 31, 2023** | 12,963,169 | 116,614 | 41,601 | 33,082 | 191,297 |

*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) | Three months ended March 31 2024 | 2023 |
|---|---|---|
| **CASH FLOWS FROM (USED IN)** | | |
| **OPERATING ACTIVITIES** | | |
| Net income for the period | **10,352** | 3,656 |
| Non cash items: | | |
| Amortization of tenant incentives (note 5 and 13) | **959** | 1,058 |
| Straight-line rent adjustments (note 13) | **131** | (174) |
| Fair value adjustment on investment properties (note 4 and 17) | **9,056** | 1,586 |
| Fair value adjustment on Class B LP Units (note 11 and 17) | **(14,996)** | (2,903) |
| Accretion on convertible debentures (note 14) | **125** | 117 |
| Fair value adjustment on derivative instruments (note 14 and 17) | **(620)** | 676 |
| Amortization of deferred financing fees (note 14) | **280** | 353 |
| | **5,287** | 4,369 |
| Payment of tenant incentives and direct leasing costs | **(906)** | (1,955) |
| Changes in operating assets and liabilities | **467** | (532) |
| | **4,848** | 1,882 |
| **INVESTING ACTIVITIES** | | |
| Change in restricted cash (note 6) | **—** | 1,000 |
| Net proceeds from disposal of asset held for sale (note 6) | **—** | 18,025 |
| Investment in property improvements (note 4) | **(492)** | (191) |
| | **(492)** | 18,834 |
| **FINANCING ACTIVITIES** | | |
| Net repayment on revolving credit facility (note 7) | **(277)** | (7,270) |
| Repayment of mortgages payable (note 9) | **(2,584)** | (11,294) |
| Repayment on Class C LP Units (note 10) | **(404)** | (587) |
| Distributions to unitholders | **(519)** | (1,556) |
| | **(3,784)** | (20,707) |
| **INCREASE IN CASH & CASH EQUIVALENTS DURING THE PERIOD** | **572** | 9 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD** | **3,289** | 3,304 |
| **CASH AND CASH EQUIVALENTS, END OF THE PERIOD** | **3,861** | 3,313 |

*See accompanying notes to the condensed interim consolidated financial statements.*

## 1. DESCRIPTION OF THE TRUST

Melcor Real Estate Investment Trust (the ''REIT'' or "we") is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust ("DOT") dated January 25, 2013 and subsequently amended and restated May 1, 2013. We began operations on May 1, 2013.

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

As at May 8, 2024, Melcor holds an approximate 55.4% effective interest in the REIT through ownership of all Class B LP Units of Melcor REIT Limited Partnership (the "Partnership"). Furthermore, Melton Holdings Ltd. owns approximately 51.3% of the outstanding shares of Melcor and pursuant to IAS 24, Related Party Disclosures, is the ultimate controlling shareholder.

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 as issued by the International Accounting Standard Board ("IFRS Accounting Standards") 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, 2023, which have been prepared in accordance with IFRS Accounting Standards. These condensed interim consolidated financial statements were authorized for issue by the Board of Trustees on May 8, 2024.

## 3. MATERIAL ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

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

*NEW AND AMENDED STANDARD ADOPTED*

We have adopted the following amendment on January 1, 2024.

***IAS 1, Presentation of financial statements*** was amended to clarify how to classify debt and other liabilities as either current or non-current. The definition of settlement has been changed to clarify that settlement of a liability includes any kind of settlement, whether in cash, other assets or in the entity's own equity. The amendment to IAS 1 is effective for annual periods beginning on or after January 1, 2024 and impacts the classification of the Class B LP Units and convertible debentures in the consolidated statement of financial position. The Class B LP Units and convertible debentures are convertible into trust units at the option of the holder and are required to be presented as current liabilities in accordance with the amendment to IAS 1. The amendment has been applied retrospectively with restatement and has resulted in the Class B LP Units of $66,919 as at December 31, 2023 and $89,172 as at January 1, 2023 that were previously included in non-current liabilities being reclassified to current liabilities. The convertible debenture of $44,056 as at January 1, 2023 that was previously included in non-current liabilities, has also been reclassified to current liabilities.

## 4. INVESTMENT PROPERTIES

| ($000s) | Three months ended March 31, 2024 | Year ended December 31, 2023 |
|---|---|---|
| **Balance - beginning of period** | **629,993** | 672,010 |
| Additions | | |
| Property improvements | **492** | 5,295 |
| Direct leasing costs (note 15) | **390** | 1,338 |
| Fair value adjustment on investment properties (note 17) | **(9,056)** | (16,794) |
| Investment properties classified as held for sale during the period (note 6) | **(7,781)** | (32,143) |
| Other adjustments | **—** | 287 |
| **Balance - end of period** | **614,038** | 629,993 |

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.

Presented separately from investment properties is $19,538 (December 31, 2023 - $20,063) in tenant incentives and $7,803 (December 31, 2023 - $7,952) in straight-line rent adjustments (note 5). The fair value of investment properties has been reduced by these amounts.

During the period, we reclassified an additional $7,781 from investment properties to assets held for sale (note 6). Fair value adjustment on investment properties includes adjustments related to assets held for sale (note 6) which was a gain of $2,000 (2023 - $nil) for the three-month period.

## 5. OTHER ASSETS

| ($000s) | March 31, 2024 | December 31, 2023 |
|---|---|---|
| **Current Assets** | | |
| Prepaid expense, and other | **1,011** | 1,024 |
| | | |
| **Non-Current Assets** | | |
| Straight-line rent adjustments | **7,803** | 7,952 |
| Tenant incentives | **19,538** | 20,063 |
| | **27,341** | 28,015 |

During the three-month period, we recorded tenant incentives of $488 (2023 - $1,449) and recorded $959 (2023 - $1,058) of amortization expense respectively.

In accordance with IFRS 16, *Leases*, amortization of tenant incentives is recorded on a straight-line basis over the term of the lease against rental revenue.

During the period, we also reclassified $54 (2023 - $nil) in tenant incentives and $18 (2023 - $nil) in straight-line rent adjustments to assets held for sale (note 6).

## 6. ASSETS HELD FOR SALE

As at March 31, 2024, assets held for sale includes three retail properties and one office building with a fair value of $41,577 (including investment property of $39,924, tenant incentives of $1,364 and straight-line rent of $289). As at March 31, 2024 management has listed these assets for sale with the intention to sell the properties.  As at December 31, 2023, assets held for sale included three retail properties with a fair value of $33,774 (including investment property of $32,143, tenant incentives of $1,360 and straight-line rent of $271).

On February 1, 2023, we disposed of an investment property classified as asset held for sale at December 31, 2022 for net proceeds of $19,025 (including a $1,000 deposit held as restricted cash at December 31, 2022), resulting from a purchase price of $19,500 less transaction costs of $475. The price was settled in cash, excluding working capital adjustments. Proceeds from the sale were used to repay the outstanding principal balance on the mortgage of $8,727 with the remaining cash being used to reduce borrowings on our credit facility.

Subsequent to the quarter, on April 16, 2024 we entered into an unconditional sale of an investment property, classified as asset held for sale, for gross proceeds of $7,800. This sale is scheduled to close on May 10, 2024. Net proceeds from the sale will be used to reduce debt.

## 7. REVOLVING CREDIT FACILITY

Under the terms of our revolving credit facility agreement the REIT maintains an available credit limit based on the lesser of the present value of discounted cash flows or 75% of the appraised value of specific investment properties to a maximum of $50,000 for general corporate purposes and acquisitions, including a $5,000 swing line sub-facility. An additional $15,000 is available by way of an accordion feature, subject to lender approval. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.25% or bankers acceptance plus 2.25% stamping fee. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. Interest payments are due and payable based upon the form of the facility drawn upon, and principal is due and payable upon maturity. The agreement also bears a standby fee of 0.45% for the unused portion of the revolving facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the facility. The facility matures on June 1, 2024. Subsequent to quarter end, we received confirmation from our lenders that they have issued credit approval for the extension of the credit facility subject to entering into an amended credit agreement and related documents.

Interest rate reform and replacement of benchmark interest rates such as CDOR and other inter-bank offered rates (‘IBORs’) has become a priority for global regulators. Our credit facility agreement references CDOR/Banker's Acceptance.
As at March 31, 2024, this loan has not transitioned to alternative interest rate benchmarks.

| **($000s)** | **March 31, 2024** | **December 31, 2023** |
|---|---|---|
| Amount drawn on facility | **37,624** | 37,901 |
| Unamortized transaction fees | **(17)** | (41) |
| | **37,607** | 37,860 |

## 8. ACCRUED LIABILITIES AND OTHER PAYABLES

| **($000s)** | **March 31, 2024** | December 31, 2023 |
|---|---|---|
| **Current Liabilities** | | |
| Tenant security deposits and pre-payments | **3,021** | 3,533 |
| Accrued finance costs | **1,331** | 759 |
| Lease obligation | **565** | 833 |
| Other accrued liabilities and payables | **6,523** | 6,191 |
| | **11,440** | 11,316 |
| **Non-Current Liabilities** | | |
| Lease obligation | **1,800** | — |
| Decommissioning obligation | **1,894** | 1,871 |
| | **3,694** | 1,871 |

The REIT's lease obligation relates to property improvements and tenant improvements at a commercial property.

## 9. MORTGAGES PAYABLE

| ($000s) | March 31, 2024 | December 31, 2023 |
|---|---|---|
| Mortgages amortized over 15-25 years at fixed interest rates | **233,931** | 236,033 |
| Mortgages amortized over 25 years at floating interest rate (fixed via floating for fixed interest rate swaps) | **78,293** | 78,775 |
| Unamortized deferred financing fees | **(1,389)** | (1,490) |
| | **310,835** | 313,318 |
| Current portion of mortgages payable | **(53,317)** | (53,698) |
| | **257,518** | 259,620 |
| Interest rate ranges | **2.62%-8.01%** | 2.62%-8.01% |

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

| ($000s) | Three months ended March 31, 2024 | Year ended December 31, 2023 |
|---|---|---|
| **Balance - beginning of period** | **313,318** | 323,639 |
| Principal repayments: | | |
| Scheduled amortization on mortgages | **(2,584)** | (10,467) |
| Mortgage repayments | **—** | (12,658) |
| New mortgages | **—** | 12,740 |
| Deferred financing fees | **(14)** | (431) |
| Amortization of deferred financing fees | **115** | 495 |
| **Balance - end of period** | **310,835** | 313,318 |

Interest rate reform and replacement of benchmark interest rates such as CDOR and other inter-bank offered rates ('IBORs') has become a priority for global regulators. We have five debt agreements with a carrying value of $78,293 which reference CDOR/Banker's Acceptance. As at March 31, 2024, these loans has not transitioned to alternative interest rate benchmarks.

## 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, 2024 | December 31, 2023 |
|---|---|---|
| Class C LP Units amortized over 15-25 years at fixed interest rates | **21,226** | 21,630 |
| Current portion of Class C LP Units | **(1,672)** | (1,648) |
| | **19,554** | 19,982 |
| Weighted average interest rate | **4.95%** | 4.97% |

As at March 31, 2024 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2023 - 10,785,613).

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

| ($000s) | Three months ended March 31, 2024 | Year ended December 31, 2023 |
|---|---|---|
| **Balance - beginning of period** | **21,630** | 37,798 |
| Principal repayments: | | |
| Scheduled amortization on Class C LP Units | **(404)** | (1,911) |
| Class C LP Units repayments | **—** | (14,257) |
| **Balance - end of period** | **21,226** | 21,630 |

## 11. CLASS B LP UNITS

Class B LP Units are held by Melcor and 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, 2024 and recognized a fair value gain of $14,996 during the three-month period (2023 - fair value gain of $2,903). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 17.

At March 31, 2024 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of $3.22 per unit or $51,923 (December 31, 2023 - 16,125,147 at $4.15 per unit or $66,919).

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

| | **Three months ended March 31, 2024** | | Year ended December 31, 2023 | |
|---|---|---|---|---|
| | **# of units** | **($000's)** | # of units | ($000's) |
| **Balance - beginning of period** | **16,125,147** | **66,919** | 16,125,147 | 89,172 |
| Fair value adjustment on Class B LP Units (note 17) | **—** | **(14,996)** | — | (22,253) |
| **Balance - end of period** | **16,125,147** | **51,923** | 16,125,147 | 66,919 |

## 12. UNITHOLDERS' EQUITY

At March 31, 2024, our issued and outstanding trust units were 12,963,169 (December 31, 2023 - 12,963,169).

| ***($000's except unit and per unit amounts)*** | **Three months ended March 31** | |
|---|---|---|
| | **2024** | **2023** |
| Net income - basic | **10,352** | 3,656 |
| Impact of Class B LP Units fair value adjustment and distributions* | **(14,351)** | (967) |
| Impact of convertible debentures interest, fair value adjustment, amortization and accretion* | **—** | — |
| Net (loss) income - diluted | **(3,999)** | 2,689 |
| | | |
| Basic weighted average trust units outstanding | **12,963,169** | 12,963,169 |
| Impact of conversion of Class B LP Units* | **16,125,147** | 16,125,147 |
| Impact of conversion of convertible debentures* | **—** | — |
| Diluted weighted average trust units outstanding | **29,088,316** | 29,088,316 |
| | | |
| Basic income per trust unit | **$0.80** | $0.28 |
| Diluted income per trust unit* | **($0.14)** | $0.09 |

*Diluted income per trust unit do not include the impact of Class B LP Units and convertible debentures when they are anti-dilutive.

## 13. RENTAL REVENUE

The components of rental revenue are as follows:

| | Three months ended March 31 | |
|---|---|---|
| **($000s)** | **2024** | **2023** |
| Lease revenue | **12,608** | 12,594 |
| Variable lease revenue | **3,688** | 3,584 |
| Service revenue | **3,699** | 3,696 |
| Amortization of tenant incentives (note 5) | **(959)** | (1,058) |
| Straight-line adjustments | **(131)** | 174 |
| | **18,905** | 18,990 |

## 14. FINANCE COSTS

The components of finance costs are as follows:

| | Three months ended March 31 | |
|---|---|---|
| **($000s)** | **2024** | **2023** |
| Interest on mortgages payable and revolving credit facility | **3,873** | 3,510 |
| Interest on Class C LP Units | **263** | 361 |
| Distributions on Class B LP Units | **645** | 1,935 |
| Interest on convertible debenture | **587** | 587 |
| Accretion on convertible debentures | **125** | 117 |
| Fair value adjustment on derivative instruments | **(620)** | 676 |
| Amortization of deferred financing fees | **280** | 353 |
| | **5,153** | 7,539 |

Total finance costs paid during the three-month period were $4,810 (2023 - $5,545).

## 15. RELATED PARTY TRANSACTIONS

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

### *a) Property and Asset Management Agreements*

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

| | Three months ended March 31 | |
|---|---|---|
| **($000s)** | **2024** | 2023 |
| ***Asset Management Agreement*** | | |
| Base Annual Management Fee | **472** | 474 |
| ***Property Management Agreement*** | | |
| Monthly Fee | **543** | 596 |
| Lease Fee | **318** | 161 |
| | **1,333** | 1,231 |

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. Lease Fees are capitalized to investment properties. As at March 31, 2024 there was $990 (December 31, 2023 - $988) 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, 2024, $645 in distributions were recorded on Class B LP Units held by Melcor (2023 - $1,935). These distributions were recorded as finance costs (note 14). As at March 31, 2024 there was $nil payable to Melcor as distributions were suspended during the quarter (December 31, 2023 - $645 for the December distribution).

Also during the three-month period ended March 31, 2024, Melcor, as holder of all Class C LP Units, was paid $667 to fund principal and interest payments on the retained debt (2023 - $948). These redemptions were recorded as a reduction of the Class C unit liability and as a finance cost (note 14).

### *c) Rental Revenue*

For the three-month period ended March 31, 2024 we collected $196 in rental revenue from Melcor and an affiliate for use of office space (2023 - $211). 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.

## 16. FINANCIAL RISK MANAGEMENT

The REIT's exposure to financial risks and how these risks could affect future financial performance is as follows:

### a) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents and accounts receivable measured at amortized cost and derivative financial asset measured at fair value. Our maximum exposure to credit risk is the carrying amount of these instruments.

We invest our cash and cash equivalents in bank accounts with major Canadian chartered banks. Accounts receivable balances include amounts due from tenants and various smaller amounts due from vendors. We manage our credit risk through careful selection of tenants and look to obtain national tenants or tenants in businesses with a long standing history, or perform financial background checks including business plan review for smaller tenants. We manage our concentration risk by renting to an expansive tenant base, with no dependency on rents from any one specific tenant.

For our accounts receivable, we apply the simplified credit loss approach, which requires us to recognize lifetime expected credit losses for all accounts receivable balances by applying an expected loss rate based on historical credit losses adjusted for current and forward looking information which may affect the ability of the customers to settle receivables. Accounts receivable have been grouped based on shared credit risk characteristics. At this time, based on current economic outlook management has assessed the current expected credit loss at $215 (2023 - $268).

Derivative instruments are with approved counter-party banks. Counter-parties are assessed prior to, during, and after the conclusion of the transactions to ensure exposure to credit risk is limited to an acceptable level.

### b) Liquidity Risk

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We manage liquidity risk to ensure that we have sufficient liquid financial resources to finance operations, meet long-term mortgage repayments, Class C LP Unit redemptions, convertible debenture payments and make monthly distributions on Class B LP Units and trust units when declared. We monitor rolling forecasts of our liquidity, which includes cash, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against capital requirements and maintain on-going debt financing plans. We believe that based on the cash flow models created by management we have access to sufficient liquidity through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

### c) Market Risk

We are subject to interest rate cash flow risk as our revolving credit facility bears interest at rates that vary in accordance with borrowing rates in Canada. For each 1% change in the rate of interest on our revolving credit facility the change in annual finance costs is approximately $376 (December 31, 2023 - $379). We are not subject to other significant market risks pertaining to our financial instruments with the exception of our Class B LP Units, which are carried at fair value based on the underlying market price of the REIT units (note 11).

## 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, accounts receivable, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.
- fair values of mortgages payable, Class C LP Units and interest rate swaps are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 3).
- fair value of the conversion features on our convertible debentures, is estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units and the fair value of convertible debenture is estimated based on the closing trading price of the REIT's debenture (Level 2).

In addition, the REIT carries its investment properties and assets held for sale at fair value which is determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows (Level 3).

The fair value hierarchy categorizes fair value measurement into three levels based upon the inputs to valuation technique, which are defined as follows:

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

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

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

| | | March 31, 2024 | | | | December 31, 2023 | |
|---|---|---|---|---|---|---|---|
| ($000s) | | Fair Value | Amortized Cost | Total Carrying Value | Total Fair Value | Total Carrying Value | Total Fair Value |
| ***Non-financial assets*** | | | | | | | |
| Investment properties | Level 3 | **614,038** | **—** | **614,038** | **614,038** | 629,993 | 629,993 |
| Assets held for sale | Level 3 | **41,577** | **—** | **41,577** | **41,577** | 33,774 | 33,774 |
| ***Financial liabilities*** | | | | | | | |
| Mortgages payable | Level 3 | **—** | **310,835** | **310,835** | **280,115** | 313,318 | 279,971 |
| Class B LP Units | Level 2 | **51,923** | **—** | **51,923** | **51,923** | 66,919 | 66,919 |
| Class C LP Units | Level 3 | **—** | **21,226** | **21,226** | **17,117** | 21,630 | 20,414 |
| Convertible debentures | Level 2 | **—** | **45,244** | **45,244** | **43,525** | 44,997 | 44,356 |
| ***Derivative financial liabilities*** | | | | | | | |
| Interest rate swaps | Level 3 | **348** | **—** | **348** | **348** | 580 | 580 |
| Conversion feature on convertible debentures | Level 3 | **176** | **—** | **176** | **176** | 154 | 154 |
| ***Derivative financial assets*** | | | | | | | |
| Interest rate swaps | Level 3 | **3,180** | **—** | **3,180** | **3,180** | 2,770 | 2,770 |

### *Investment properties*

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

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

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

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

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

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

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

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

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

Investment properties were valued by Melcor's internal valuation team as at March 31, 2024 of which 16 investment properties (of 52 legal phases valued) with a fair value of $141,350 were valued by qualified independent external valuation professionals during the period. Valuations performed during the three-month period resulted in fair value losses of $9,056. During the year ended December 31, 2023 Melcor's internal valuation team valued investment properties of which 18 investment properties (of 52 legal phases valued) with a fair value of $256,850 were valued by qualified independent external valuation professionals during the year. Valuations performed during the year ended December 31, 2023 resulted in fair value loss of $16,794.

Weighted average stabilized net operating income for investment properties is $1,653 (December 31, 2023 - $1,654) per property. 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, 2024** | | | December 31, 2023 | | |
|---|---|---|---|---|---|---|
| | **Min** | **Max** | **Weighted Average** | Min | Max | Weighted Average |
| Capitalization rate | 5.50% | 10.50% | 7.22% | 5.50% | 10.50% | 7.24% |
| Terminal capitalization rate | 6.00% | 9.25% | 7.30% | 6.00% | 9.25% | 7.31% |
| Discount rate | 6.75% | 10.25% | 8.18% | 6.75% | 10.25% | 8.19% |

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by approximately $44,300 (December 31, 2023 - $44,900). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by approximately $50,900 (December 31, 2023 - $51,500).

### *Non-derivative financial instruments*

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

### *Derivative financial instruments*

Our derivative financial instruments are comprised of floating for fixed interest rate swaps on certain mortgages (level 3) and the conversion features on our convertible debentures (level 3).

The fair value of the interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at March 31, 2024 the fair value of the interest rate swap asset is $3,180 (December 31, 2023 - $2,770) and liability of $348 (December 31, 2023 - $580).

The significant unobservable inputs used in the fair value measurement of the conversion features on the convertible debentures are volatility and credit spread. As at March 31, 2024, the fair value of the conversion feature on our convertible debentures was $176 liability (December 31, 2023 - $154 liability).

Valuations performed during the three-month period resulted in fair value gains of $620 (2023 - fair value loss of $676).

### *Class B LP Units*

Class B LP Units are remeasured to fair value on a recurring basis and categorized as Level 2 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, 2024 the fair value of the Class B LP Units was $51,923 (December 31, 2023 - $66,919), resulting in a fair value gains of $14,996 for the three-month period (December 31, 2023 - fair value gains of $22,253).