



MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2023

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2023

(Unaudited)

(\$000s)	March 31, 2023	December 31, 2022
ASSETS		
Current Assets		
Cash and cash equivalents	3,313	3,304
Restricted cash	—	1,000
Accounts receivable	2,590	2,079
Other assets (note 5)	825	956
Asset held for sale (note 4)	—	19,500
	6,728	26,839
Non-Current Assets		
Investment properties (note 4, 14 and 16)	671,149	672,010
Other assets (note 5)	28,737	28,172
Derivative financial asset (note 16)	2,964	3,748
	702,850	703,930
TOTAL ASSETS	709,578	730,769
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 6)	24,308	31,634
Accounts payable	1,725	2,216
Distribution payable	1,163	1,163
Accrued liabilities and other payables (note 7)	8,854	9,673
Class C LP Units (note 9)	26,182	26,657
Mortgages payable (note 8)	53,865	56,339
	116,097	127,682
Non-Current Liabilities		
Accrued liabilities and other payables (note 7)	1,863	1,809
Class B LP Units (note 10 and 16)	86,269	89,172
Class C LP Units (note 9)	11,029	11,141
Mortgages payable (note 8)	258,433	267,300
Convertible debentures	44,286	44,056
Derivative financial liabilities (note 16)	304	412
TOTAL LIABILITIES	518,281	541,572
UNITHOLDERS' EQUITY	191,297	189,197
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	709,578	730,769

See accompanying notes to the condensed interim consolidated financial statements.

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

For the three months ended March 31

(Unaudited)

(\$000s)	2023	2022
Rental revenue (note 12 and 14)	18,990	18,965
Direct operating expenses (note 14)	(8,352)	(8,009)
Net rental income	10,638	10,956
General and administrative expenses (note 14)	(779)	(788)
Fair value adjustment on investment properties (note 4 and 16)	(1,586)	(3,662)
Fair value adjustment on Class B LP Units (note 10 and 16)	2,903	(7,095)
Income (loss) before finance costs	11,176	(589)
Interest income	19	7
Finance costs (note 13 and 14)	(7,539)	(5,956)
Net finance costs	(7,520)	(5,949)
Net income (loss) and comprehensive income (loss)	3,656	(6,538)
Basic income (loss) per trust unit (note 11)	\$0.28	(\$0.50)
Diluted income (loss) per trust unit (note 11)	\$0.09	(\$0.50)

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, 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

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2021	12,966,993	116,652	41,588	7,594	165,834
Trust units repurchased (note 11)	(3,824)	(38)	13	—	(25)
Net loss for the period	—	—	—	(6,538)	(6,538)
Distributions to unitholders	—	—	—	(1,556)	(1,556)
Balance at March 31, 2022	12,963,169	116,614	41,601	(500)	157,715

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)	2023	2022
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income (loss) for the period	3,656	(6,538)
Non cash items:		
Amortization of tenant incentives (note 5 and 12)	1,058	901
Straight-line rent adjustments (note 12)	(174)	(2)
Fair value adjustment on investment properties (note 4 and 16)	1,586	3,662
Fair value adjustment on Class B LP Units (note 10 and 16)	(2,903)	7,095
Accretion on convertible debentures (note 13)	117	154
Fair value adjustment on derivative instruments (note 13 and 16)	676	(525)
Amortization of deferred financing fees (note 13)	353	351
	4,369	5,098
Payment of tenant incentives and direct leasing costs	(1,955)	(1,733)
Changes in operating assets and liabilities	(532)	928
	1,882	4,293
INVESTING ACTIVITIES		
Change in restricted cash (note 4)	1,000	—
Net proceeds from disposal of asset held for sale (note 4)	18,025	—
Investment in property improvements (note 4)	(191)	(217)
	18,834	(217)
FINANCING ACTIVITIES		
Repayment of revolving credit facility (note 6)	(7,270)	—
Proceeds from mortgages payable (note 8)	—	7,750
Repayment of mortgages payable	(11,294)	(9,017)
Repayment on Class C LP Units (note 9)	(587)	(611)
Units repurchased (note 11)	—	(25)
Distributions to unitholders	(1,556)	(1,556)
	(20,707)	(3,459)
INCREASE IN CASH & CASH EQUIVALENTS DURING THE PERIOD	9	617
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	3,304	7,255
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	3,313	7,872

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 14).

As at May 2, 2023, Melcor, through an affiliate, 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 50.2% 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") 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, 2022, which have been prepared in accordance with IFRS. These condensed interim consolidated financial statements were authorized for issue by the Board of Trustees on May 2, 2023.

3. SIGNIFICANT 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. There are no new or amended standards adopted during the quarter.

4. INVESTMENT PROPERTIES

(\$000s)	Three months ended March 31, 2023	Year ended December 31, 2022
Balance - beginning of period	672,010	699,142
Additions		
Property improvements	191	3,452
Direct leasing costs (note 14)	266	1,393
Fair value adjustment on investment properties (note 16)	(1,586)	(11,995)
Investment property classified as held for sale during the period	—	(19,089)
Other adjustments	268	(893)
Balance - end of period	671,149	672,010

In accordance with our policy we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized net operating income ("NOI"). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 16.

Presented separately from investment properties is \$20,331 (December 31, 2022 - \$19,940) in tenant incentives and \$8,406 (December 31, 2022 - \$8,232) in straight-line rent adjustments (note 5). The fair value of investment properties has been reduced by these amounts.

Disposition

On February 1, 2023, we disposed of an investment property classified as asset held for sale at year end for net proceeds of \$19,025 (including a \$1,000 deposit held as restricted cash at year end), resulting from a purchase price of \$19,500 less transaction costs of \$475.

This property was classified as asset held for sale at year end with a fair value of \$19,500 (including investment property of \$19,089, tenant incentives of \$316 and straight line rent of \$95). 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 our borrowings on our credit facility.

5. OTHER ASSETS

(\$000s)	March 31, 2023	December 31, 2022
Current Assets		
Prepaid expense, and other	825	956
Non-Current Assets		
Straight-line rent adjustments	8,406	8,232
Tenant incentives	20,331	19,940
	28,737	28,172

During the three-month period, we recorded tenant incentives of \$1,449 (2022 - \$3,292) and recorded \$1,058 (2022 - \$901) 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.

6. REVOLVING CREDIT FACILITY

On February 10, 2023, we entered into the fourth amendment to our revolving credit facility agreement with our existing lenders. 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 cashflows 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 swingline 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.

(\$000s)	March 31, 2023	December 31, 2022
Amount drawn on facility	24,427	31,697
Unamortized transaction fees	(119)	(63)
	24,308	31,634

7. ACCRUED LIABILITIES AND OTHER PAYABLES

(\$000s)	March 31, 2023	December 31, 2022
Current Liabilities		
Tenant security deposits and pre-payments	3,074	3,561
Accrued finance costs	1,340	778
Other accrued liabilities and payables	4,440	5,334
	8,854	9,673
Non-Current Liabilities		
Decommissioning obligation	1,863	1,809

8. MORTGAGES PAYABLE

(\$000s)	March 31, 2023	December 31, 2022
Mortgages amortized over 15-25 years at fixed interest rates	262,345	273,247
Mortgages amortized over 25 years at floating interest rate (fixed via floating for fixed interest rate swaps)	45,713	46,070
Mortgage amortized over 20 years at floating interest rate of prime plus 1%	5,841	5,876
Unamortized deferred financing fees	(1,601)	(1,554)
	312,298	323,639
Current portion of mortgages payable	(53,865)	(56,339)
	258,433	267,300
Interest rate ranges	2.62%-7.70%	2.62%-7.45%

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

(\$000s)	Three months ended March 31, 2023	Year ended December 31, 2022
Balance - beginning of period	323,639	335,830
Principal repayments:		
Scheduled amortization on mortgages	(2,567)	(10,792)
Mortgage repayments	(8,727)	(11,805)
Mortgage amendment	—	(893)
New mortgages	—	11,049
Deferred financing fees	(287)	(249)
Amortization of deferred financing fees	240	499
Balance - end of period	312,298	323,639

9. 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, 2023	December 31, 2022
Class C LP Units amortized over 15-25 years at fixed interest rates	37,211	37,798
Current portion of Class C LP Units	(26,182)	(26,657)
	11,029	11,141
Weighted average interest rate	3.89 %	3.89%

As at March 31, 2023 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2022 - 10,785,613).

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

(\$000s)	Three months ended March 31, 2023	Year ended December 31, 2022
Balance - beginning of period	37,798	40,160
Principal repayments:		
Scheduled amortization on Class C LP Units	(587)	(2,362)
Balance - end of period	37,211	37,798

10. 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, 2023 and recognized a fair value gain of \$2,903 during the three-month period (2022 - fair value loss of \$7,095). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 16.

At March 31, 2023 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of \$5.35 per unit or \$86,269 (December 31, 2022 - 16,125,147 at \$5.53 per unit or \$89,172).

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

	Three months ended March 31, 2023		Year ended December 31, 2022	
	# of units	(\$000's)	# of units	(\$000's)
Balance - beginning of period	16,125,147	89,172	16,125,147	109,490
Fair value adjustment on Class B LP Units (note 16)	—	(2,903)	—	(20,318)
Balance - end of period	16,125,147	86,269	16,125,147	89,172

11. UNITHOLDERS' EQUITY

On April 1, 2021 we commenced a normal course issuer bid ("NCIB") which allowed the REIT to purchase up to 652,525 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units, up to maximum daily limit of 3,824. The price which the REIT paid for trust units repurchased under the plan were the market price at the time of acquisition. The NCIB ended on March 31, 2022.

During the quarter, we did not have an active NCIB. In the comparative period, we purchased 3,824 units at a cost of \$25, pursuant to the NCIB prior to its expiration (trust units were reduced by \$38 and contributed surplus increased by \$13).

At March 31, 2023, our issued and outstanding trust units were 12,963,169 (December 31, 2022 - 12,963,169).

(\$000's except unit and per unit amounts)	Three months ended March 31,	
	2023	2022
Net income (loss) - basic	3,656	(6,538)
Impact of Class B LP Units fair value adjustment and distributions*	(967)	—
Impact of convertible debentures interest, fair value adjustment, amortization and accretion*	—	—
Net income (loss) - diluted	2,689	(6,538)
Basic weighted average trust units outstanding	12,963,169	12,986,885
Impact of conversion of Class B LP Units*	16,125,147	—
Impact of conversion of convertible debentures*	—	—
Diluted weighted average trust units outstanding	29,088,316	12,986,885
Basic income (loss) per trust unit	\$0.28	(\$0.50)
Diluted income (loss) per trust unit*	\$0.09	(\$0.50)

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

12. RENTAL REVENUE

The components of rental revenue are as follows:

(\$000s)	Three months ended March 31,	
	2023	2022
Lease revenue	12,594	12,869
Variable lease revenue	3,584	3,592
Service revenue	3,696	3,403
Amortization of tenant incentives (note 5)	(1,058)	(901)
Straight-line adjustments	174	2
	18,990	18,965

13. FINANCE COSTS

The components of finance costs are as follows:

(\$000s)	Three months ended March 31,	
	2023	2022
Interest on mortgages payable and revolving credit facility	3,510	2,849
Interest on Class C LP Units	361	304
Distributions on Class B LP Units	1,935	1,935
Interest on convertible debenture	587	888
Accretion on convertible debentures	117	154
Fair value adjustment on derivative instruments	676	(525)
Amortization of deferred financing fees	353	351
	7,539	5,956

Total finance costs paid during the three-month period were \$5,545 (2022 - \$5,011).

14. 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:

(\$000s)	Three months ended March 31,	
	2023	2022
<i>Asset Management Agreement</i>		
Base Annual Management Fee	474	479
<i>Property Management Agreement</i>		
Monthly Fee	596	549
Lease Fee	161	469
	1,231	1,497

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, 2023 there was \$725 (December 31, 2022 - \$672) 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, 2023, \$1,935 in declared distributions were recorded on Class B LP Units held by Melcor (2022 - \$1,935). These distributions were recorded as finance costs (note 13). As at March 31, 2023 there was \$645 payable to Melcor for the March distributions (December 31, 2022 - \$645 for the December distribution).

Also during the three-month period ended March 31, 2023, Melcor, as holder of all Class C LP Units, was paid \$948 to fund principal and interest payments on the retained debt (2022 - \$915).

c) *Rental Revenue*

For the three-month period ended March 31, 2023 we collected \$211 in rental revenue from Melcor and an affiliate for use of office space (2022 - \$207). 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.

15. 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 receivables 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 receivables 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 \$191 (2022 - \$256).

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. 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 and certain mortgages 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 and certain mortgages the change in annual finance costs is approximately \$303 (December 31, 2022 - \$376). 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 10).

16. FAIR VALUE MEASUREMENT

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

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

- the carrying amounts of cash and cash equivalents, 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 derivative financial liabilities, the conversion features on our convertible debentures, are estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units and the fair value of convertible debenture is estimated based on the closing trading price of the REIT's debenture (Level 2).

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

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

- Level 1: 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, 2023				December 31, 2022	
		Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
(\$000s)							
Non-financial assets							
Investment properties	Level 3	671,149	—	671,149	671,149	672,010	672,010
Asset held for sale	Level 3	—	—	—	—	19,500	19,500
Financial liabilities							
Mortgages payable	Level 3	—	312,298	312,298	287,777	323,639	298,549
Class B LP Units	Level 2	86,269	—	86,269	86,269	89,172	89,172
Class C LP Units	Level 3	—	37,211	37,211	33,906	37,798	36,756
Convertible debentures	Level 2	—	44,286	44,286	42,600	44,056	41,011
Derivative financial liabilities							
Conversion feature on convertible debentures	Level 3	304	—	304	304	412	412
Derivative financial assets							
Interest rate swaps	Level 3	2,964	—	2,964	2,964	3,748	3,748

Investment properties

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

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

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

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

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

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

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

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

Investment properties were valued by Melcor's internal valuation team as at March 31, 2023 of which one investment property (of 52 legal phases valued) with a fair value of \$33,800 was valued by qualified independent external valuation professionals during the period. Valuations performed during the three-month period resulted in fair value losses of \$1,586. During the year ended December 31, 2022 Melcor's internal valuation team valued investment properties of which 44 investment properties (of 53 legal phases valued) with a fair value of \$578,350 were valued by qualified independent external valuation professionals during the year. Valuations performed during the year ended December 31, 2022 resulted in fair value loss of \$11,995.

Weighted average stabilized net operating income for investment properties is \$1,621 (December 31, 2022 - \$1,613) 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, 2023			December 31, 2022		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.00%	7.11%	5.50%	10.00%	7.08%
Terminal capitalization rate	6.00%	8.75%	7.18%	6.00%	8.75%	7.16%
Discount rate	6.75%	9.75%	8.08%	6.25%	9.75%	8.04%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by approximately \$46,100 (December 31, 2022 - \$47,300). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by approximately \$53,100 (December 31, 2022 - \$54,500).

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 two of our 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, 2023 the fair value of the interest rate swap asset is \$2,964 (December 31, 2022 - \$3,748).

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, 2023, the fair value of the conversion feature on our convertible debentures was \$304 liability (December 31, 2022 - \$412 liability).

Valuations performed during the three-month period resulted in fair value losses of \$676 (2021 - fair value gains of \$525).

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, 2023 the fair value of the Class B LP Units was \$86,269, resulting in a fair value gains of \$2,903 for the three-month period (December 31, 2022 - fair value gains of \$20,318).

17. SUBSEQUENT EVENTS

Distributions

On April 14, 2023, we declared the following distributions:

Month	Record Date	Distribution Date	Distribution Amount
April 2023	April 28, 2023	May 15, 2023	\$0.04 per unit
May 2023	May 31, 2023	June 15, 2023	\$0.04 per unit
June 2023	June 30, 2023	July 14, 2023	\$0.04 per unit