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 Trusts'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
Chief Financial Officer

Edmonton, Alberta
March 8, 2023

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, 2022 and 2021, 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, 2022 and 2021;
- the consolidated statements of income (loss) and comprehensive income (loss) 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, 2022. These matters were

PricewaterhouseCoopers LLP
Stantec Tower, 10220 103 Avenue NW, Suite 2200, Edmonton, Alberta, Canada T5J 0K4
T: +1 780 441 6700, F: +1 780 441 6776

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

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.

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 26 – Fair value measurement to the consolidated financial statements.* The REIT measures its investment properties at fair value and as at December 31, 2022, these assets were valued at $672 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, 2022 of which 44 investment properties (of 53 legal phases valued) with a fair value of $578 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	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.

Key audit matter	How our audit addressed the key audit matter
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 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.	– 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 rates and vacancy rates.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express 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, 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.

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 Steven Hollinger.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Edmonton, Alberta
March 8, 2023

MELCOR REAL ESTATE INVESTMENT TRUST

Consolidated Financial Statements

December 31, 2022

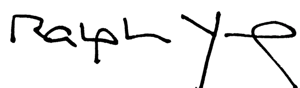
Consolidated Statements of Financial Position

As at December 31

($000s)	2022	2021
ASSETS		
Current Assets		
Cash and cash equivalents	3,304	7,255
Restricted cash (note 3(d))	1,000	—
Accounts receivable (note 25(a))	2,079	1,996
Other assets (note 7)	956	1,971
Asset held for sale (note 8 and 26)	19,500	—
	26,839	11,222
Non-Current Assets		
Investment properties (note 6 and 26)	672,010	699,142
Other assets (note 7)	28,172	24,587
Derivative financial assets (note 11, 13 and 26)	3,748	717
	703,930	724,446
TOTAL ASSETS	730,769	735,668
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 9)	31,634	—
Accounts payable	2,216	1,566
Distribution payable	1,163	1,164
Accrued liabilities and other payables (note 10 and 20)	9,673	8,805
Class C LP Units (note 12)	26,657	14,084
Mortgages payable (note 11)	56,339	36,996
Convertible debentures (note 13)	—	22,458
	127,682	85,073
Non-Current Liabilities		
Accrued liabilities and other payables (note 10)	1,809	1,774
Class B LP Units (note 14 and 26)	89,172	109,490
Class C LP Units (note 12)	11,141	26,076
Mortgages payable (note 11)	267,300	298,834
Convertible debentures (note 13)	44,056	43,179
Derivative financial liabilities (note 13 and 26)	412	5,408
TOTAL LIABILITIES	541,572	569,834
UNITHOLDERS' EQUITY	189,197	165,834
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	730,769	735,668

See accompanying notes to the consolidated financial statements.

By order of the REIT's Board of Trustees



Ralph Young - Chair

Carolyn Graham - Audit Committee Chair

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

For the years ended December 31

($000s)	**2022**	**2021**
Rental revenue (note 16 and 20)	**74,105**	74,094
Direct operating expenses (note 20)	**(31,060)**	(30,340)
Net rental income	**43,045**	43,754
General and administrative expenses (note 20)	**(3,358)**	(2,953)
Fair value adjustment on investment properties (note 6 and 26)	**(11,995)**	2,879
Fair value adjustment on Class B LP Units (note 14 and 26)	**20,318**	(31,606)
Income before finance costs	**48,010**	12,074
Interest income	**31**	30
Finance costs (note 17 and 20)	**(18,431)**	(28,391)
Net finance costs	**(18,400)**	(28,361)
Net income (loss) and comprehensive income (loss)	**29,610**	(16,287)
Basic earnings (loss) per trust unit (note 19)	**$2.28**	($1.25)
Diluted earnings (loss) per trust unit (note 19)	**$0.59**	($1.25)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Unitholders’ Equity

As at December 31

($000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2020	**13,050,503**	**117,473**	**41,275**	**29,659**	**188,407**
Trust units repurchased (note 15)	(85,683)	(846)	313	—	(533)
Issuance of trust units (note 15)	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**
Trust units repurchased (note 15)	**(3,824)**	**(38)**	**13**	**—**	**(25)**
Net income for the year	**—**	**—**	**—**	**29,610**	**29,610**
Distributions to unitholders	**—**	**—**	**—**	**(6,222)**	**(6,222)**
Balance at December 31, 2022	**12,963,169**	**116,614**	**41,601**	**30,982**	**189,197**

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

For the years ended December 31

($000s)	**2022**	**2021**
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income (loss) for the year	**29,610**	(16,287)
Non cash items:		
Amortization of tenant incentives (note 7 and 16)	**3,725**	4,218
Straight-line rent adjustments (note 16)	**(451)**	(208)
Fair value adjustment on investment properties (note 6 and 26)	**11,995**	(2,879)
Fair value adjustment on Class B LP Units (note 14 and 26)	**(20,318)**	31,606
Accretion on convertible debenture (note 17)	**625**	588
Fair value adjustment on derivative financial instruments (note 17)	**(8,027)**	2,847
Amortization of deferred financing fees (note 17)	**1,268**	1,363
	18,427	21,248
Payment of tenant incentives and direct leasing costs	**(8,779)**	(6,130)
Changes in operating assets and liabilities (note 3(o))	**2,288**	(237)
	11,936	14,881
INVESTING ACTIVITIES		
Change in restricted cash (note 3(d))	**(1,000)**	—
Investment property improvements (note 6)	**(3,452)**	(2,322)
	(4,452)	(2,322)
FINANCING ACTIVITIES		
Change in revolving credit facility	**31,697**	(10,000)
Proceeds from mortgages payable (note 11)	**11,049**	74,292
Repayment of mortgages payable	**(22,597)**	(51,236)
Repayment on Class C LP Units	**(2,362)**	(15,920)
Units repurchased (note 15)	**(25)**	(533)
Repayment of debentures (note 13)	**(22,975)**	—
Distributions to unitholders	**(6,222)**	(5,651)
	(11,435)	(9,048)
(DECREASE) INCREASE IN CASH & CASH EQUIVALENTS DURING THE YEAR	**(3,951)**	3,511
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	**7,255**	3,744
CASH AND CASH EQUIVALENTS, END OF THE YEAR	**3,304**	7,255

See accompanying notes to the consolidated financial statements.

1. DESCRIPTION OF THE TRUST

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

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 20).

As at March 8, 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.

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 8, 2023.

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 (2021 – three) with 50% interests. Refer to note 21 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.

d) Restricted cash

Restricted cash can only be used for specific purposes. Our restricted cash represents deposits held in trust related to the sale of an investment property classified as asset held for sale at year-end.

e) 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 valuators 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 20), and no amounts for internal allocations are capitalized with respect to the negotiation or arranging of tenant leases.

f) 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.

g) 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.

h) 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.

i) 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.

j) 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.

k) 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.

l) 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, 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.

m) 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.

n) 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 certain 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.

o) 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, 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.

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(e). 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. Refer to note 6 and 26 for further information about methods and assumptions used in determining fair value.

5. NEW STANDARDS

NEW AND AMENDED STANDARDS 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.

Impact of adoption

The adoption of the amendment to IAS 37 did not result in any adjustments in our treatment of provisions, contingent liabilities and contingent assets.

NEW AND AMENDED STANDARDS NOT YET ADOPTED

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.

The amendment to IAS 1 is required to be applied for annual periods beginning on or after January 1, 2024. We are currently evaluating the impact of this standard on our financial statements.

6. INVESTMENT PROPERTIES

($000s)	**2022**	**2021**
Balance - beginning of year	**699,142**	692,991
Additions		
Property improvements	**3,452**	2,322
Direct leasing costs	**1,393**	950
Fair value adjustment on investment properties (note 26)	**(11,995)**	2,879
Investment property classified as held for sale during the year (note 8)	**(19,089)**	—
Other adjustments	**(893)**	—
Balance - end of year	**672,010**	699,142

In accordance with our policy, as detailed in note 3(e), 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 significant assumptions, is included in note 26.

Presented separately from investment properties is $19,940 (December 31, 2021 - $16,711) in tenant incentives and $8,232 (December 31, 2021 - $7,876) in straight-line rent adjustments (note 7). The fair value of investment properties has been reduced by these amounts. During the year, we reclassified $19,089 from investment properties to asset held for sale (note 8).

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)	**2022**	**2021**
Within one year	**45,373**	45,547
Later than one year but not later than 2 years	**39,925**	40,597
Later than 2 years but not later than 3 years	**33,249**	34,275
Later than 3 years but not later than 4 years	**25,408**	27,529
Later than 4 years but not later than 5 years	**19,619**	19,771
Later than 5 years	**44,489**	54,082
	208,063	221,801

7. OTHER ASSETS

($000s)	2022	2021
Current Assets		
Prepaid expense and other	956	1,971
Non-Current Assets		
Straight-line rent adjustments	8,232	7,876
Tenant incentives	19,940	16,711
	28,172	24,587

During the year we recorded tenant incentives of $7,270 (December 31, 2021 - $5,296) and $3,725 (December 31, 2021 - $4,218) 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.

At December 31, 2022 we also reclassified $316 in tenant incentives and $95 in straight-line rent adjustments to asset held for sale (note 8).

8. ASSET HELD FOR SALE

As at December 31, 2022, we classified an office property as asset held for sale with a fair value of $19,500 (including investment property of $19,089, tenant incentives of $316 and straight-line rent of $95). As at December 31, 2022 management has committed to a plan of sale of the property with a contract in place. Deposits held in trust of $1,000 were classified as restricted cash at year-end. Subsequent to year-end, the property was sold to a third party for net proceeds of $19,025, resulting from a purchase price of $19,500 less transaction costs of $475 (note 27).

9. REVOLVING CREDIT FACILITY

Under the terms of our revolving credit facility agreement the REIT maintains an available credit limit based on the lesser of the present value of discounted cashflows or 65% of the appraised 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 facility. The facility matures on June 1, 2024 and has been amended subsequent to year-end (note 27). In the comparative period, unamortized transaction fees of $106 was included in other assets.

As at December 31, 2022, the carrying value of pledged properties was $56,700 (December 31, 2021 - $62,100).

As at December 31, 2022, we have an approved credit facility of $34,104 (December 31, 2021 - $35,000). As at December 31, 2022 we had $31,634 (December 31, 2021 - $nil) drawn from the facility (net of unamortized transaction fees and unamortized discount on bankers acceptance); and posted no letters of credit (December 31, 2021 - $nil).

($000s)	2022	2021
Amount drawn on facility	31,697	—
Unamortized transaction fees	(63)	—
	31,634	—

10. ACCRUED LIABILITIES AND OTHER PAYABLES

($000s)	2022	2021
Current Liabilities		
Tenant security deposits and pre-payments	3,561	3,403
Accrued finance costs	778	757
Other accrued liabilities and payables	5,334	4,645
	9,673	8,805
Non-Current Liabilities		
Decommissioning obligation	1,809	1,774

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, 2021 - $2,014). At December 31, 2022, a discount rate of 4.00% (December 31, 2021 - 4.00%) and an inflation rate of 2.00% (December 31, 2021 - 2.00%) were 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.

11. MORTGAGES PAYABLE

($000s)	2022	2021
Mortgages amortized over 15-25 years at fixed interest rates	273,247	303,711
Mortgages amortized over 25 years at a fixed interest rate (via floating for fixed interest rate swaps)	46,070	33,923
Mortgage at floating interest rate of prime plus 1%	5,876	—
Unamortized deferred financing fees	(1,554)	(1,804)
	323,639	335,830
Current portion of mortgages payable	(56,339)	(36,996)
	267,300	298,834
Interest rate ranges	(2.62%-7.45%)	(2.62%-4.20%)

Specific investment properties with a carrying value of $580,111 (December 31, 2021 - $575,532) 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 3.51% (December 31, 2021 – 3.35%).

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
2023	10,216	46,123	56,339
2024	9,161	38,254	47,415
2025	7,899	15,496	23,395
2026	6,813	47,454	54,267
2027	5,747	12,235	17,982
Thereafter	12,885	112,910	125,795
	52,721	272,472	325,193

We have floating for fixed interest rate swaps which fix the interest rate on our variable rate mortgages at 2.62% to 4.59% for the term of the mortgages. As at December 31, 2022 the fair value of the interest rate swap contract in an asset of $3,748 (2021 - $601). Interest rate swaps are not designated as hedges for accounting purposes, which means they are recorded at fair value, with changes in fair value reflected in finance cost.

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

($000s)	2022	2021
Balance at January 1,	**335,830**	312,997
Principal repayments:		
Scheduled amortization on mortgages	**(10,792)**	(10,191)
Mortgage repayments	**(11,805)**	(41,045)
Mortgage amendment	**(893)**	—
New mortgages	**11,049**	74,292
Deferred financing fees capitalized	**(249)**	(707)
Amortization of deferred financing fees	**499**	484
Balance at December 31,	**323,639**	335,830

12. CLASS C LP UNITS

On closing of the Initial Public Offering (IPO), Melcor retained the debt on certain Initial Properties (the "Retained Debt"). 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 REIT acquired additional properties from Melcor over the years, for which Melcor has retained the associated mortgage and additional Class C LP Units were issued to Melcor. The Class C LP Units are classified as debt and a portion of the distributions are recognized as finance costs.

As at December 31, 2022 the carrying value of the Class C LP Units, included in the consolidated statement of financial position, was as follows:

($000s)	2022	2021
Class C LP Units amortized over 15-25 years at fixed interest rates	**37,798**	40,160
Current portion of Class C LP Units	**(26,657)**	(14,084)
	11,141	26,076
Effective interest rate	**3.89 %**	3.30 %

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

($000s)	2022	2021
Balance at January 1,	**40,160**	56,080
Principal repayments:		
Scheduled amortization on Class C LP Units	**(2,362)**	(2,744)
Class C LP Units repayments	**—**	(13,176)
Balance at December 31,	**37,798**	40,160

As at December 31, 2022 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2021 - 10,785,613).

Specific investment properties with a carrying value of $62,300 (December 31, 2021 - $58,227) 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.

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

($000s)	Principal Installment Repayments	Balance Maturing	Total
2023	1,186	25,471	**26,657**
2024	458	—	**458**
2025	474	—	**474**
2026	494	9,715	**10,209**
	2,612	35,186	**37,798**

During the year $1,374 (2021 - $1,550) was recognized in finance costs (note 17).

13. 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, 2022**		December 31, 2021
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 %	—	—	22,458
2019 Debentures	Oct 29, 2019	Dec 31, 2024	112.3596	5.10 %	**46,000**	**44,056**	43,179
					46,000	**44,056**	65,637

*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, 2020	64,339	1,871	66,210
Fair value adjustment on conversion features (note 26)	—	3,421	3,421
Amortization of discount and transaction costs	735	—	735
Accretion on convertible debentures	588	—	588
2017 Debenture conversion (note 15 (c))	(25)	—	(25)
Balance at December 31, 2021	65,637	5,292	70,929
Fair value adjustment on conversion features (note 26)	**—**	**(4,880)**	**(4,880)**
Amortization of discount and transaction costs	**769**	**—**	**769**
Accretion on convertible debentures	**625**	**—**	**625**
2017 Debenture repayment	**(22,975)**	**—**	**(22,975)**
Balance at December 31, 2022	**44,056**	**412**	**44,468**

During the year $3,553 of interest expense was recognized in finance costs (note 17) (2021 - $3,553).

At December 31, 2022 we remeasured the conversion features to a fair value $412 liability (2021 - $116 asset and $5,408 liability) resulting in a fair value gain of $4,880 (2021 - loss of $3,421). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 26.

During the year, our 2017 Debentures matured resulting in a repayment of $22,975.

14. 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. 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 15(b)). Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units.

Distributions on Class B LP Units for the year were $7,740 (2021 - $7,176), and are included in finance costs (note 17).

In accordance with our policy, as detailed in note 3(h), we record Class B LP Units at fair value. We remeasured the Class B LP Units at December 31, 2022 and recognized a fair value gain of $20,318 during the year (2021 - fair value loss of $31,606). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 26.

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

		2022		**2021**
($000s except unit amounts)	**Units**	**$ Amount**	Units	$ Amount
Balance - beginning of year	**16,125,147**	**109,490**	16,125,147	77,884
Fair value adjustment on Class B LP Units (note 26)	**—**	**(20,318)**	—	31,606
Balance - end of year	**16,125,147**	**89,172**	16,125,147	109,490

At December 31, 2022 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of $5.53 per unit or $89,172 (December 31, 2021 - 16,125,147 Class B LP Units issued and outstanding at a fair value of $6.79 per unit or $109,490).

15. 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 ("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 year the REIT purchased a total of 3,824 units for cancellation (2021 - 85,683 units) pursuant to the above NCIB at a cost of $25 (2021 - $533), for the year ended December 31, 2022. Trust units were reduced by $38 (2021 - $846) and contributed surplus increased by $13 (2021 - $313).

In the comparative year, $25 of convertible debentures were converted into 2,173 trust units.

Issued and outstanding trust units at December 31, 2022 are 12,963,169 (December 31, 2021 - 12,966,993).

(Units)	2022	2021
Balance, beginning of year	12,966,993	13,050,503
Issuance of trust units	—	2,173
Repurchase of trust units	(3,824)	(85,683)
Balance, end of year	**12,963,169**	**12,966,993**

16. RENTAL REVENUE

The components of rental revenue are as follows:

For the years ended December 31 ($000s)	2022	2021
Lease revenue	50,639	51,746
Variable lease revenue	13,641	13,494
Service revenue	13,099	12,864
Amortization of tenant incentives (note 7)	(3,725)	(4,218)
Straight-line adjustments	451	208
	74,105	74,094

17. FINANCE COSTS

The components of finance costs are as follows:

For the years ended December 31 ($000s)	2022	2021
Interest on mortgages payable and revolving credit facility	11,898	11,314
Interest on Class C LP Units	1,374	1,550
Distributions on Class B LP Units	7,740	7,176
Interest on convertible debentures	3,553	3,553
Accretion on convertible debentures	625	588
Fair value adjustment on derivative financial instruments	(8,027)	2,847
Amortization of deferred financing fees	1,268	1,363
	18,431	28,391

Total finance costs paid during the year were $24,793 (2021 - $23,456). Included in amortization of deferred financing fees are fees amortized related to convertible debentures $769 (2021 - $735).

18. INCOME TAXES

As at December 31, 2022 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)	2022	2021
Net income (loss)	29,610	(16,287)
Statutory rate	23 %	23 %
	6,810	(3,746)
Non-deductible (non-taxable) portion of fair value adjustments	1,379	(331)
Allocation of taxable (income) loss to unitholders	(8,189)	4,077
	—	—

19. INCOME (LOSS) PER UNIT

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

($000s except unit amounts)	2022	2021
Net income (loss) - basic	29,610	(16,287)
Impact of Class B LP unit fair value adjustment and distributions	(12,578)	—
Impact of convertible debentures interest, fair value adjustment, amortization and accretion	—	—
Net income (loss) - diluted	17,032	(16,287)
Basic weighted average trust units outstanding	12,963,955	12,989,119
Impact of conversion of Class B LP Units	16,125,147	—
Impact of conversion of convertible debentures	—	—
Diluted weighted average trust units outstanding	29,089,102	12,989,119
Basic earnings (loss) per trust unit	$2.28	($1.25)
Diluted earnings (loss) per trust unit*	$0.59	($1.25)

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

20. RELATED PARTY TRANSACTIONS

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

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 3.0% of gross property revenue; (b) an upfront market fee payable on a transaction by transaction basis, but only for transactions where a third party leasing agent was not engaged. The lease fee structure shall represent current market terms in each particular market where leasing services are provided to the REIT. In the comparative year, the leasing fee was 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/expansions for the first 5 years.

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

For the year ended December 31 ($000s)	2022	2021
Asset Management Agreement		
Base Annual Management Fee	1,916	1,916
Property Management Agreement		
Monthly Fee	2,147	2,198
Lease Fee	509	903
	4,572	5,017

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)), Lease Fees are capitalized to investment properties. As at December 31, 2022 there was $672 payable to Melcor related to these fees (December 31, 2021 - $674) which is included in accrued liabilities and other payables.

a. Distributions on Class B LP Units and Redemptions of Class C LP Units

During the year $7,740 in distributions were recorded on Class B LP Units held by Melcor (2021 - $7,176). These distributions were recorded as finance costs (note 17). As at December 31, 2022 there was $645 payable to Melcor for the December distribution (December 31, 2021 - $645) which is included in distribution payable.

Also during the year, Melcor, as holder of all Class C LP Units, was paid $3,736 to fund principal and interest payments on the Retained Debt (2021 - $4,294). These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs (note 17). In 2021, the REIT repaid the maturing balances on 1,891,911 Class C LP Units with a carrying value of $13,176.

b. Rental Revenue

During the year the REIT collected $853 in rental revenue from Melcor and an affiliate for use of office space (2021 - $870).

c. 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.

21. JOINT ARRANGEMENTS

The table below discloses our rights to and share of the assets, liabilities, revenues, and earnings of three joint arrangements (2021 – 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%

($000's)	**Assets**	**Liabilities**	**Revenue**	**Earnings**
For the year ended and as at December 31				
2022	**68,006**	**33,188**	**5,379**	**4,194**
2021	65,279	33,226	5,206	2,531

22. 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.

23. 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 $2,289 (2021 - $2,292).

The REIT retains a loan guarantee related to the mortgage transferred as part of a prior year property sale. As at December 31, 2022 the loan balance was $3,169 (2021 - $3,277).

24. 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, 2022, 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, 2022, 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, 2022, 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.

25. 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 and interest rate swaps 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. Interest rate swaps 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.

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, management has assessed the current expected credit loss at $256 (2021 - $518). Amounts receivable and related loss allowance are summarized as follows:

($000s)	**2022**	**2021**
Accounts receivable	**2,335**	2,514
Loss allowance	**(256)**	(518)
Accounts receivable, net	**2,079**	**1,996**

Bad debt expense recorded during the year was $63 (2021 - $63). These amounts are included in direct operating expenses, net of recoveries. 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. 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.

Refer to notes 11, 12 and 13 for the maturity analysis of mortgages payable, Class C LP Units and convertible debentures. Amounts drawn under the revolving credit facility was $31,697 at December 31, 2022 (2021 - $nil) (note 9). 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 and certain mortgages bear 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 $376 (December 31, 2021 - $nil) 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.

26. 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.
- fair values of mortgages payable, Class C LP Units and interest rate swap are estimated by discounting the future cash flows associated with the instrument 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 and asset held for sale 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.

		December 31, 2022				December 31, 2021	
($000s)	Fair Value Hierarchy	**Fair Value**	**Amortized Cost**	**Total Carrying Value**	**Total Fair Value**	Total Carrying Value	Total Fair Value
Non-financial assets							
Investment properties	Level 3	**672,010**	**—**	**672,010**	**672,010**	699,142	699,142
Asset held for sale	Level 3	**19,500**	**—**	**19,500**	**19,500**	—	—
Financial liabilities							
Mortgages payable	Level 3		**323,639**	**323,639**	**298,549**	335,830	335,343
Class B LP Units	Level 2	**89,172**	**—**	**89,172**	**89,172**	109,490	109,490
Class C LP Units	Level 3	**—**	**37,798**	**37,798**	**36,756**	40,160	40,160
Convertible debentures	Level 2	**—**	**44,056**	**44,056**	**41,011**	65,637	63,683
Derivative financial liability							
Conversion features on convertible debentures	Level 3	**412**	**—**	**412**	**412**	5,408	5,408
Derivative financial asset							
Interest rate swap	Level 3	**3,748**	**—**	**3,748**	**3,748**	601	601
Conversion features on convertible debentures	Level 3	**—**	**—**	**—**	**—**	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;
- 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 valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued.

Investment properties were valued by Melcor's internal valuation team as at December 31, 2022 with the assistance of qualified independent external valuation professionals of which 44 investment properties (of 53 legal phases valued) with a fair value of $578,350 (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 loss of $11,995. During the year ended December 31, 2021 Melcor's internal valuation team valued investment properties 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 ended December 31, 2021 resulted in fair value gains of $2,879.

Weighted average stabilized net operating income for investment properties is $1,613 (2021 - $1,584) 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, 2022			**December 31, 2021**		
	Min	**Max**	**Weighted Average**	Min	Max	Weighted Average
Capitalization rate	**5.50%**	**10.00%**	**7.08%**	5.50%	10.00%	6.81%
Terminal capitalization rate	**6.00%**	**8.75%**	**7.16%**	5.75%	9.00%	6.90%
Discount rate	**6.25%**	**9.75%**	**8.04%**	6.25%	9.75%	7.86%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $47,300 (2021 - $49,700). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $54,500 (2021 - $57,500).

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 certain mortgages (level 3) and the conversion features on our convertible debentures (level 3).

The fair value of the interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at December 31, 2022 the fair value of the interest rate swap asset is $3,748 (2021 - $601).

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, 2022 was derived from the historical prices of the REIT's trust units. Volatility was 23.80% (2021 - 37.44%).
- Credit spread - the credit spread of the convertible debenture was imputed from the traded price of the convertible debenture as at December 31, 2022. The credit spread used was 11.13% (2021 - 7.88%).

At December 31, 2022 we remeasured the conversion features to a fair value $412 liability (2021 - $116 asset and $5,408 liability) resulting in a fair value gain of $4,880 (2021 - loss of $3,421).

Valuations performed during the year resulted in fair value gain of $8,027 (2021 - losses of $2,847).

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, 2022 the fair value of the Class B LP Units was $89,172 (2021 - $109,490), resulting in a fair value gains of $20,318 in income for the year (2021 - fair value loss of $31,606).

27. SUBSEQUENT EVENTS

Distributions declared

Subsequent to December 31, 2022, we declared the following distributions:

Month	Date Declared	Record Date	Distribution Date	Distribution Amount
January 2023	January 16, 2023	January 31, 2023	February 15, 2023	$0.04 per unit
February 2023	January 16, 2023	February 28, 2023	March 15, 2023	$0.04 per unit
March 2023	January 16, 2023	March 31, 2023	April 14, 2023	$0.04 per unit

Asset Disposition

On February 1, 2023, we sold an investment property for net proceeds of $19,025, resulting from a purchase price of $19,500 less transaction costs of $475. The price was settled in cash, excluding working capital adjustments. Proceeds from the sale were used to repay the outstanding principle balance on the mortgage, with the remaining cash of $9,030 being used to reduce our borrowings on our credit facility.

Revolving credit facility

On February 10, 2023 we entered in the fourth amendment to our revolving credit agreement with our existing lenders (the “Credit Facility Amendment”). The following terms were amended pursuant to the Credit Facility Amendment:

- the maximum available credit limit was increased from $35,000 to $50,000;
- changes to the inputs used in the calculation of available credit limit; and
- additional property pledged as collateral with a carrying value of $11,900.