

Management's Responsibility for Financial Reporting

The consolidated financial statements, management's discussion and analysis (MD&A) and all financial information contained in the annual report are the responsibility of management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, have incorporated estimates based on the best judgment of management.

To discharge its responsibility for financial reporting, management is responsible for implementing and maintaining adequate internal controls to provide reasonable assurance that the Trust's assets are safeguarded, that transactions are properly authorized and that reliable financial information is relevant, accurate and available on a timely basis.

The consolidated financial statements have been examined by PricewaterhouseCoopers LLP, the Trust's external auditors. The external auditors are responsible for examining the consolidated financial statements and expressing their opinion on the fairness of the financial statements in accordance with International Financial Reporting Standards. The auditor's report outlines the scope of their audit examination and states their opinion.

The Board of Trustees, through the Audit Committee, is responsible for ensuring management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee is comprised of three financially literate and independent directors. This committee meets regularly with management and the external auditors to review significant accounting, financial reporting and internal control matters. PricewaterhouseCoopers LLP have unrestricted access to the Audit Committee with and without the presence of management. The Audit Committee reviews the financial statements, the auditor's report, and MD&A and submits its report to the board of trustees for formal approval. The Audit Committee is also responsible for reviewing and recommending the annual appointment of external auditors and approving the external audit plan. These consolidated financial statements and Management's Discussion and Analysis have been approved by the Board of Trustees for inclusion in the Annual Report based on the review and recommendation of the Audit Committee.



Andrew Melton
Chief Executive Officer



Naomi Stefura, CA
Executive Vice President and Chief Financial Officer

Edmonton, Alberta
March 3, 2022



Independent auditor's report

To the Unitholders of Melcor Real Estate Investment Trust

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Melcor Real Estate Investment Trust and its subsidiaries (together, the REIT) as at December 31, 2021 and 2020, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The REIT's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2021 and 2020;
- the consolidated statements of (loss) income and comprehensive (loss) income for the years then ended;
- the consolidated statements of changes in unitholders' equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the REIT in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2021. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

PricewaterhouseCoopers LLP
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Key audit matter

How our audit addressed the key audit matter

Valuation of investment properties

Refer to note 3 – Significant accounting policies, note 4 – Significant judgments and critical accounting estimates, note 6 – Investment properties and note 25 – Fair value measurement to the consolidated financial statements.

The REIT measures its investment properties at fair value and as at December 31, 2021, these assets were valued at \$699 million. The fair values of investment properties are determined by management based on the valuation methods of direct income capitalization or discounted future 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. Under the discounted future cash flows method, the forecasted future cash flows of each property are projected over ten years, a terminal value is applied and the cash flows are discounted using an appropriate discount rate. Investment properties were valued by Melcor Development Ltd.'s internal valuation team as at December 31, 2021 of which ten investment properties with a fair value of \$130 million were valued with the assistance of qualified independent external valuation professionals. At least once every two years, the valuations are performed by qualified external valuation professionals.

The significant assumptions made in the valuation methods include stabilized net operating income, capitalization rates, discount rates, terminal capitalization rates and forecasted future cash flows, which involve assumptions of future rental income, including estimated market rental rates, vacancy rates and estimated direct operating costs. In determining the fair value of investment properties, significant judgment is required by management.

We considered this a key audit matter due to significant judgments made by management when determining the fair values of the investment

Our approach to addressing the matter included the following procedures, among others:

- Tested the design and operating effectiveness of internal controls related to the valuation of investment properties, including management's review of the significant assumptions used in the direct income capitalization method and discounted future cash flows method.
- For a sample of investment properties, tested how management determined the fair value based on the valuation methods of direct income capitalization or discounted future cash flows, which included the following:
 - Evaluated the appropriateness of the valuation methods used by management.
 - Tested the underlying data used in the methods.
 - Evaluated whether stabilized net operating income, changes in stabilized net operating income compared to the prior year independent external valuations and forecasted future cash flows, including assumptions related to future rental income and estimated direct operating costs, were reasonable, by considering the approved budget, and the current and past performance of the property, as applicable.
 - Evaluated the reasonability of changes in the capitalization rates compared to the prior year independent external valuations by considering available third party published economic data relevant to the property.
 - Professionals with specialized skill and knowledge in the field of real estate valuations further assisted us in assessing the appropriateness of the methods and evaluating the reasonableness of the discount rates, capitalization rates, terminal capitalization rates, estimated market rental



Key audit matter	How our audit addressed the key audit matter
properties and a high degree of complexity in assessing audit evidence related to the significant assumptions made by management. In addition, the audit effort involved the use of professionals with specialized skill and knowledge in the field of real estate valuations.	rates and vacancy rates.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.



In preparing the consolidated financial statements, management is responsible for assessing the REIT's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the REIT or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the REIT's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the REIT's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the REIT's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the REIT to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the REIT to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Gordon R. Keiller.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Edmonton, Alberta
March 3, 2022



MELCOR REAL ESTATE INVESTMENT TRUST

Consolidated Financial Statements

December 31, 2021

Consolidated Statements of Financial Position

As at December 31

(\$000s)	2021	2020
ASSETS		
Current Assets		
Cash and cash equivalents	7,255	3,744
Accounts receivable (note 24(a))	1,996	2,768
Other assets (note 7)	1,971	1,790
	11,222	8,302
Non-Current Assets		
Investment properties (note 6 and 25)	699,142	692,991
Other assets (note 7)	24,587	23,301
Derivative financial assets (note 10, 12 and 25)	717	64
	724,446	716,356
TOTAL ASSETS	735,668	724,658
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 8)	—	9,986
Accounts payable	1,566	1,958
Distribution payable	1,164	875
Accrued liabilities and other payables (note 9 and 19)	8,805	8,518
Class C LP Units (note 11)	14,084	28,932
Mortgages payable (note 10)	36,996	50,269
Convertible debentures (note 12)	22,458	—
	85,073	100,538
Non-Current Liabilities		
Accrued liabilities and other payables (note 9)	1,774	1,706
Class B LP Units (note 13 and 25)	109,490	77,884
Class C LP Units (note 11)	26,076	27,148
Mortgages payable (note 10)	298,834	262,728
Convertible debentures (note 12)	43,179	64,339
Derivative financial liabilities (note 10, 12 and 25)	5,408	1,908
TOTAL LIABILITIES	569,834	536,251
UNITHOLDERS' EQUITY	165,834	188,407
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	735,668	724,658

See accompanying notes to the consolidated financial statements.

By order of the REIT's Board of Trustees



Carolyn Graham - Audit Committee Chair



Ralph Young - Chair

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

For the years ended December 31

(\$000s)	2021	2020
Rental revenue (note 15 and 19)	74,094	74,572
Direct operating expenses (note 19)	(30,340)	(31,240)
Net rental income	43,754	43,332
General and administrative expenses (note 19)	(2,953)	(3,043)
Fair value adjustment on investment properties (note 6 and 25)	2,879	(62,748)
Fair value adjustment on Class B LP Units (note 13 and 25)	(31,606)	53,052
Income before finance costs	12,074	30,593
Interest income	30	72
Finance costs (note 16 and 19)	(28,391)	(24,902)
Net finance costs	(28,361)	(24,830)
Net (loss) income and comprehensive (loss) income	(16,287)	5,763
Basic (loss) earnings per trust unit (note 18)	(\$1.25)	\$0.44
Diluted loss per trust unit (note 18)	(\$1.25)	(\$1.38)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Unitholders' Equity

As at December 31

<i>(\$000s except unit amounts)</i>	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2019	13,133,293	118,291	40,793	29,635	188,719
Trust units repurchased (note 14)	(82,790)	(818)	482	—	(336)
Net income for the year	—	—	—	5,763	5,763
Distributions to unitholders	—	—	—	(5,739)	(5,739)
Balance at December 31, 2020	13,050,503	117,473	41,275	29,659	188,407
Trust units repurchased (note 14)	(85,683)	(846)	313	—	(533)
Issuance of trust units (note 14)	2,173	25	—	—	25
Net loss for the year	—	—	—	(16,287)	(16,287)
Distributions to unitholders	—	—	—	(5,778)	(5,778)
Balance at December 31, 2021	12,966,993	116,652	41,588	7,594	165,834

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended December 31

(\$000s)	2021	2020
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net (loss) income for the year	(16,287)	5,763
Non cash items:		
Amortization of tenant incentives (note 7 and 15)	4,218	3,779
Straight-line rent adjustments (note 15)	(208)	(655)
Fair value adjustment on investment properties (note 6 and 25)	(2,879)	62,748
Fair value adjustment on Class B LP Units (note 13 and 25)	31,606	(53,052)
Amortization of fair value adjustment on Class C LP Units (note 16)	—	(98)
Accretion on convertible debenture (note 16)	588	553
Fair value adjustment on derivative financial instruments (note 16)	2,847	(1,063)
Amortization of deferred financing fees (note 16)	1,363	1,167
	21,248	19,142
Payment of tenant incentives and direct leasing costs	(6,130)	(5,566)
Changes in operating assets and liabilities (note 3(n))	(237)	210
	14,881	13,786
INVESTING ACTIVITIES		
Investment property improvements (note 6)	(2,322)	(1,473)
Proceeds on loan receivable	—	900
	(2,322)	(573)
FINANCING ACTIVITIES		
Change in revolving credit facility	(10,000)	(13,025)
Proceeds from mortgages payable (note 10)	74,292	32,890
Repayment of mortgages payable	(51,236)	(12,548)
Repayment on Class C LP Units	(15,920)	(12,643)
Units repurchased (note 14)	(533)	(336)
Distributions to unitholders	(5,651)	(6,087)
	(9,048)	(11,749)
INCREASE IN CASH & CASH EQUIVALENTS DURING THE YEAR	3,511	1,464
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	3,744	2,280
CASH AND CASH EQUIVALENTS, END OF THE YEAR	7,255	3,744

See accompanying notes to the consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

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.

The principal business of the REIT is to acquire, own and manage office, retail and industrial properties in select markets across 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 (see note 19).

As at March 3, 2022, 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”) 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 consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

These consolidated financial statements are presented in Canadian dollars, which is the presentation and functional currency of the REIT; and were authorized for issue by the Board of Trustees on March 3, 2022.

3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

a) Basis of measurement

These consolidated financial statements have been prepared under the historical cost convention, except for investment properties, Class B LP Units and derivative financial instruments which are measured at fair value.

We prepare our consolidated financial statements in conformity with IFRS which requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Changes in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions change. We believe that the underlying assumptions are appropriate. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

b) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the REIT. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. These consolidated financial statements include the accounts of the REIT and its subsidiaries, its controlled partnership Melcor REIT Limited Partnership (the “Partnership”), and its general partner, Melcor REIT GP Inc.

Joint arrangements

These arrangements are undivided interests in the assets, liabilities, revenues and expenses under arrangement and we record our proportionate share in accordance with the agreements as joint operations. These consolidated financial statements include investments in three joint arrangements (2020 – three) with 50% interests. Refer to note 20 for additional details on our joint arrangements.

All intercompany transactions and balances are eliminated on consolidation.

c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

d) Investment properties

Investment properties include office, retail and industrial properties, and a manufactured home community held for the long term to earn rental income or for capital appreciation, or both. It also includes property under development for future use as investment properties.

Acquired investment properties are measured initially at cost, including transaction costs associated with the acquisition when the acquisition is accounted for as an asset purchase. Costs capitalized to properties under development include direct development and construction costs, borrowing costs, and property taxes.

After initial recognition, investment properties are recorded at fair value, determined based on the valuation methods of direct income capitalization or discounted future cash flows.

The REIT's management company, Melcor Developments Ltd. ("Melcor") is responsible for determining the fair value of investment properties quarterly. Melcor has an internal valuation team consisting of individuals who are knowledgeable and have experience in the fair value techniques applied in valuing investment property. 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 properties being valued. The quarterly valuations, including significant assumptions, are reviewed by the REIT's Chief Executive Officer and Chief Financial Officer and are discussed with the REIT's Audit Committee prior to being finalized.

Changes in fair value are recognized in the consolidated statements of income and comprehensive income in the period in which they arise.

Fair value measurement of an investment property under development is only applied if the fair value is considered to be reliably measurable. In rare circumstances, investment property under development is carried at cost until its fair value becomes reliably measurable. It may sometimes be difficult to determine reliably the fair value of an investment property under development. In order to evaluate whether the fair value of an investment property under development can be determined reliably, management considers the following factors, among others:

- the provisions of the construction contract;
- the stage of completion;
- whether the project or property is standard (typical for the market) or non-standard;
- the level of reliability of cash inflows after completion;
- the development risk specific to the property;
- past experience with similar construction; and
- status of construction permits.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to the REIT and the cost of the item can be measured reliably. All repairs and maintenance costs are expensed when incurred.

Initial direct leasing costs incurred in negotiating and arranging tenant leases are added to the carrying amount of investment properties. All direct leasing costs are external expenditures, including those charged under the Property Management Agreement with Melcor (note 19), and no amounts for internal allocations are capitalized with respect to the negotiation or arranging of tenant leases.

e) Other assets

Other assets include prepaid expenses, deposits, straight-line rent adjustments and tenant incentives incurred in respect of new or renewed leases. Tenant incentives are amortized on a straight-line basis over the lease term and are recorded as a reduction of revenue.

f) Provision for decommissioning obligation

Decommissioning obligations are measured at the present value of the expected cost to settle the obligation. A corresponding decommissioning cost is added to the carrying amount of the associated investment property. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows as well as any changes in the discount rate. Actual costs incurred upon settlement of the decommissioning obligation are recorded against the provision.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

g) Class B LP Units

The Class B LP Units are exchangeable into trust units at the option of the holder and, therefore, are considered a puttable instrument in accordance with International Accounting Standard (“IAS”) 32, Financial instruments — presentation (“IAS 32”). The Class B LP Units, as puttable instruments, are required to be accounted for as financial liabilities. The Class B LP Units are designated as fair value through profit or loss financial liabilities and are remeasured to fair value at each period end date based on the trading price of the trust units at the period end date with any changes in fair value recognized in the consolidated statements of income and comprehensive income. Distributions declared on Class B LP Units are recorded as finance costs in the consolidated statement of income and comprehensive income.

h) Unit capital

The trust units are redeemable at the option of the holders and, therefore, are considered a puttable instrument in accordance with IAS 32. Puttable instruments are required to be accounted for as financial liabilities, except where certain conditions are met in accordance with IAS 32, in which case, the puttable instruments may be presented as equity. The trust units meet the conditions of IAS 32 and are, therefore, classified and accounted for as equity.

i) Distributions

Distributions to unitholders are recognized as a liability in the period in which the distributions are approved by the Board of Trustees and are recorded as a reduction of retained earnings.

j) Recognition of revenue

Tenant leases are accounted for as operating leases given that we have retained substantially all of the risks and benefits of the ownership of our investment properties.

Rental revenues include both lease revenue and service revenue components. Lease revenues from investment properties include base rents, recoveries of operating expenses including property taxes, parking revenue, incidental income and sign and storage lease revenue. Revenue recognition under a lease commences when the tenant has a right to use the leased asset. The total amount of contractual rent to be received from the operating leases is recognized on a straight line basis over the term of the lease; a straight line rent receivable which is included in other assets, is recorded for the difference between the rental revenue recognized and the contractual amount received. When incentives are provided to our tenants, the cost of these incentives is recognized over the lease term, on a straight line basis as a reduction to rental revenue.

Service revenues are amounts outlined separately in the lease agreement for distinct services provided including utilities, maintenance and security recoveries from tenants which are recognized on a monthly basis in the period in which the corresponding costs are incurred and performance obligations are completed.

k) Finance costs

Finance costs are comprised of interest expense on mortgages, interest and other finance fees on our revolving credit facility, interest on Class C LP Units, amortization of fair value adjustment on Class C LP Units, distributions on Class B LP Units, interest on convertible debentures, accretion on convertible debentures, fair value adjustment on derivative financial instruments and amortization of deferred financing fees. Borrowing costs are recognized in income using the effective interest rate method.

l) Income taxes

The REIT qualifies as a mutual fund trust within the meaning of the Income Tax Act (Canada) (“Tax Act”) and as a real estate investment trust eligible for the ‘REIT Exception’, as defined in the rules applicable to Specified Investment Flow-Through (“SIFT”) trusts and partnerships in the Tax Act. We expect to allocate all taxable income and to continue to qualify for the REIT Exception. Accordingly, no income tax expense or deferred income tax assets or liabilities have been recorded in these consolidated financial statements subsequent to the formation of the REIT.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

m) Financial instruments

At initial recognition, we classify our financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Financial assets

Financial assets that are held for collection of contractual cash flows represent solely payments of principal and interest are measured at amortized cost. This includes cash and cash equivalents and accounts receivable. Financial assets are initially recognized at fair value plus transaction costs, adjusted for an expected credit loss.

Subsequent to initial recognition, receivables are measured at amortized cost using the effective interest rate method adjusted for expected credit losses. For financial assets, the REIT applies the simplified expected credit loss approach, which requires expected lifetime losses to be recognized from initial recognition.

Financial assets are derecognized only when the contractual rights to the cash flows from the financial asset expire or the REIT transfers substantially all risks and rewards of ownership. From time to time the REIT may agree with tenants to modify the terms of lease agreements, including changes to the consideration under the lease. When the changes result in a reduction in amounts receivable relating to past lease periods, the REIT applies IFRS 9, in determining whether to partially or fully derecognize those receivables.

Financial liabilities

We record our financial liabilities at fair value on initial recognition. Subsequently, financial liabilities are measured at amortized cost using the effective interest rate method and financial liabilities designated as fair value through profit or loss ("FVTPL") are remeasured at fair value with changes in their fair value recorded through income. Financial liabilities measured at amortized cost include the revolving credit facility, accounts payable, distribution payable, mortgages payable, and Class C LP Units. Class B LP Units are classified as FVTPL.

Compound financial instrument

Our compound financial instrument is comprised of convertible debentures that can be converted to trust units at the option of the holder, and the number of units to be issued does not vary with changes in their fair value. We also have the ability to redeem the debentures at a price equal to the principal amount thereof plus accrued and unpaid interest. We also have the ability to convert the debentures into trust units; however, the number of units to be issued at conversion varies with the market price of the units.

On initial recognition, convertible debentures are separated into two financial liability components: the host instrument and the conversion feature. The conversion feature is required to be presented as a financial liability as the feature permits the holder to convert the debenture into trust units that, except for the available exemption under IAS 32, would normally be presented as a liability due to their redemption feature. Both components are measured based on their respective estimated fair values at the date of issuance. The host instrument financial liability is recognized initially at the fair value of a similar liability that does not have a conversion feature. The conversion feature is recognized at fair value. The fair value of the host instrument is recorded net of any related transaction costs.

Subsequent to initial recognition, the host instrument is measured at amortized cost using the effective interest method. The conversion feature derivative of the convertible debenture is classified as FVTPL and measured at fair value.

Financial derivatives

Our financial derivatives are comprised of the conversion features on our convertible debentures and interest rate swaps on two of our mortgages. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and subsequently remeasured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Derivative instruments are recorded in the consolidated statement of financial position at their fair value. Changes in fair value of derivative instruments that are not designated as hedges for accounting purposes are recognized in the consolidated statement of income and comprehensive income.

The REIT has not designated any derivatives as hedges for accounting purposes.

n) Statements of cash flows

Operating assets and liabilities is defined as the net change of accounts receivable, prepaid expense, and other, accounts payable, distribution payable, accrued liabilities and other payables, deferred interest payments and deferred finance fees capitalized during the year. Excluded from operating assets and liabilities are investment property additions and tenant incentive payments that are unpaid and included in accounts payable at year end.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

4. SIGNIFICANT JUDGMENTS AND CRITICAL ACCOUNTING ESTIMATES

Estimates and judgments are continually evaluated and are based on historical experience as adjusted for current market conditions and other factors.

Significant judgments

In the process of applying our accounting policies, we make various judgments, apart from those involving estimations, that can significantly impact the amounts recognized in the consolidated financial statements. These include:

a) Investment properties

Our accounting policies related to investment properties are described in note 3(d). In applying this policy, judgment is required in determining whether certain costs are additions to the carrying amount of an investment property.

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

b) Classification of tenant incentives

Payments are often made to, or on behalf of, tenants of our commercial properties when new leases are signed. When the payments add future value to the space independent of the lease in place, such costs are capitalized to the investment property. If the costs incurred are specific to the lessee, and do not have stand-alone value, these costs are treated as tenant incentives and amortized on a straight-line basis to revenue over the lease term in accordance with IFRS 16, Leases.

c) Compliance with REIT exemption under ITA

Under current tax legislation, a real estate investment trust is not liable for Canadian income taxes provided that its taxable income is fully allocated to unitholders during the year. In order to continue to be taxed as a mutual fund trust, we need to maintain our REIT status. At inception, we qualify as a REIT under the specified investment flow-through ("SIFT") rules in the Income Tax Act (Canada). The REIT's current and continuing qualification as a REIT depends on our ability to meet the various requirements imposed under the SIFT rules, which relate to matters such as our organizational structure and the nature of our assets and revenues. We apply judgment in determining whether we continue to qualify as a REIT under the SIFT rules. Should we cease to qualify, we would be subject to income tax on our earnings and would reflect current and deferred tax balances on our consolidated financial statements.

Critical accounting estimates

We make estimates and assumptions that affect the carrying amounts of assets and liabilities, disclosure of contingent liabilities and the reported amount of income for the period. Actual results could differ from estimates previously reported. The estimates and assumptions that are critical to the determination of the amounts reported in the consolidated financial statements relate to the following:

a) Valuation of investment properties

The fair value of investment properties is dependent on stabilized net operating income or forecasted future cash flows and property specific capitalization or discount rates. The stabilized net operating income or forecasted future cash flows involve assumptions of future rental income, including estimated market rental rates and vacancy rates, estimated direct operating costs and estimated capital expenditures. Capitalization and discount rates take into account the location, size and quality of the property, as well as market data at the valuation date. The significant economic uncertainty resulting from COVID-19 has impacted the availability of reliable market metrics. Accordingly, the REIT has made estimates of stabilized net operating income or forecasted future cash flows and capitalization and discount rates based on the best information available. The impact of COVID-19 will continue to be considered and monitored when determining the fair value of investment properties. Due to the uncertainty of the situation, estimates could be subject to changes and such changes may be material. Refer to note 6 and 25 for further information about methods and assumptions used in determining fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

5. NEW STANDARDS

NEW AND AMENDED STANDARDS NOT YET ADOPTED

IAS 37, Provisions, contingent liabilities and contingent assets amendments were made to IAS 37, Provisions, contingent liabilities and contingent assets in order to clarify (i) the meaning of "costs to fulfil a contract", and (ii) that, before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets used in fulfilling the contract, rather than on assets dedicated to that contract.

IAS 37 is required to be applied for annual periods beginning on or after January 1, 2022. We are currently evaluating the impact of this standard on our financial statements.

IAS 1, Presentation of financial statements amendments were made to IAS 1, Presentation of financial statements in order to clarify how to classify debt and other liabilities as either current or non-current.

IAS 1 is required to be applied for annual periods beginning on or after January 1, 2023. We are currently evaluating the impact of this standard on our financial statements.

6. INVESTMENT PROPERTIES

(\$000s)	2021	2020
Balance - beginning of year	692,991	753,483
Additions		
Property improvements	2,322	1,473
Direct leasing costs	950	783
Fair value adjustment on investment properties (note 25)	2,879	(62,748)
Balance - end of year	699,142	692,991

In accordance with our policy, as detailed in note 3(d), 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"). Due to the uncertainty of the economic environment as a result of COVID-19, fair value estimates could be subject to significant changes and such changes could be material. Supplemental information on fair value measurement, including valuation techniques and significant assumptions, is included in note 25.

Presented separately from investment properties is \$16,711 (December 31, 2020 - \$15,633) in tenant incentives and \$7,876 (December 31, 2020 - \$7,668) in straight-line rent adjustments (note 7). The fair value of investment properties has been reduced by these amounts.

Our investment properties are leased to tenants primarily under long term operating leases. Rent is receivable from tenants monthly. Minimum lease payments under non-cancellable operating leases of investment properties are receivable as follows:

(\$000s)	2021	2020
Within one year	45,547	46,364
Later than one year but not later than 2 years	40,597	42,214
Later than 2 years but not later than 3 years	34,275	35,458
Later than 3 years but not later than 4 years	27,529	28,346
Later than 4 years but not later than 5 years	19,771	21,341
Later than 5 years	54,082	55,732
	221,801	229,455

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In \$000s except unit and per unit amounts)

7. OTHER ASSETS

(\$000s)	2021	2020
Current Assets		
Prepaid expense and other	1,971	1,790
Non-Current Assets		
Straight-line rent adjustments	7,876	7,668
Tenant incentives	16,711	15,633
	24,587	23,301

During the year we recorded tenant incentives of \$5,296 (December 31, 2020 - \$3,696) and \$4,218 (December 31, 2020 - \$3,779) 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.

8. REVOLVING CREDIT FACILITY

On June 1, 2021 we entered into the third amendment to our revolving credit facility agreement with our existing lenders. Under the terms of the amending agreement the REIT maintains an available credit limit based upon the carrying value of specific investment properties to a maximum of \$35,000 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 new facility. The facility matures June 1, 2024. Unamortized transaction fees of \$106 are included in other assets.

As at December 31, 2021, the carrying value of pledged properties was \$62,100 (December 31, 2020 - \$61,804).

As at December 31, 2021 we had \$nil (December 31, 2020 - \$9,986) drawn from the facility (net of unamortized transaction fees and unamortized discount on bankers acceptance); and posted letters of credit of \$nil (December 31, 2020 - \$nil).

(\$000s)	2021	2020
Amount drawn on facility	—	10,000
Unamortized transaction fees	—	(14)
	—	9,986

9. ACCRUED LIABILITIES AND OTHER PAYABLES

(\$000s)	2021	2020
Current Liabilities		
Tenant security deposits and pre-payments	3,403	3,097
Accrued finance costs	757	765
Other accrued liabilities and payables	4,645	4,656
	8,805	8,518
Non-Current Liabilities		
Decommissioning obligation	1,774	1,706

The REIT's decommissioning obligation relates to one of our commercial properties. The total decommissioning obligation is estimated based on the future obligation and timing of these expenditures to be incurred. We estimate the net present value of the obligation based on an undiscounted total future provision of \$2,014 (December 31, 2020 - \$2,014). At December 31, 2021, a discount rate of 4.00% (December 31, 2020 - 4.00%) and an inflation rate of 2.00% (December 31, 2020 - 2.00%) were

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used to calculate the net present value of the obligation. Due to uncertainty surrounding the nature and timing of this obligation amounts are subject to change.

10. MORTGAGES PAYABLE

(\$000s)	2021	2020
Mortgages amortized over 15-25 years at fixed interest rates	303,711	293,695
Mortgages amortized over 25 years at a fixed interest rate (via floating for fixed interest rate swaps)	33,923	20,443
Mortgage with interest only payments at floating interest rate of prime plus 1%	—	440
Unamortized deferred financing fees	(1,804)	(1,581)
	335,830	312,997
Current portion of mortgages payable	(36,996)	(50,269)
	298,834	262,728
Interest rate ranges	(2.62%-4.20%)	(2.58%-4.20%)

Specific investment properties with a carrying value of \$575,532 (December 31, 2020 - \$534,602) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above mortgages. The weighted average effective interest rate for the above mortgages, based on period end balances, is 3.35% (December 31, 2020 - 3.42%).

The minimum contractual principal payments due within each of the next five years and thereafter are as follows:

(\$000s)	Principal Installment Repayments	Balance Maturing	Total
2022	10,418	26,578	36,996
2023	9,631	36,408	46,039
2024	8,688	38,254	46,942
2025	7,145	21,059	28,204
2026	6,003	47,454	53,457
Thereafter	16,321	109,675	125,996
	58,206	279,428	337,634

We have floating for fixed interest rate swaps which fix the interest rate on our variable rate mortgages at 2.97% and 3.04% for the term of the mortgages. As at December 31, 2021 the fair value of the interest rate swap contract in an asset position is \$601 (2020 - \$64) and the fair value of the interest rate swap contract in a liability position is \$nil (2020 - \$37). This financial instrument has not been designated as a hedge for accounting purposes. Supplemental information on fair value measurement, including valuation technique and key inputs, is included in note 25.

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

(\$000s)	2021	2020
Balance at January 1,	312,997	291,620
Principal repayments:		
Scheduled amortization on mortgages	(10,191)	(7,077)
Mortgage repayments	(41,045)	(5,471)
New mortgages	74,292	32,890
Mortgage interest payments deferred	—	971
Deferred financing fees capitalized	(707)	(281)
Amortization of deferred financing fees	484	345
Balance at December 31,	335,830	312,997

During the year ended December 31, 2020, the REIT entered into mortgage amending agreements with various lenders in order to obtain temporary payment relief as a result of COVID-19. In 2020, mortgage amending agreements had been entered into related to twenty-three mortgages with an outstanding principal balance of \$230,228. The terms of the agreements

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varied by lender and mortgage, providing the REIT with relief of scheduled principal and interest payments or provision of interest only payments for a specified period of time. Deferred payments were subject to interest and repayable over a term up to the remaining term of the mortgage. No changes were made as to the maturity date, interest rate, amortization period or security provided. The REIT accounted for these agreements as debt modifications, with the impact of these modifications being insignificant. All deferral periods ended in 2020, and regular repayments resumed by end of fiscal year 2020.

11. CLASS C LP UNITS

On closing of the Initial Public Offering (IPO), Melcor retained the debt on certain Initial Properties (the “Retained Debt”), with an outstanding principal balance of \$94,544 at April 30, 2013. The Class C LP Units were initially recognized at their fair value of \$96,506. The fair value of the Class C LP Units was determined based upon future payments at market interest rates. In consideration of the Retained Debt, Melcor received 9,454,411 Class C LP Units of Melcor REIT Limited Partnership (the “Partnership”), a subsidiary of the REIT, on which priority distributions are made 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 finance costs.

During the year ended December 31, 2020, the REIT entered into amending mortgage agreements with various financial institutions, including those encumbered by Class C LP Units. These amendments had been entered into in order to provide the REIT with temporary relief periods related to the principal payments on these Class C LP Units in an effort to conserve cash. These amendments resulted in a period of time in which the REIT was not required to make principal payments, but the term and interest rate related to the mortgage did not change. Deferred payments were subject to interest and repayable over the remaining term of the mortgage. The REIT accounted for these agreements as debt modifications, with the impact of these modifications being insignificant.

As at December 31, 2021 the carrying value of the Class C LP Units, included in the consolidated statement of financial position, were as follows:

(\$000s)	2021	2020
Class C LP Units amortized over 15-25 years at fixed interest rates	40,160	56,080
Current portion of Class C LP Units	(14,084)	(28,932)
	26,076	27,148
Effective interest rate	3.30 %	3.40 %

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

(\$000s)	2021	2020
Balance at January 1,	56,080	68,821
Principal repayments:		
Scheduled amortization on Class C LP Units	(2,744)	(2,909)
Class C LP Units repayments	(13,176)	(9,734)
Amortization of fair value adjustment on Class C LP Units (note 16)	—	(98)
Balance at December 31,	40,160	56,080

As at December 31, 2021 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2020 - 10,785,613).

During the year the REIT repaid the maturing balances of 1,891,911 Class C LP units with a carrying value of \$13,176.

Specific investment properties with a carrying value of \$58,227 (December 31, 2020 - \$91,995) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above Class C LP Units, along with a guarantee by the Partnership.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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The minimum contractual principal payments due within each of the next five years and thereafter are as follows:

(\$000s)	Principal Installment Repayments	Balance Maturing	Total
2022	1,665	12,419	14,084
2023	674	14,265	14,939
2024	458	—	458
2025	474	—	474
2026	490	9,715	10,205
	3,761	36,399	40,160

During the year \$1,550 (2020 - \$2,270) was recognized in finance costs (note 16).

12. CONVERTIBLE DEBENTURES

The principal amount outstanding and the carrying value for the REIT's convertible debentures are as follows:

(\$000s) except amounts stated in units					December 31, 2021		December 31, 2020
Convertible Debentures	Date Issued	Maturity Date	Conversion rate in units*	Interest Rate	Outstanding Principal	Carrying Value	Carrying Value
2017 Debentures	Dec 21, 2017	Dec 31, 2022	86.9565	5.25 %	22,975	22,458	22,007
2019 Debentures	Oct 29, 2019	Dec 31, 2024	112.3596	5.10 %	46,000	43,179	42,332
					68,975	65,637	64,339

*The conversion rate is the number of trust units per one thousand principal amount of convertible debentures.

As compound financial instruments, the fair value of the host instrument components were calculated using a market interest rate for an equivalent non-convertible, non-extendible bond. The conversion feature components are recognized at fair value and presented as a liability.

A reconciliation of the convertible debentures are as follows:

(\$000s)	Host Instruments	Conversion Features	Total
Balance at December 31, 2019	63,104	3,080	66,184
Fair value adjustment on conversion features (note 25)	—	(1,209)	(1,209)
Amortization of discount and transaction costs	682	—	682
Accretion on convertible debenture	553	—	553
Balance at December 31, 2020	64,339	1,871	66,210
Fair value adjustment on conversion features (note 25)	—	3,421	3,421
Amortization of discount and transaction costs	735	—	735
Accretion on convertible debenture	588	—	588
2017 Debenture conversion (note 14 (c))	(25)	—	(25)
Balance at December 31, 2021	65,637	5,292	70,929

During the year \$3,553 of interest expense was recognized in finance costs (note 16) (2020 - \$3,554).

At December 31, 2021 we remeasured the conversion features to fair value of \$116 asset (2020 - \$nil) and \$5,408 liability (2020 - \$1,871) resulting in a fair value loss of \$3,421 (2020 - gain of \$1,209). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 25.

13. CLASS B LP UNITS

Melcor, through an affiliate, holds an approximate 55.4% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. The Class B LP Units are exchangeable at the option of the holder for one trust unit of the REIT and accompanied by one special voting unit (note 14(b)). Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units.

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Distributions on Class B LP Units for the year were \$7,176 (2020 - \$7,075), and are included in finance costs (note 16).

In accordance with our policy, as detailed in note 3(g), we record Class B LP Units at fair value. We remeasured the Class B LP Units at December 31, 2021 and recognized a fair value loss of \$31,606 during the year (2020 - fair value gain of \$53,052). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 25.

The following table summarizes the change in Class B LP Units for the year.

(\$000s except unit amounts)	2021		2020	
	Units	\$ Amount	Units	\$ Amount
Balance - beginning of year	16,125,147	77,884	16,125,147	130,936
Fair value adjustment on Class B LP Units (note 25)	—	31,606	—	(53,052)
Balance - end of year	16,125,147	109,490	16,125,147	77,884

At December 31, 2021 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of \$6.79 per unit or \$109,490 (December 31, 2020 - 16,125,147 Class B LP Units issued and outstanding at a fair value of \$4.83 per unit or \$77,884). The REIT notes that it is currently not possible to estimate the long-term impact that COVID-19 will have on the economy, including the equity markets. As the valuation of the Class B LP Units is dependent on the trading price of the trust units, the impact on the valuation of the Class B LP Units cannot be estimated at this time and such impact could be material.

14. UNITHOLDERS' EQUITY

a) Trust Units

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 participate pro rata in any distributions by the REIT.

Unitholders are entitled to demand, at any time, the REIT to redeem all or part of the trust units at a "Redemption Price" as defined in the REIT's DOT. Upon receipt of notice to redeem trust units, the Unitholder surrenders all rights to and under the units tendered for redemption.

b) Special Voting Units

Pursuant to the DOT, special voting units have no economic entitlement in the REIT or in the distributions or assets of the REIT but entitle the holder to one vote per special voting unit at any meeting of the Unitholders. Special voting units may only be issued in connection with or in relation to securities exchangeable into Units, including Class B LP Units, for the purpose of providing voting rights with respect to the REIT to the holders of such securities. Special voting units will not be transferable separately from the exchangeable securities to which they are attached and will be automatically transferred upon the transfer of such exchangeable securities.

c) Units Outstanding

On April 1, 2021 we commenced a normal course issuer bid ("2021 NCIB") which allows the REIT to purchase up to 652,525 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units. The trust units may be repurchase up to a maximum daily limit of 3,824. The price which the REIT will pay for trust units repurchased under the plan will be the market price at the time of acquisition. The NCIB will end one year from commencement on March 31, 2022.

On April 1, 2020 we commenced a normal course issuer bid ("2020 NCIB") which allowed the REIT to purchase up to 655,792 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units. The trust units may be repurchased up to a maximum daily limit of 3,207. The price which the REIT will pay for trust units repurchased under the plan will be the market price at the time of acquisition. The NCIB ended one year from commencement, on March 31, 2021.

In connection with the commencement of the NCIBs, the REIT also entered into an automatic purchase plan agreement with a broker to allow for the purchase of trust units under the NCIB at times when the REIT ordinarily would not be active in the market due to regulatory restrictions or self-imposed trading blackout periods. This plan was cancelled during 2020 in order to conserve cash as a response to COVID-19 and then subsequently reinstated effective April 1, 2021.

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During the year the REIT purchased a total of 85,683 units for cancellation (2020 - 82,790 units) pursuant to the above NCIBs at a cost of \$533 (2020 - \$336), for the year ended December 31, 2021. Trust units were reduced by \$846 (2020 - \$818) and contributed surplus increased by \$313 (2020 - \$482).

During the year, \$25 of convertible debenture were converted into 2,173 trust units.

Issued and outstanding trust units at December 31, 2021 are 12,966,993 (December 31, 2020 - 13,050,503).

(Units)	2021	2020
Balance, beginning of year	13,050,503	13,133,293
Issuance of trust units	2,173	—
Repurchase of trust units	(85,683)	(82,790)
Balance, end of year	12,966,993	13,050,503

15. RENTAL REVENUE

The components of rental revenue are as follows:

For the years ended December 31 (\$000s)	2021	2020
Lease revenue	51,746	50,985
Variable lease revenue	13,494	13,681
Service revenue	12,864	13,030
Amortization of tenant incentives (note 8)	(4,218)	(3,779)
Straight-line adjustments	208	655
	74,094	74,572

In 2020, as a result of COVID-19 and the direct impact on many of the REIT's tenants, the REIT had proactively engaged with lessees in order to provide temporary relief. The amount and duration of relief provided was dependent on the tenant's situation and included full or partial deferral of lease payments for periods of one to four months or on a month to month basis. Deferred amounts remained owing and were repayable over a fixed term. During the year ended December 31, 2020, the government announced the Canada Emergency Commercial Rent Assistance (CECRA) for small businesses. The program provided forgivable loans to qualifying commercial property owners to cover up to 50% of six monthly rent payments that are payable by eligible small business tenants, requiring the landlord to forgive at least 25% of rent covered by the application, with the tenant paying the balance. This program ended in 2020 and has resulted in \$nil rent payments forgiven in 2021 (2020 - \$706 recorded in direct operating expenses).

16. FINANCE COSTS

The components of finance costs are as follows:

For the years ended December 31 (\$000s)	2021	2020
Interest on mortgages payable and revolving credit facility	11,314	11,346
Interest on Class C LP Units	1,550	2,368
Amortization of fair value adjustments on Class C LP Units	—	(98)
Distributions on Class B LP Units	7,176	7,075
Interest on convertible debentures	3,553	3,554
Accretion on convertible debentures	588	553
Fair value adjustment on derivative financial instruments	2,847	(1,063)
Amortization of deferred financing fees	1,363	1,167
	28,391	24,902

Total finance costs paid during the year were \$23,456 (2020 - \$24,883).

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17. INCOME TAXES

As at December 31, 2021 the REIT qualifies as a mutual fund trust within the meaning of the Tax Act and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through ("SIFT"); 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.

Reconciliation of income tax expense based on the statutory rate to the recovery recorded using the effective tax rate is as follows:

For the years ended December 31 (\$000s)	2021	2020
Net (loss) income	(16,287)	5,763
Statutory rate	23 %	24 %
	(3,746)	1,383
Non-taxable portion of capital gains and fair value adjustments	(331)	7,534
Allocation of taxable loss to unitholders (note 3(l))	4,077	(8,917)
	—	—

18. (LOSS) INCOME PER UNIT

Basic and diluted (loss) earnings per trust unit for the year are calculated as follows:

(\$000s except unit amounts)	2021	2020
Net (loss) income - basic	(16,287)	5,763
Impact of Class B LP unit fair value adjustment and distributions	—	(45,976)
Impact of convertible debentures interest, fair value adjustment, amortization and accretion	—	—
Net loss - diluted	(16,287)	(40,213)
Basic weighted average trust units outstanding	12,989,119	13,074,444
Impact of conversion of Class B LP Units	—	16,125,147
Impact of conversion of convertible debentures	—	—
Diluted weighted average trust units outstanding	12,989,119	29,199,591
Basic (loss) earnings per trust unit	(\$1.25)	\$0.44
Diluted loss per trust unit*	(\$1.25)	(\$1.38)

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

19. RELATED PARTY TRANSACTIONS

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

a) Property and Asset Management Agreements

The REIT is externally managed, administered and operated by Melcor pursuant to the terms and conditions as set forth under the Property Management Agreement and Asset Management Agreement.

Asset Management Agreement – we pay a quarterly management fee which is comprised of the following: (a) a base annual management fee calculated and payable on a quarterly basis, equal to 0.25% of the REIT's gross book value; (b) a capital expenditures fee equal to 5% of all hard construction costs incurred on capital projects in excess of \$0.10 million; (c) an acquisition fee equal to 0.50% - 1.00% of the purchase price; (d) a financing fee equal to 0.25% of the debt and equity of all financing transactions completed for the REIT to a maximum of actual expenses incurred by Melcor.

Property Management Agreement – we pay a monthly fee which is comprised of the following: (a) a base fee of 1/12 of 3% of gross property revenue, excluding amongst other things, lease termination fees and actual bad debt expense; (b) a

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leasing fee equal to 5% of aggregate base rent for new leases for the first 5 years and 2.5% thereafter, and 2.5% of aggregate base rent for lease renewals and expansions for the first 5 years.

Pursuant to the terms of the agreements the REIT incurred the following fees during the year:

<i>For the year ended December 31 (\$000s)</i>	2021	2020
Asset Management Agreement		
Base Annual Management Fee	1,916	1,916
Property Management Agreement		
Monthly Fee	2,198	2,070
Lease Fee	903	770
	5,017	4,756

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. In accordance with our policy (3(d)), Acquisition Fees and Lease Fees are capitalized to investment properties. As at December 31, 2021 there was \$674 payable to Melcor related to these fees (December 31, 2020 - \$662) which is included in accrued liabilities and other payables.

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

During the year \$7,176 in distributions were recorded on Class B LP Units held by Melcor (2020 - \$7,075). These distributions were recorded as finance costs (note 16). As at December 31, 2021 there was \$645 payable to Melcor for the December distribution (December 31, 2020 - \$484) which is included in distribution payable.

Also during the year, Melcor, as holder of all Class C LP Units, was paid \$4,294 to fund principal and interest payments on the Retained Debt (2020 - \$5,277). These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs (note 16). In addition, during the year the REIT repaid the maturing balances of 1,891,911 Class C LP units with a carrying value of \$13,176.

c) Rental Revenue

During the year the REIT collected \$870 in rental revenue from Melcor and an affiliate for use of office space (2020 - \$958).

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.

20. JOINT ARRANGEMENTS

The table below discloses our rights to and share of the assets, liabilities, revenues, and earnings of three joint arrangements (2020 – three) that are recorded in these consolidated financial statements:

	Interest
Capilano Investments Joint Venture	50%
Westmere Properties Joint Venture	50%
Watergrove Developments Joint Venture	50%

<i>(\$000's)</i>	Assets	Liabilities	Revenue	Earnings
<i>For the year ended and as at December 31</i>				
2021	65,279	33,226	5,206	2,531
2020	64,934	34,094	5,377	(769)

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21. SEGMENTED INFORMATION

All the properties included in these consolidated financial statements are located in Western Canada, and are viewed by the Chief Operating Decision Maker (determined to be the Chief Executive Officer) as one operating segment in the context of these consolidated financial statements.

22. COMMITMENTS AND CONTINGENCIES

The REIT is contingently liable under guarantees that are issued in the normal course of business and with respect to litigation and claims that arise from time to time. In the opinion of management, any liability that may arise from such contingencies would not have a material adverse effect on the consolidated financial statements of the REIT.

In the normal course of operations we enter into lease agreements with tenants which specify tenant incentive payments upon completion of the related tenant improvements. The REIT has entered into lease agreements that may require tenant incentive payments of approximately \$2,292 (2020 - \$2,929).

The REIT retains a loan guarantee related to the mortgage transferred as part of a prior year property sale. As at December 31, 2021 the loan balance was \$3,277 (2020 - \$3,381).

23. MANAGEMENT OF CAPITAL RESOURCES

We define capital as unitholders' equity, Class B LP Units, Class C LP Units, mortgages payables and convertible debentures. Our objective when managing capital is to ensure sufficient funds are available to make unitholder distributions, support the growth of our assets, and finance capital requirements. Specifically, we plan to utilize a combination of short, medium and long-term debt financing that aligns with the characteristics of each property.

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 debenture). At December 31, 2021, and throughout the period, we were in compliance with the Degree of Leverage Ratio.

We are also subject to financial covenants on our \$35,000 revolving credit facility. The covenants include a maximum debt to gross book value ratio of 60% (excluding convertible debentures), a minimum debt service coverage ratio of 1.25, and a minimum adjusted unitholders' equity of \$140,000. As at December 31, 2021, and throughout the period, we were in compliance with our financial covenants. We also have financial covenants on certain mortgages for investment properties. At December 31, 2021, 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.

24. FINANCIAL RISK MANAGEMENT

We are exposed to the following risks as a result of holding financial instruments:

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. 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.

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At this time, based on current economic outlook and the unpredictable time-line impact of COVID-19, management has assessed the current expected credit loss at \$518 (2020 - \$802). Amounts receivable and related loss allowance are summarized as follows:

(\$000s)	2021	2020
Accounts receivable	2,514	3,570
Loss allowance	(518)	(802)
<i>Accounts receivable, net</i>	1,996	2,768

Bad debt expense recorded during the year was \$63 (2020 - \$1,041), with \$nil (2020 - \$706) in bad debts related to participation in the CECRA program (which ended in 2020). These amounts are included in direct operating expenses. Accounts receivables are written off when there is no reasonable expectation of recovery. Indicators that there are no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan, and failure to make contractual payments for a period of greater than 120 days past due.

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 we have access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts. We believe that based on the updated cash flows created in order to incorporate the effects of COVID-19 we have access to sufficient liquidity through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

To mitigate the risk associated with the refinancing of maturing debt, we stagger the maturity dates of our mortgage portfolio over a number of years. Further, to mitigate the risk associated with the economic uncertainty caused by COVID-19, in 2020 the REIT entered into several amending agreements during the year to obtain relief periods in which payments of interest and principal were suspended temporarily. These relief periods did not change the terms of the mortgages and therefore the maturity dates will continue to be staggered in order to mitigate the risk associated with refinancing of matured debt. The agreement amendments entered in 2020 were in response to programs put in place by the government. This was solely a 2020 event and as such, there were no agreement amendments for the year ended December 31, 2021.

Refer to notes 10, 11 and 12 for the maturity analysis of mortgages payable, Class C LP Units and convertible debentures. Amounts drawn under the revolving credit facility was \$nil at December 31, 2021. Amounts drawn are due upon the maturity of the facility, on or before June 1, 2024. Accounts payable are expected to be repaid in the next twelve months. Distributions declared on trust units and Class B LP Units are paid one month following the date of declaration.

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 \$nil (December 31, 2020 - \$100) based upon applicable period end debt balances. We are also subject to interest rate risk on refinancing of our fixed rate debts in the year of maturity. We are not subject to other significant market risks pertaining to our financial instruments, with the exception of Class B LP units.

25. FAIR VALUE MEASUREMENT

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

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

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

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(In \$000s except unit and per unit amounts)

- fair values of mortgages payable, Class C LP Units, derivative financial asset - interest rate swap, and derivative financial liability - interest rate swap 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 debenture, is estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units and the fair value of convertible debenture are estimated based on the closing trading price of the REIT's debentures (Level 2).

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

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

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

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

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

(\$000s)	Fair Value Hierarchy	December 31, 2021			December 31, 2020		
		Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
Non-financial assets							
Investment properties	Level 3	699,142	—	699,142	699,142	692,991	692,991
Financial liabilities							
Mortgages payable	Level 3	—	335,830	335,830	335,343	312,997	315,531
Class B LP Units	Level 2	109,490	—	109,490	109,490	77,884	77,884
Class C LP Units	Level 3	—	40,160	40,160	40,160	56,080	56,080
Convertible debentures	Level 2	—	65,637	65,637	63,683	64,339	56,779
Derivative financial liability							
Interest rate swap	Level 3	—	—	—	—	37	37
Conversion features on convertible debentures	Level 3	5,408	—	5,408	5,408	1,871	1,871
Derivative financial asset							
Interest rate swap	Level 3	601	—	601	601	64	64
Conversion features on convertible debentures	Level 3	116	—	116	116	—	—

Investment properties

Investment properties are remeasured to fair value on a recurring basis, determined based on the 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;

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- 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 significant assumptions 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 December 31, 2021 with the assistance of qualified independent external valuation professionals of which 10 investment properties (of 53 legal phases valued) with a fair value of \$130,250 (including amounts presented as tenant incentives and straight-line rent adjustments) were valued by qualified independent external valuation professionals during the year. Valuations performed during the year resulted in fair value gains of \$2,879. During the year ended December 31, 2020 Melcor's internal valuation team valued investment properties of which 53 investment properties (of 53 legal phases valued) with a fair value of \$716,292 (including amounts presented as tenant incentives and straight-line rent adjustments) were valued by qualified independent external valuation professionals during the year. Valuations performed during the year ended December 31, 2020 resulted in fair value losses of \$62,748.

Weighted average stabilized net operating income for investment properties is \$1,584 (2020 - \$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.

	December 31, 2021			December 31, 2020		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.00%	6.81%	5.50%	10.00%	7.00%
Terminal capitalization rate	5.75%	9.00%	6.90%	5.75%	9.00%	6.92%
Discount rate	6.25%	9.75%	7.86%	6.25%	9.75%	8.02%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by \$49,666 (2020 - \$47,934). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by \$57,538 (2020 - \$55,306). Due to the uncertainty of the economic environment as a result of COVID-19, these estimates could be subject to significant changes and such changes could be material.

Non-derivative financial liabilities

The fair value of mortgages payable and Class C LP Units have 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).

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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 December 31, 2021 the fair value of the interest rate swap asset is \$601 (2020 - \$64) and interest rate swap liability is \$nil (2020 - \$37).

The significant unobservable inputs used in the fair value measurement of the conversion feature on the convertible debentures are as follows:

- Volatility - expected volatility as at December 31, 2021 was derived from the historical prices of the REIT's trust units. Volatility was 37.44% (2020 - 41.63%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at December 31, 2021. The credit spread used was 7.88% (2020 - 11.34%).

As at December 31, 2021 the fair value of the conversion features on our convertible debentures was a \$5,408 liability and a \$116 asset (2020 - \$1,871 liability).

Valuations performed during the year resulted in fair value losses of \$2,847 (2020 - gains of \$1,063). The REIT notes that it is currently not possible to estimate the long-term impact that COVID-19 will have on the economy, including the equity and debt markets. As the valuation of the conversion feature on our convertible debentures is dependent on the historical price of the REIT's trust units and the trading price of the convertible debenture, the impact on the valuation of the conversion feature on our convertible debentures cannot be estimated at this time and such impact could be material.

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 December 31, 2021 the fair value of the Class B LP Units was \$109,490 (2020 - \$77,884), resulting in a fair value loss of \$31,606 in income for the year (2020 - fair value gain of \$53,052). The REIT notes that it is currently not possible to estimate the long-term impact that COVID-19 will have on the economy, including the equity markets. As the valuation of the Class B LP Units is dependent on the trading price of the trust units, the impact on the valuation of the Class B LP Units cannot be estimated at this time and such impact could be material.

26. SUBSEQUENT EVENTS

Distributions declared

Subsequent to December 31, 2021, we declared the following distributions:

Month	Date Declared	Record Date	Distribution Date	Distribution Amount
January 2022	January 17, 2022	January 31, 2022	February 15, 2022	\$0.040 per unit
February 2022	February 15, 2022	February 28, 2022	March 15, 2022	\$0.040 per unit
March 2022	March 3, 2022	March 31, 2022	April 15, 2022	\$0.040 per unit