

Management's Discussion & Analysis

May 14, 2020

The following Management's Discussion and Analysis (MD&A) of Melcor Real Estate Investment Trust's (the REIT) results should be read in conjunction with the unaudited condensed interim consolidated financial statements and related notes for the quarter ended March 31, 2020 and the MD&A and consolidated financial statements and related notes for the year ended December 31, 2019. The discussion outlines strategies and provides analysis of our financial performance for the first quarter of 2020.

The underlying financial statements in this MD&A, including 2019 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted. All dollar amounts included in this MD&A are Canadian dollars unless otherwise specified.

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

The REIT's Board of Trustees, on the recommendation of the Audit Committee, approved the content of this MD&A on May 14, 2020. Disclosure contained in this MD&A is current to May 14, 2020, unless otherwise indicated.

Regulatory Filings

Additional information about the REIT, including our annual information form, management information circular and quarterly reports, is available on our website at MelcorREIT.ca and on SEDAR at sedar.com.

Non-standard Measures

We refer to terms and measures which are not specifically defined in the CPA Handbook and do not have any standardized meaning prescribed by IFRS. These measures include funds from operations (FFO), adjusted funds from operations (AFFO), adjusted cash flow from operations (ACFO) and net operating income (NOI), which are key measures of performance used by real estate businesses. We believe that these measures are important in evaluating the REIT's operating performance, financial risk, economic performance, and cash flows. These non-standard measures may not be comparable to similar measures presented by other companies and real estate investment trusts and should not be used as a substitute for performance measures prepared in accordance with IFRS.

Non-standard measures included in this MD&A are defined in the section "*Non-standard Measures*".

Forward-looking Statements

In order to provide our investors with an understanding of our current results and future prospects, our public communications often include written or verbal forward-looking statements.

Forward-looking statements are disclosures regarding possible events, conditions, or results of operations that are based on assumptions about future economic conditions, courses of action and include future-oriented financial information.

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent the REIT's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Forward-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2020 and beyond, future leasing, acquisition and financing plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

By their nature, forward-looking statements require assumptions and involve risks and uncertainties related to the business and general economic environment, many beyond our control. There is significant risk that the predictions, forecasts, valuations, conclusions or projections we make will not prove to be accurate and that our actual results will be materially different from targets, expectations, estimates or intentions expressed in forward-looking statements. We caution readers of this document not to place undue reliance on forward-looking statements. Assumptions about the performance of the Canadian economy and how this performance will affect the REIT's business are material factors we consider in determining our forward-looking statements. For additional information regarding material risks and assumptions, please see the discussion under Business Environment and Risks in the 2019 annual financial statements.

Readers should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Except as may be required by law, we do not undertake to update any forward-looking statement, whether written or oral, made by the REIT or on its behalf.

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Our Business: Vision, Goals & Strategy

Melcor REIT has an established and diversified portfolio in western Canada. We currently own 39 income-producing office, retail and industrial properties representing 3.21 million square feet (sf) in gross leasable area (GLA). These high-quality properties feature stable occupancy and a diversified mix of tenants, some of whom have been in place for over 25 years. We are externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the asset management and property management agreements entered into at our IPO.

As at May 14, 2020, Melcor, through an affiliate, holds an approximate 55.3% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

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

Acquire:

We continue to actively seek strategic third party and proprietary property acquisitions (via the Melcor Developments pipeline of commercial properties) that meet our investment criteria. Year to date, we have not completed any acquisitions.

In 2019, we executed on our strategy and had two third party acquisitions which brought on an additional 339,000 sf of retail space.

Improve:

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

Asset Enhancement:

Our buildings undergo annual assessments to identify preventative maintenance and capital investment requirements, and we continuously monitor and log all equipment and maintenance activity. Many of our continuous improvement initiatives focus on sustainability and energy reduction strategies to ensure our buildings are green. As we upgrade and replace equipment, we do so with technology that promotes energy efficiency. We also engage specialists to monitor and analyze our energy usage to identify ways it can be improved.

In order to strengthen the REIT's flexibility to respond to and support distressed tenants through COVID-19, the REIT has temporarily suspended its 2020 capital expenditures program.

Property Management:

We responded to 99% of calls to our signature customer care line within 30 minutes in Q1-2020, exceeding our target of a 95% on time response rate. We use this metric as an indicator of our success in providing responsive care to our tenants.

SIGNIFICANT EVENT - COVID-19

In March 2020, the COVID-19 global pandemic arrived in western Canada. Since its arrival, federal and provincial governments responded rapidly to enact emergency measures to slow the spread of the virus and ensure that our medical system did not become overwhelmed. New measures were introduced on a weekly and often daily basis. Measures include travel bans, self-imposed quarantine periods, physical distancing, mandatory isolation for those exhibiting symptoms, restrictions on gatherings of larger than 15 people, mandatory closure of all non-essential businesses including personal services, schools and daycares, and restaurants and food services reduced to pick-up/take-out only. These measures led to an economic slowdown and material disruption for many businesses. The Canadian government reacted with interventions intended to stabilize the economy and support both businesses and employees who are affected by temporary furlough or lay-offs. While some jurisdictions have now announced relaunch strategies, the long-term impact of COVID-19 related economic stressors remains to be seen. We are unable to estimate the future impact to the REIT's financial performance and cash position.

The REIT responded quickly to the situation and implemented a variety of measures to provide safe and clean work environments and keep our tenants and visitors to our properties safe while doing our part to slow the spread. These measures include:

- Intensified cleaning of high-touch surfaces three times per day.
- Health and safety best practice education via a variety of mediums, including posters in prominent locations in our properties, tenant memos and social media.
- Additional hand sanitation stations throughout properties.
- Deferral of non-emergency maintenance.
- Closure of the management office to guests with all staff able to work from home doing so.

COVID-19 has impacted many of our tenants and the REIT is committed to working with our tenants on a case by case basis, making arrangement for deferrals where appropriate, depending on the tenant's financial need and potential to access government relief programs. These arrangements demonstrate our continued solidarity and partnership with our tenants and belief that support will provide our tenants the best opportunity to endure the pandemic and be successful in the long-term.

We are all in this together. We see ourselves as partners with our tenants and our main objective is to help each other survive and thrive when the COVID-19 impact on the economy levels out.

We continue to actively monitor ongoing COVID-19 developments to ensure a healthy and safe environment.

Operations Update

The REIT announced a series of measures taken over the past two months to conserve cash and place the REIT in a position to support our tenants through these unprecedented times and we continue to monitor the situation and our cash position. These measures include:

- Reducing the April and May 2020 distribution to \$0.03 per trust unit.
- Deferring discretionary capital spending of approximately \$1.3 million planned for 2020 in an effort to improve near term liquidity and reduce non-essential activities at our properties. We remain committed to strategic value-adding asset enhancement and preservation projects as a integral component of our strategy to improve our assets and retain and attract tenants.
- Deferring and suspending where appropriate operating expenses, representing approximately 20% of budgeted April expenditures. We will continue to monitor our maintenance program as tenants resume operations in order to continue to provide best in class service while ensuring efficiency and cost effectiveness.
- Deferring sales tax, property tax and utility payments where available.
- Working with lenders to defer mortgage payments where available.

We continue to monitor relief programs that may apply to the REIT.

We anticipate that the emergency measures enacted to contain the COVID-19 pandemic and the resulting economic impact will have a negative impact on our future cash flow and net operating income. The extent and duration of the impact of COVID-19 on our results cannot be accurately predicted at this time.

COVID-19 did not have an impact on Q1 rent.

Collections Update

Due to non-essential business closure orders issued by the provincial governments, some of our retail tenants are closed at the date of this report. Most will be allowed to re-open mid May; however, many retailers are taking a very cautious approach to reopening, including delaying their opening to ensure they can comply with new recommendations and procedures to ensure public health and safety. The following table outlines the our rent collections in April and May by asset class.

<i>Collections by Asset Class (% of Total Rent)</i>		
	April 2020	May 2020
Retail	69%	61%
Office	86%	79%
Industrial	93%	86%
Residential	100%	99%
Total	79%	71%

Over 97% of retail tenants surveyed in late April and early May let us know that they intend to apply for the federal government Canada Emergency Commercial Rent Assistance (CECRA) program, provided they qualify. As full CECRA program details were not available at the time of writing, we are uncertain of the impact this will have on the REIT going forward.

Q1-2020 Disclosures

Management points out that Q1-2020 was largely concluded when COVID-19 measures restricting certain businesses were enacted and thus the impact on Q1 results is minimal. Throughout our MD&A, we speak to Q1-2020 results, mentioning COVID impacts where they had a direct impact on Q1 results only.

Q1-2020 Highlights & Key Performance Indicators

Financial Highlights

	Three months ended March 31		
(\$000s)	2020	2019	△%
Non-standard KPIs			
Net operating income (NOI)	11,964	11,012	9 %
Same-asset NOI	10,671	11,012	(3)%
Funds from operations (FFO)	6,730	6,531	3 %
Adjusted funds from operations (AFFO)	4,862	4,617	5 %
Adjusted cash flow from operations (ACFO) ⁽⁵⁾	4,966	4,631	7 %
Rental revenue	19,292	17,944	8 %
Income before fair value adjustments	2,942	3,252	(10)%
Fair value adjustment on investment properties ⁽¹⁾	(6,187)	1,159	nm
Cash flows from operations	3,453	2,751	26 %
Distributions to unitholders	2,216	2,225	— %
Distributions ⁽²⁾	\$0.17	\$0.17	— %
Per Unit Metrics			
Net income			
Basic	\$6.39	\$0.19	
Diluted	\$0.08	\$0.19	
Weighted average number of units for net income (000s): ⁽³⁾			
Basic	13,130	13,187	— %
Diluted	29,255	13,187	122 %
FFO			
Basic	\$0.23	\$0.23	
Diluted	\$0.22	\$0.23	
Payout ratio	73%	73%	
AFFO			
Basic	\$0.17	\$0.16	
Payout ratio	102%	103%	
ACFO ⁽⁵⁾			
Basic	\$0.17	\$0.16	
Payout ratio	99%	102%	
Weighted average number of units for FFO, AFFO and ACFO (000s): ⁽⁴⁾			
Basic	29,255	28,086	4 %
Diluted	36,424	32,813	11 %

1. The abbreviation nm is shorthand for not meaningful and is used through this MD&A where appropriate.
2. Distributions for the current and comparative periods have been paid out at a rate of \$0.05625 per unit per month.
3. For the purposes of calculating per unit net income the basic weighted average number of units includes Trust Units and the diluted weighted average number of units includes Class B LP Units and convertible debentures, to the extent that their impact is dilutive.
4. For the purposes of calculating per unit FFO, AFFO and ACFO the basic weighted average number of units includes Trust Units and Class B LP Units.
5. In Q4-2019 we amended our definition of amortization of deferred financing fees to exclude accretion on convertible debenture. Amortization of deferred financing fees is an adjusting item in the calculation of ACFO. This change was applied retroactively.

Operational Highlights

	Mar 31, 2020	Dec 31, 2019	△%
Total assets (\$000s)	777,435	783,534	(1)%
Equity (\$000s) ⁽¹⁾	289,643	289,873	— %
Debt (\$000s) ⁽²⁾	452,631	454,013	— %
Weighted average interest rate on debt	3.76%	3.78%	(1)%
Debt to GBV, excluding convertible debentures (maximum threshold - 60%)	50%	50%	—%
Debt to GBV (maximum threshold - 65%)	59%	59%	—%
Finance costs coverage ratio ⁽³⁾	2.43	2.45	(1)%
Debt service coverage ratio ⁽⁴⁾	2.15	2.26	(5)%

1. Calculated as the sum of trust units and Class B LP Units at their book value. In accordance with IFRS the Class B LP Units are presented as a financial liability in the consolidated financial statements.
2. Calculated as the sum of total amount drawn on revolving credit facility, mortgages payable, Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units and convertible debentures, excluding unamortized discount and transaction costs.
3. Calculated as the sum of FFO and finance costs; divided by finance costs, excluding distributions on Class B LP Units and fair value adjustment on derivative instruments. This metrics is not calculated for purposes of covenant compliance on any of our debt facilities. Please refer to page 17 for further discussion and analysis.
4. Calculated as FFO; divided by sum of contractual principal repayments on mortgages payable and distributions of Class C LP Units, excluding amortization of fair value adjustment on Class C LP Units. This metrics is not calculated for purposes of covenant compliance on any of our debt facilities. Please refer to page 17 for further discussion and analysis.

Operational Highlights

	Mar 31, 2020	Dec 31, 2019	△%
Number of properties	39	39	— %
Gross leasable area (GLA) (sf)	3,208,463	3,208,950	— %
Occupancy (weighted by GLA)	88.1%	88.0%	—%
Retention (weighted by GLA)	86.7%	59.6%	45%
Weighted average remaining lease term (years)	4.35	4.37	— %
Weighted average base rent (per sf)	\$16.69	\$16.79	(1)%

Q1-2020 Highlights:

Our portfolio performance remained stable through the first three months of 2020 with continued leasing stability in spite of challenging markets. We continued to proactively renew existing tenants and pursue new tenants, resulting in a healthy retention rate of 86.7% at quarter-end and overall occupancy of 88.1%.

Highlights of our performance in the first quarter include:

FINANCIAL HIGHLIGHTS

- The 12% growth in our portfolio's square footage via third party acquisitions in 2019 contributed to revenue growth of 8% and net operating income (NOI) growth of 9% compared to Q1-2019.
- Net income in the current and comparative periods is significantly impacted by non-cash fair value adjustments on Class B LP Units due to changes in the REIT's unit price and fair value adjustments on investment properties due to changes in NOI/capitalization rates. Management believes funds from operations (FFO) is a better reflection of our true operating performance. FFO was \$6.73 million or \$0.23 per unit, compared to \$6.53 million or \$0.23 in Q1-2019.
- Adjusted cash from operations (ACFO) was up 7% from Q1-2019 at \$4.97 million or \$0.17 per unit, compared to \$4.63 million or \$0.16 per unit. Management believes that ACFO better reflects our cash position and therefore our ability to pay distributions.

- As at March 31, 2020 we had \$1.89 million in cash and \$10.11 million in additional capacity under our revolving credit facility.

OPERATING HIGHLIGHTS

- Same-asset NOI was down 3% compared to Q1-2019 as the drag from the large tenant that vacated a downtown Edmonton office building continues.
- We continued to execute on our proactive leasing strategy to both retain existing and attract new tenants. We completed lease renewals representing 74,320 sf (including holdovers) for a retention rate of 86.7% at March 31, 2020. New leasing has been steady across the portfolio with 24,147 sf in new deals commencing to date in 2020 and an additional 74,000 sf committed for future occupancy.

CREATING UNITHOLDER VALUE

- We paid distributions of \$0.05625 per trust unit in January, February and March for a quarterly payout ratio of 99% based on ACFO and 73% based on FFO.
- On April 1, 2019 we commenced a normal course issuer bid (NCIB) which allows the REIT to purchase approximately 5% of our issued and outstanding trust units for cancellation. Under this NCIB, we purchased 76,768 units for \$0.53 million at a weighted average cost of \$6.95 per unit or 70% of book value. This NCIB plan expired on March 31, 2020.

SUBSEQUENT EVENT

- On April 1, 2020 we renewed the NCIB. We are entitled to purchase up to 655,792 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units. We believe that our units have been trading in a price range which does not reflect the value of the units in relation to our current and future business prospects. 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 ends one year from commencement, on March 31, 2021. Subsequent to the quarter we purchased 49,905 units for \$0.18 million under the NCIB purchase plan which commenced April 1, 2020. Following the expiration of the blackout on May 15, 2020 the REIT will suspend its purchases under the NCIB program in light of continued market volatility and in an effort to conserve cash.
- Today the Board declared a distribution of \$0.03 per trust unit, payable on June 15, 2020 to unitholders of record on May 29, 2020.

Consolidated Revenue & Net Operating Income

(\$000s)	Three months ended March 31		
	2020	2019	△%
Base rent	12,179	10,992	11 %
Recoveries	7,245	6,850	6 %
Other	684	570	20 %
Amortization of tenant incentives	(1,067)	(765)	39 %
Straight-line rent adjustment	251	297	(15)%
Rental revenue	19,292	17,944	8 %
Operating expenses	3,727	3,383	10 %
Utilities and property taxes	4,417	4,017	10 %
Direct operating expenses	8,144	7,400	10 %
Net rental income	11,148	10,544	6 %
NOI	11,964	11,012	9 %
Same asset NOI	10,671	11,012	(3)%
Operating margin	58%	59%	(2)%

Revenue

Rental revenue for the period ended March 31, 2020 increased \$1.3 million or 8% over 2019 as a result of properties acquired within the past twelve months: Melcor Crossing (Nov-2019) and Staples Centre (Apr-2019) contributing rental revenue of \$2.10 million in Q1-2020 (2019 - \$nil). The increase in rental revenue was offset by a decrease in same-asset performance in our office portfolio.

Year to date, we signed 98,467 sf of new and renewed leasing (including holdovers) and maintained steady occupancy at 88.1%, compared with 88.0% at year end. In 2020, 104 leases representing 332,622 sf or 10.4% of our portfolio are up for renewal. We have retained 86.7% of expiring leases (representing 74,320 sf) as at March 31, 2020 in spite of challenging market conditions in many of our operating regions.

The table below summarizes the leasing activity for 2020 year to date:

	Square feet	Weighted average base rent (per sf)	Occupancy %
Opening occupancy	2,824,787	\$16.79	88.0%
Expiring Leases	(85,711)	\$13.85	
Other Terminations	(10,688)	\$17.39	
Renewals/Holdovers	74,320	\$13.31	
New Leasing	24,147	\$14.28	
Lease Amendments	(378)	\$—	
Closing occupancy	2,826,477	\$16.69	88.1%

Weighted average base rent was \$16.69, down \$0.10 compared to December 31, 2019 and up \$0.09 over Q1-2019. Occupancy has remained stable (up 0.1%) over year end.

The following table summarizes our average base rent, GLA, occupancy and retention:

	Mar 31, 2020	Mar 31, 2019	△%	Dec 31, 2019	△%
Weighted average base rent (per sq. ft.)	\$16.69	\$16.60	1 %	\$16.79	(1)%
Weighted average remaining lease term	4.35	4.53	(4)%	4.37	— %
GLA	3,208,463	2,869,743	12 %	3,208,950	— %
Occupancy %	88.1%	89.3%	(1)%	88.0%	— %
Retention %	86.7%	88.9%	(2)%	59.6%	45 %

Recoveries are amounts recovered from tenants for direct operating expenses incurred and include a nominal administrative charge. We typically expect recovery revenue to correlate with changes in recoverable operating expenses. Recovery revenue was up 6% in the quarter while direct operating expenses were up 10%. The decline in our recovery ratio is due to the higher vacancy at certain properties and fluctuations in the timing of expenditures incurred within the portfolio.

Other revenue includes parking and other miscellaneous revenue that is ancillary to our business and fluctuates from period to period.

Amortization of tenant incentives can fluctuate based on the timing of lease rollovers and leasing incentives. Straight-line rent adjustments relate to new leases which have escalating rent rates and/or rent-free periods. The increase in tenant incentives is due to higher deal costs, particularly within our office portfolio. Straight-line rent adjustments fluctuate due to the timing of signed leases and the passage of time under individual leases.

Direct operating expenses

Direct operating expenses were up 10% compared with Q1-2019 largely due to acquisitions made in the past twelve months. On a same-asset basis, direct operating expenses were up 1% in 2020.

Property taxes and utilities increased by 1% on a same-asset basis (10% overall). As a cornerstone of our property management strategy, we are committed to efficient and cost effective maintenance of our buildings to ensure maximum value to our tenants and unitholders.

NOI and Same-asset NOI

Net operating income (NOI) and same-asset NOI are non-standard metrics used in the real estate industry to measure the performance of investment properties. The IFRS measure most directly comparable to NOI and same-asset NOI is net income.

NOI was up 9% over Q1-2019 due to properties acquired in the last twelve months. Same-asset NOI was down 3% over Q1-2019 due to lower occupancy on certain properties and higher operating costs. Same-asset NOI was stable over Q4-2019.

The calculation of same-asset NOI is as follows (refer to *Non-standard Measures* for calculation of NOI and reconciliation to net income):

	Three months ended				
(\$000s)	31-Mar-20	31-Mar-19	△%	31-Dec-19	△%
Same-asset NOI	10,671	11,012	(3)%	10,702	— %
Acquisitions	1,293	—		744	
NOI	11,964	11,012	9 %	11,446	5 %
Amortization of operating lease incentives	(1,067)	(765)		(870)	
Straight-line rent adjustment	251	297		153	
Net rental income	11,148	10,544	6 %	10,729	4 %

Property Analysis

At March 31, 2020 our portfolio included interests in 39 retail, office and industrial income-producing properties located in western Canada for a total of 3,208,463 sf of GLA, and a land lease community.

The following table summarizes the composition of our properties at March 31, 2020 by property type:

Property Type	Number of Properties	GLA (sf)/ Lots	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	Net rental income for the three months ended March 31, 2020 (\$000s)
Retail	14	1,396,927	43.5%	417,217	6,572
Office	21	1,603,445	50.0%	294,097	3,583
Industrial	3	208,091	6.5%	42,663	738
Land Lease Community	1	308 lots	n/a	16,200	255
	39	3,208,463	100.0%	770,177	11,148

The following table details key financial and operational metrics for each of our asset classes for the three months ended March 31, 2020:

	Retail		Office		Industrial		Land Lease Community	
	2020	2019	2020	2019	2020	2019	2020	2019
<u>Three months ended March 31 (\$000s)</u>								
Rental revenue	9,942	7,746	8,063	8,926	944	936	343	336
Net rental income	6,572	5,177	3,583	4,375	738	732	255	260
Same-asset NOI	5,283	5,230	4,370	4,780	763	742	255	260
<u>As at March 31</u>								
Weighted average base rent (sf)	\$19.91	\$20.67	\$13.71	\$13.86	\$14.77	\$14.51	n/a	n/a
Occupancy	92.4%	92.7%	82.8%	85.7%	100.0%	100.0%	100.0%	100.0%

Retail – our 14 retail properties include 6 multi-building regional power centres, 7 neighborhood shopping centres and a single tenant property. Rental revenue was up 28% over Q1-2019 mainly due to the acquisition of Melcor Crossing (Nov-2019) and Staples Centre (Apr-2019) which contributed \$2.10 million to rental revenue in Q1-2020. Occupancy decreased 0.30% from Q1-2019. Same-asset NOI was up 1% due to step ups on leases with multiple rent escalations and fewer tenants on rent-free periods.

Office – our 21 office properties include low and medium-rise buildings located in strategic urban and suburban centres. Our office portfolio is our most geographically diverse asset class, with properties across Alberta, in Regina, SK and Kelowna, BC. Rental revenue was lower over Q1-2019 as a direct result of the departure of one of our larger tenants from a downtown Edmonton office building on October 1, 2019, which also contributed to the decrease in occupancy. Weighted average base rents decreased over Q1-2019 due to continued downward market pressure on new and renewed leasing. Ongoing competition for downtown Edmonton office tenants and its impact on the suburban market continues to drag on the portfolio. Same-asset NOI was down 9% compared to Q1-2019 due to higher operating costs and higher vacancy during the current period.

Industrial – our 3 industrial properties include single and multi-tenant buildings. Our assets remained fully occupied to date in 2020. Same-asset NOI was up 3% in the first quarter as a result of step ups on leases with multiple rent escalations and lower non-recoverable costs.

Land Lease Community – we have one land lease community in Calgary, AB, consisting of 308 pad lots. It was 100% occupied at March 31, 2020 (December 31, 2019 and March 31, 2019 – 100%). Revenue on our land lease community was up 2% in Q1-2020 due to increased pad rates effective May 2019. NOI was down 2% over Q1-2019 as a result of timing of operating expenses.

Regional Analysis

The following table summarizes the composition of our properties at March 31, 2020 by geographic region:

Geographic Region	Number of Properties	GLA (sf)	% of Portfolio (GLA)	Fair Value of Investment Properties (\$000s)	Net rental income for the three months ended March 31, 2020 (\$000s)
Northern Alberta	22	1,955,120	60.9%	460,700	6,539
Southern Alberta	10	887,413	27.7%	239,656	3,707
Saskatchewan & British Columbia	7	365,930	11.4%	69,821	902
	39	3,208,463	100.0%	770,177	11,148

The following table details key financial and operational metrics for each of our geographic regions for the three months ended March 31, 2020:

	Northern Alberta		Southern Alberta		Saskatchewan & British Columbia	
	2020	2019	2020	2019	2020	2019
<u>Three months ended March 31 (\$000s)</u>						
Rental revenue	11,730	10,182	5,828	5,911	1,734	1,851
Net rental income	6,539	5,781	3,707	3,760	902	1,003
Same-asset NOI	5,961	6,043	3,648	3,868	1,062	1,101
<u>As at March 31</u>						
Weighted average base rent (per sf)	\$17.31	\$16.99	\$16.98	\$17.09	\$12.81	\$13.74
Occupancy	85.2%	86.5%	93.8%	94.6%	90.0%	90.0%

Northern Alberta - our Northern Alberta assets are located throughout the greater Edmonton area, including Leduc and Spruce Grove, and in Red Deer and Grande Prairie. Rental revenue and net rental income were up over Q1-2019 mainly due to the acquisition of Melcor Crossing (Nov-2019) which contributed \$1.86 million to rental revenue in Q1-2020 and \$1.19 million to net rental income. Same-asset NOI decreased 1% over Q1-2019 due to lower occupancy in our office portfolio.

Southern Alberta - our Southern Alberta assets are located throughout the greater Calgary area, including Chestermere and Airdrie, and in Lethbridge. Rental revenue and net rental income have decreased modestly due to higher vacancy and declining lease rates. This was offset by the acquisition of Staples Centre in April 2019 which contributed \$0.24 million to rental revenue in Q1-2020 and \$0.23 million to net rental income. Same-asset NOI was down 6% from Q1-2019 due to higher vacancy within our office portfolio and higher operating costs.

Saskatchewan and British Columbia - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue was down by 6% and same-asset NOI was down 4% due to higher lower lease rates. Occupancy remained stable over Q1-2019.

General & Administrative Expenses

(\$000s)	Three months ended March 31		
	2020	2019	△%
Asset management fee	479	437	10 %
Professional fees	95	67	42 %
Public company costs	148	131	13 %
Other	82	87	(6)%
General & administrative expenses	804	722	11%

General & administrative expenses (G&A) were \$0.80 million or 4% of rental revenue in Q1-2020. G&A was higher in the first quarter compared with Q1-2019 due to timing of expenditures incurred and an increase in asset management fee over the comparative period. Asset management fees increased as a result of acquisitions completed in 2019. We are committed to prudent financial stewardship and carefully monitor discretionary G&A expenses to ensure maximum value to our unitholders. We expect G&A to be approximately 5% of rental revenue.

Finance Costs

(\$000s)	Three months ended March 31		
	2020	2019	△%
Interest on mortgages payable and revolving credit facility	2,804	2,314	21 %
Interest on Class C LP Units	608	639	(5)%
Amortization of fair value adjustment on Class C LP Units	(32)	(33)	(3)%
Interest on convertible debentures	888	776	14 %
Accretion on convertible debentures	136	47	189 %
Fair value adjustment on derivative instruments	(2,823)	145	nm
Amortization of deferred financing fees	304	341	(11)%
Finance costs before distributions	1,885	4,229	(55)%
Distributions on Class B LP Units	2,721	2,514	8 %
Finance costs	4,606	6,743	(32)%

Finance costs were down \$2.14 million or 32% in Q1-2020 as a result of fair value adjustments on our derivative instruments. Excluding the impact of fair value adjustment on derivative instruments, finance costs were 13% higher than Q1-2019.

Higher interest on mortgages payable and revolving credit facility was due to a higher draw on our line of credit and portfolio growth resulting in new mortgages and higher interest expense. Comparatively, lower interest on Class C LP units was due to repayments made in the past twelve months, which reduced the outstanding balance.

On October 29, 2019 we issued the \$46.00 million 2019 Debentures, paying a coupon of 5.10%. On December 19, 2019 we redeemed the 5.50% \$34.50 million 2014 Debentures. The \$23.00 million 2017 Debentures pay a coupon of 5.25% annually.

Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units (\$0.17 per unit during the quarter). In Q4-2019, we issued 1,225,822 Class B LP Units to Melcor for \$10.00 million, increasing the distributions paid in Q1-2020 by 8% over Q1-2019.

As at March 31, 2020 the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debentures was 3.76% (December 31 - 3.78%).

Income Taxes

As at March 31, 2020, the REIT qualifies as a mutual fund trust within the meaning of the *Income Tax Act* (Canada) and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through (SIFT) rules; accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT.

Funds from Operations, Adjusted Funds from Operations & Adjusted Cash Flow From Operations

Funds From Operations (FFO), Adjusted Funds From Operations (AFFO) and Adjusted Cash Flow From Operations (ACFO) are non-standard measures used in the real estate industry to measure the operating and cash flow performance of investment properties.

Funds from operations & adjusted funds from operations

REALpac defines Funds From Operations (FFO) as net income (calculated in accordance with IFRS), adjusted for, among other things, fair value adjustments, amortization of tenant incentives and effects of puttable instruments classified as financial liabilities (distributions on Class B LP Units). The REIT calculates FFO in accordance with REALpac.

We believe that FFO is an important measure of operating performance and the performance of real estate properties, while AFFO is an important cash flow measure. AFFO is not a substitute for cash flow from operations as it does not include changes in operating assets and liabilities.

FFO and AFFO are not a substitute for net income established in accordance with IFRS when measuring the REIT's performance. While our methods of calculating FFO and AFFO comply with REALpac recommendations, they may differ from and not be comparable to those used by other entities.

(\$000s, except per unit amounts)	Three months ended March 31		
	2020	2019	△%
Net income for the period	83,912	2,478	
Add / (deduct)			
Fair value adjustment on investment properties	6,187	(1,159)	
Fair value adjustment on Class B LP Units	(84,334)	1,788	
Amortization of tenant incentives	1,067	765	
Distributions on Class B LP Units	2,721	2,514	
Fair value adjustment on derivative instruments	(2,823)	145	
Funds From Operations (FFO)	6,730	6,531	3%
Deduct			
Straight-line rent adjustments	(251)	(297)	
Normalized capital expenditures	(587)	(587)	
Normalized tenant incentives and leasing commissions	(1,030)	(1,030)	
Adjusted Funds from Operations (AFFO)	4,862	4,617	5%
FFO/Unit	\$0.23	\$0.23	
AFFO/Unit	\$0.17	\$0.16	
Weighted average number of units (000s): ⁽¹⁾	29,255	28,086	4%

(1) For the purposes of calculating per unit FFO and AFFO the basic weighted average number of units includes Trust Units and Class B LP Units.

Our convertible debentures can be converted into trust units at the holder's option and are considered a dilutive instrument.

The following table calculates diluted FFO and diluted FFO/Unit:

(\$000s, except per unit amounts)	Three months ended March 31		
	2020	2019	△%
Funds From Operations (FFO)	6,730	6,531	3%
Convertible debentures interest	888	776	
Amortization of deferred financing fees	166	208	
Accretion on convertible debentures	136	47	
Funds From Operations - Diluted (FFO - Diluted)	7,920	7,562	5%
FFO - Diluted/Unit	\$0.22	\$0.23	
Diluted weighted average number of units (000s): ⁽¹⁾	36,424	32,813	11%

(1) The diluted weighted average number of units includes Trust Units, Class B LP Units and convertible debentures.

Capital Expenditures

We continually invest in our assets with value-adding investments that enhance property quality, which contributes to higher occupancy and rental rates. These upgrades typically focus on increasing operating efficiency, property attractiveness, functionality and desirability, as well as initiatives focused on sustainability and energy reduction strategies to ensure our buildings are green. Asset enhancement and preservation investments fluctuate based on the nature and timing of projects undertaken, and are impacted by many factors including, but not limited to, the age and location of the property, and the leasing profile and strategy. The majority of building improvement expenditures are recoverable from tenants over 5-25 years. As actual expenditures can vary from one period to another, the REIT uses a normalized capital expenditure in determining AFFO and sustainable, economic cash flow of investment properties.

Normalized expenditures exclude new property development initiatives such as densification and non-recoverable capital as these are discretionary in nature. Normalized capital expenditures are calculated based on a trailing 5 year historical actual spend plus 5 year projected spend.

The following summarizes our actual expenditures compared to normalized amounts.

(\$000s)	Three months ended March 31, 2020	Year ended December 31, 2019
Actual capital expenditures	115	2,517
Normalized capital expenditures	587	2,349
Variance	(472)	168

Actual capital expenditures were below normalized capital expenditures by \$0.47 million for the three-months ended March 31, 2020 due to the type and timing of projects undertaken. In order to strengthen the REIT's flexibility to respond to and support tenants through COVID-19, the REIT is deferring non-emergency maintenance.

Tenant Incentive & Direct Leasing Expenditures

We continually invest in tenant incentives and direct leasing expenditures as part of our leasing strategy. Tenant incentives are directly correlated with base rent achieved on leasing deals, with higher tenant incentives carrying higher base rent. Expenditures on any particular building are impacted by many factors including, but not limited to, the lease maturity profile and strategy, market conditions and the property's location and asset class. As actual expenditures can vary from one period to another, the REIT uses a normalized capital expenditure in determining AFFO and sustainable, economic cash flow of investment properties. Normalized tenant incentives are calculated based on a trailing 5 year actual spend plus 5 year projected spend.

The following summarizes our actual expenditures compared to normalized amounts.

(\$000s)	Three months ended March 31, 2020	Year ended December 31, 2019
Actual tenant incentives and direct leasing expenditures	853	5,716
Normalized tenant incentives and direct leasing expenditures	1,030	4,119
Variance	(177)	1,597

Actual tenant incentives and direct leasing expenditures were lower than normalized amounts due to the timing and type of leasing activity. There is currently insufficient information to determine the impact of COVID-19 on our projected spending.

Adjusted cash flow from operations

REALpac defines Adjusted Cash Flow from Operations (ACFO) as cash flow from operations adjusted for, among other things, changes in operating assets and liabilities, payments of tenant incentives and direct leasing costs, non-cash finance costs, normalized capital expenditures and normalized tenant incentives and direct leasing costs. We calculate ACFO in accordance with the guidelines set out by REALpac; however, our calculation may differ from and not be comparable to other entities.

	Three months ended March 31		
(\$000s)	2020	2019	△%
Cash flows from operations	3,453	2,751	26%
Distributions on Class B LP Units	2,721	2,514	
Actual payment of tenant incentives and direct leasing costs	1,414	1,073	
Changes in operating assets and liabilities	(701)	251	
Amortization of deferred financing fees ⁽¹⁾	(304)	(341)	
Normalized capital expenditures	(587)	(587)	
Normalized tenant incentives and leasing commissions	(1,030)	(1,030)	
Adjusted Cash flow from Operations (ACFO)	4,966	4,631	7%
ACFO/Unit	\$0.17	\$0.16	
Weighted average number of units (000s) ⁽²⁾	29,255	28,086	4%

(1) In Q4-2019 we amended our definition of amortization of deferred financing fees to exclude accretion on convertible debentures. Amortization of deferred financing fees is an adjusting item in the calculation of ACFO. This change has been applied retroactively.

(2) For purposes of calculating per unit ACFO the basic weighted average number of units includes Trust Units and Class B LP Units.

In order to continue to qualify for the 'REIT Exception' as provided under the SIFT rules, we must allocate substantially all taxable income. As such, we allocate monthly distributions to unitholders as determined and approved by the Board of Trustees. We made monthly distributions to unitholders at a rate of \$0.05625 per unit during the quarter. Distributions to unitholders during the three-month period were \$2.22 million (Q1-2019 - \$2.23 million).

Distributions made during the three-months ended March 31, 2020 represent a payout ratio of approximately 99% of ACFO (Q1-2019 - 102%). On an FFO basis, distributions represent a payout ratio of 73% (Q1-2019 - 73%).

We use ACFO in evaluating our ability to continue to fund distributions. The most similar IFRS measure is cash flow from operations. Cash flow from operations, which includes Class B LP Unit distributions as a financing charge, exceeded distributions by \$1.24 million in the three-months ended March 31, 2020 as illustrated below (Q1-2019 - \$0.53 million respectively).

	Three months ended March 31		
(\$000s)	2020	2019	△%
Cash flows from operations	3,453	2,751	26 %
Distributions on Class B LP Units	2,721	2,514	8 %
Cash flow from operations before Class B LP Unit Distributions	6,174	5,265	17 %
Distributions to unitholders	(2,216)	(2,225)	— %
Distributions on Class B LP Units	(2,721)	(2,514)	8 %
Total distributions	(4,937)	(4,739)	4 %
Cash flow from operations before Class B LP Unit distributions less total distributions	1,237	526	135 %
Total distributions as a % of cash flow from operations before Class B LP Unit distributions	80%	90%	(11)%

Investment Properties

We carry our investment properties at fair value in accordance with IFRS 13, *Fair value measurement*. The following table summarizes key metrics of our investment properties and components of the fair value calculation:

	Three months ended March 31, 2020	Year ended December 31, 2019
Number of properties	39	39
Total GLA (sf)	3,338,561	3,339,030
GLA (REIT owned %) (sf)	3,208,463	3,208,950
Fair value of portfolio (\$000s)	770,177	776,212
Value per square foot	\$240	\$242
NOI (\$000s)	11,964	45,300
Weighted average capitalization rate	6.80%	6.82%
Weighted average discount rate	6.86%	6.87%
Weighted average terminal capitalization rate	7.73%	7.76%

For the quarter ended March 31, 2020, Melcor's internal valuation team performed the valuation assessment. To date in 2020, 4 phases of 53 legal phases with a fair value of \$55.05 million were valued by qualified independent external valuation professionals. The remaining portfolio was assessed by management, with valuations performed during the period resulting in fair value losses of \$6.19 million. For the year ended December 31, 2019, 32 phases of 53 legal phases with a fair value of \$444.70 million were valued by qualified independent external valuation professionals. valuations performed in 2019 resulted in fair value losses of \$1.62 million.

Phases are a result of the property development process when a larger project is developed over an extended period of time and subdivided into legal phases for increased flexibility.

The breakdown of our fair value adjustment on investment properties by geographic region is as follows:

(\$000s)	Three months ended March 31, 2020	Year ended December 31, 2019
Northern Alberta	(5,704)	2,431
Southern Alberta	(2,485)	(1,469)
Saskatchewan & British Columbia	2,002	(2,584)
	(6,187)	(1,622)

Fair value losses in Alberta were due to declines in stabilized NOI, primarily within our retail portfolio. Fair value gains in Saskatchewan & British Columbia was due to a decline in the capitalization rate on a Kelowna, BC office property. The remainder of fair value losses across the portfolio were due to capital and tenant incentive spending that did not result in a significant change in the fair value of the related property. Fair value adjustments represent a change of less than 1% in the fair value of our portfolio.

Fair values are most sensitive to changes in capitalization rates.

	March 31, 2020			December 31, 2019		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.50%	6.80%	5.50%	10.50%	6.82%
Terminal capitalization rate	5.75%	9.00%	6.86%	5.75%	9.00%	6.87%
Discount rate	6.25%	9.50%	7.73%	6.50%	9.50%	7.76%

A capitalization rate increase of 50 basis points (+0.5%) would decrease the fair value of investment properties by \$53.37 million (December 31, 2019 - \$53.11 million) while a 50 basis points decrease (-0.5%) would increase it by \$61.83 million (December 31, 2019 - \$61.51 million).

COVID-19 has impacted many of our tenants and the REIT is committed to working with our tenants, making arrangement for deferrals where appropriate. These arrangements demonstrate our continued solidarity and partnership with our tenants and belief that support will provide our tenants the best opportunity to endure the pandemic and be successful in the long-term. In spite of our efforts and the efforts of various orders of government the pandemic may have a negative long-term impact on our investment properties. Due to the rapidly changing and evolving environment it is not certain as to the long-term impact on stabilized NOI, including market rents, leasing costs, vacancy rates, as well as discount rates and capitalization rate. The REIT will continue to monitor its portfolio and the market in assessing fair value changes and cautions readers that material fair value adjustments may be required in the future.

Liquidity & Capital Resources

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

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

Cash Flows

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

(\$000s)	Three months ended March 31		
	2020	2019	△\$
Cash from operating activities	3,453	2,751	702
Cash used in investing activities	(115)	(882)	767
Cash used in financing activities	(3,726)	(1,903)	(1,823)
Decrease in cash and cash equivalents	(388)	(34)	(354)
Cash and cash equivalents, beginning of the period	2,280	1,581	699
Cash and cash equivalents, end of the period	1,892	1,547	345

Operating activities

Cash from operating activities was up \$0.70 million over Q1-2019. Excluding changes in operating assets and liabilities and payment of tenant incentives and direct leasing costs, cash from operating activities was stable at \$4.17 million (2019 - \$4.08 million).

Our tenant incentives and direct leasing cost investments were \$1.41 million in the quarter (2019 - \$1.07 million) as we completed 98,467 sf of new and renewed leasing, resulting in period-end occupancy of 88.1%. The timing of lease expiries impacts the level of spending on tenant incentives and direct leasing costs and will fluctuate from period to period.

Investing activities

In the first quarter we commenced work on our scheduled maintenance program, with \$0.12 million invested (2019 - \$0.88 million). Our 2020 capital program is currently suspended due to COVID-19 in an effort to improve near term liquidity and reduce non-essential activities at our properties. We remain committed to strategic value-adding asset enhancement and preservation projects as a integral component of our strategy to improve our assets and retain and attract tenants. Asset enhancement investments fluctuate based on the nature and timing of projects undertaken.

Financing activities

We drew \$1.75 million in Q1-2020 from our revolving credit facility in order to fund capital and leasing activities.

On April 1, 2019 we commenced an NCIB which expired on March 31, 2020. During the quarter, we repurchased 23,264 units at a cost of \$0.13 million. On April 1, 2020 a new NCIB program was put in place and we are continuing to buy back trust units.

Our distribution remained stable at \$0.05625 per unit for quarterly distributions of \$2.22 million (Q1-2019 - \$2.23 million). Subsequent to the quarter we announced cash distributions of \$0.03 for the month of April and May, a 47% reduction from the previous distribution, which had been in place since IPO in 2013.

The reduction in the REIT's distribution rate, combined with other measures undertaken to preserve cash will provide near term liquidity and counterbalance operating income uncertainty. We believe that internally generated cash flows, supplemented by borrowings through our revolving credit facility and mortgage financings, where required, will be sufficient to cover our normal operating, debt service, distribution and capital expenditure requirements. We regularly review our credit facility limits and manage our liquidity requirements accordingly.

As at March 31, 2020 we had \$1.89 million in cash and cash equivalents in addition to \$10.11 million in funds available under our revolving credit facility.

Capital Structure

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

Pursuant to the Declaration of Trust ("DOT") Degree of Leverage Ratio, we may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, our total indebtedness would be more than 60% (65% including any convertible debentures) of Gross Book Value (GBV). Throughout the period we were in compliance with the Degree of Leverage Ratio and had a ratio of 59% as at March 31, 2020 (50% excluding convertible debentures).

As at March 31, 2020, our total capitalization was \$742.27 million and is comprised of:

(\$000s)	March 31, 2020	Dec 31, 2019
Revolving credit facility ⁽¹⁾	24,772	23,025
Mortgages payable ⁽¹⁾	291,064	293,265
Class C LP Units ⁽²⁾	67,795	68,723
Indebtedness, excluding convertible debentures	383,631	385,013
Convertible debentures ⁽³⁾	69,000	69,000
Indebtedness	452,631	454,013
Class B LP Units ⁽⁴⁾	160,207	160,207
Trust units	129,436	129,666
Equity	289,643	289,873
Total capitalization	742,274	743,886
Gross Book Value (GBV)⁽⁵⁾	766,457	766,457
Debt to GBV, excluding convertible debentures (maximum threshold - 60%)	50%	50%
Debt to GBV (maximum threshold - 65%)	59%	59%

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

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

(3) Convertible debentures are presented at face value, excluding unamortized transaction costs and amounts allocated to conversion feature.

(4) Class B LP Units are classified as equity for purposes of this calculation and are included at their book value.

(5) GBV is calculated as the cost of the total assets acquired and development costs less dispositions.

We are also subject to financial covenants on our \$35.00 million 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 \$140.00 million as defined within our credit agreement. As at March 31, 2020, and throughout the period, we were in compliance with our financial covenants. We also have financial covenants on certain mortgages for investment properties. At March 31, 2020 we are in compliance with all of our obligations and debt covenants. We prepare financial forecasts to monitor changes to our debt and capital levels and manage our ability to meet our financial covenants.

Indebtedness

Debt Repayment Schedule – the following table summarizes our contractual obligations and illustrates certain liquidity and capital resource requirements:

	<i>as at March 31</i>						
(\$000s)	Total	2020	2021	2022	2023	2024	Thereafter
Revolving credit facility	24,772	24,772	—	—	—	—	—
Mortgages payable	291,064	21,306	39,130	33,762	42,388	43,225	111,253
Class C LP Units	67,795	26,218	14,675	1,095	14,932	451	10,424
Convertible debentures	69,000	—	—	23,000	—	46,000	—
Total	452,631	72,296	53,805	57,857	57,320	89,676	121,677
% of portfolio	100%	16%	12%	13%	13%	20%	26%

We ladder the renewal and maturity dates on our borrowings as part of our capital management strategy. This mitigates the concentration of interest rate and financing risk associated with refinancing in any particular period. In addition, we try to match the maturity of our debt portfolio with the weighted average remaining lease term on our properties.

Over the next twelve months, four mortgages are up for renewal with an outstanding principal balance of \$17.54 million with a weighted average interest rate of 3.10% at March 31, 2020. We also have three properties encumbered by Class C LP Units

where the underlying mortgages - held by Melcor - are up for renewal in the next 12 months. The Class C LP Units have an outstanding principal balance of \$24.81 million and a weighted average interest rate of 3.76% (3.22% including interest rate subsidies) at March 31, 2002. The financing environment, including commercial lending, has been significantly impacted by the effects of COVID-19 and various government measures undertaken. Uncertainty as to the timing of when markets will return to more 'normal' operation will impact near term financing strategies. Excluding one mortgage, with a principal balance of \$2.40 million due July 1; the remaining debts mature in the latter part of the year. The REIT is proactively engaging with its lenders in regards to upcoming maturities.

We are in the process of working with our lenders for payment relief on various debts as a result of the COVID-19 pandemic. Temporary payment relief combined with other capital management strategies deployed will allow the REIT the near term liquidity to support our tenants and partners through this period of uncertainty.

The REIT and Melcor has a good, long standing relationship with its lending partners and is committed to working with our lenders through this period.

We continually monitor our upcoming mortgage renewals to identify opportunities and risks.

Debt Analysis – our mortgages payable, Class C LP Units and convertible debenture bear interest at fixed rates (including one variable rate mortgage fixed via a floating for fixed interest rate swap contract); our revolving credit facility bears interest at variable rates. The following table summarizes the interest rates and terms to maturity:

(\$000s)	Total	Fixed	Variable	Weighted average interest rate	Weighted average term to maturity
Revolving credit facility	24,772	—	24,772	3.93%	1.17
Mortgages payable	291,064	274,684	16,380	3.50%	5.23
Class C LP Units	67,795	67,795	—	3.40%	2.34
Convertible debentures	69,000	69,000	—	5.15%	4.09
Total	452,631	411,479	41,152	3.76%	4.40

The weighted average interest rate on our debts was 3.76% (December 31, 2019 - 3.78%).

Debt Service Coverage Ratio and Finance Costs Coverage Ratio – we calculate debt service coverage ratio as FFO for the period divided by principal repayments on mortgages payable and Class C LP Units made during the period. We calculate interest coverage as FFO plus finance costs for the period divided by finance costs expensed during the period, less distributions on Class B LP Units. We consider these measures to be useful in evaluating our ability to service our debt. These metrics are not calculated for purposes of covenant compliance on any of our debt facilities.

(\$000s)	Three months ended March 31, 2020	Year ended December 31, 2019
FFO	6,730	25,581
Principal repayments on Mortgages payable	2,201	7,700
Principal repayments on Class C LP Units	928	3,628
Debt service coverage ratio	2.15	2.26
FFO plus finance costs	11,438	43,177
Finance costs ⁽¹⁾	4,708	17,596
Finance costs coverage ratio	2.43	2.45

(1) Finance costs excluding finance expense recognized on Class B LP Unit distributions and fair value adjustment on derivative instruments.

Equity

The REIT is authorized to issue an unlimited number of trust units and an unlimited number of special voting units. Each trust unit represents a holder's proportionate undivided beneficial ownership interest in the REIT and will confer the right to one vote at any meeting of the unitholders and to receive any distributions by the REIT. Special voting units have no economic entitlement in the REIT but entitle the holder to one vote per special voting unit. Special voting units may only be issued in connection with securities exchangeable into trust units (including Class B LP Units).

Class B LP Units of the Partnership are economically equivalent to, and exchangeable into, trust units at the option of the holder, and therefore, are considered a dilutive instrument. The Class B LP Units are classified as financial liabilities in accordance with IAS 32, *Financial Instruments – presentation*, due to their puttable feature.

On April 1, 2020 we commenced a new NCIB to buy back our trust units. We are entitled to purchase up to 655,792 trust units for cancellation, representing approximately 5% of the REIT's issued and outstanding trust units. We believe that our units have been trading in a price range which does not reflect the value of the units in relation to our current and future business prospects. 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 ends one year from commencement, on March 31, 2021. Subsequent to the quarter we purchased 49,905 units for \$0.18 million under the NCIB purchase plan which commenced April 1, 2020.

Under the previous NCIB which expired on March 31, 2020, we purchased 23,264 units for \$0.23 million. In total, the REIT purchased and cancelled 76,768 units for \$0.53 million at a weighted average cost of \$6.95 per unit or 70% of book value.

The following table summarizes the trust units issued and the fully diluted number of units outstanding as at March 31, 2020 and December 31, 2019:

	March 31, 2020		December 31, 2019	
	Units	\$ Amount	Units	\$ Amount
Issued and fully paid units (\$000s)				
Balance, beginning of period	13,133,293	129,666	13,186,797	130,194
Repurchase of trust units	(23,264)	(230)	(53,504)	(528)
Balance, end of period	13,110,029	129,436	13,133,293	129,666
<i>Dilutive securities</i>				
Class B LP Units ⁽¹⁾	16,125,147	160,207	16,125,147	160,207
Convertible debentures	7,168,541	69,000	7,168,541	69,000
Diluted balance, end of period	36,403,717	358,643	36,426,981	358,873

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

Quarterly Results

	2020	2019				2018		
(\$000s except per unit amount)	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	19,292	18,273	17,468	17,474	17,944	17,336	17,283	17,537
Net income (loss) ⁽¹⁾	83,912	(5,220)	2,310	(56)	2,478	6,737	3,097	(1,768)
Funds from operations (FFO)	6,730	6,002	6,570	6,478	6,531	6,382	6,277	6,723
Adjusted funds from operations (AFFO) ⁽²⁾	4,862	4,232	4,860	4,776	4,617	4,792	4,494	4,973
Adjusted cash flows from operations (ACFO) ⁽⁴⁾	4,965	4,315	4,875	4,790	4,630	4,796	4,484	4,961
Per unit metrics								
Basic earnings (loss) per unit	\$ 6.39	\$ (0.35)	\$ 0.18	\$ —	\$ 0.19	\$ 0.51	\$ 0.23	\$ (0.13)
FFO (basic)	\$ 0.23	\$ 0.21	\$ 0.23	\$ 0.23	\$ 0.23	\$ 0.23	\$ 0.22	\$ 0.24
AFFO ⁽²⁾ (basic)	\$ 0.17	\$ 0.15	\$ 0.17	\$ 0.17	\$ 0.16	\$ 0.17	\$ 0.16	\$ 0.18
ACFO (basic) ⁽⁴⁾	\$ 0.17	\$ 0.15	\$ 0.17	\$ 0.17	\$ 0.16	\$ 0.17	\$ 0.16	\$ 0.18
Annualized distribution rate ⁽³⁾	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675	\$0.675
FFO Payout Ratio	73%	81%	72%	73%	73%	74%	76%	70%
AFFO Payout Ratio	102%	114%	97%	99%	103%	99%	105%	95%
ACFO Payout Ratio	99%	112%	97%	99%	102%	99%	106%	96%
Period-end closing unit price	\$2.89	\$8.12	\$7.74	\$7.65	\$7.58	\$7.46	\$8.10	\$8.22
Annualized distribution yield on closing unit price (%) ⁽³⁾	23.36%	8.31%	8.72%	8.82%	8.91%	9.05%	8.33%	8.21%

(1) Net income (loss) is significantly impacted by the results of non-cash fair value adjustments on assets and liabilities carried at fair value. Management believes that FFO is a better measure of operating performance and that AFFO is a better measure of cash flows.

(2) Annualized distribution yield is calculated as the annualized distribution rate divided by the period-end closing price.

(3) On March 20, 2020 the REIT announced a cut to its distribution for April 2020 to \$0.03 per trust units (from \$0.05625 per unit). On May 14, 2020 the REIT announced distributions for the month of May of \$0.03 per trust unit.

(4) In Q4-2019 we amended our definition of amortization of deferred financing fees to exclude accretion on convertible debenture. Amortization of deferred financing fees is an adjusting item in the calculation of ACFO. This change was applied retroactively.

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

There were no material changes to the above titled sections at March 31, 2020 in comparison to the December 31, 2019 annual MD&A except as described below.

Business Environment & Risks

Pandemics, Natural Disasters or Other Unanticipated Events

The occurrence of pandemics, natural disasters, or other unanticipated events, in any of the areas where we or our partners and suppliers operate could disrupt operations. In addition, pandemics, natural disasters or other unanticipated events could have a material adverse effect on our business, financial condition, results of operations and cash flows. The outbreak of the novel strain of the coronavirus (COVID-19) has resulted in governments worldwide enacting emergency measures to contain the spread of the virus. Future outbreaks of viruses or other contagions, epidemic or pandemic diseases including a potential second wave outbreak of COVID-19 may lead to prolonged voluntary or mandatory building and/or business closures, restrictions on travel and gatherings, quarantines, self-isolation and physical distancing. The impact of these measures may cause a general shutdown of economic activity and disrupt workforce and business operations in the regions where we operate. An occurrence such as this, including the COVID-19 pandemic, could have material adverse effects and increased risk, including but not limited to:

- negative impact on pricing and availability of Canadian debt and equity capital markets
- material reduction in rental revenue and related collections due to financial hardship and government ordered closures of certain business
- reduced demand for commercial real estate leading to a material increase in vacancy and decline in revenue

- trading price of the REIT's securities
- negative impact to real estate valuations from declining revenue and lack of market activity
- ability to access capital markets at a reasonable cost
- uncertainty regarding delivering services due to illness, REIT or government imposed isolation programs, restructurings on the movement of personnel, closures and supply chain disruptions
- impact of additional legislation, regulation, fiscal and monetary policies and other government interventions

This is not an exhaustive list of all risk factors.

To mitigate these risks, we have a comprehensive health and safety program and have expanded it to include pandemics. We have introduced new policies and practices both internally and at the properties that we manage to reduce the spread of COVID-19 through:

- education
- plentiful access to hand sanitizer
- more frequent cleaning schedules emphasizing disinfection of high-touch surfaces multiple times per day.

We are currently reviewing additional measures and will continue to transparently communicate with our staff, tenants and stakeholders.

Internal Control over Financial Reporting and Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer have evaluated whether there were material changes to internal control over financial reporting during the quarter ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Melcor, the REIT's asset and property manager, initiated a crisis management plan in response to the COVID-19 pandemic in March. To support physical distancing, Melcor's employee base began to work from home wherever practical. The remote work arrangements did not have an impact on the design of our internal controls. The REIT will continue to monitor and mitigate the risks associated with changes to its control environment in response to COVID 19.

Declaration of Trust

The investment guidelines and operating policies of the REIT are outlined in the Amended and Restated Declaration of Trust (DOT) dated May 1, 2013. A copy of the DOT is filed on SEDAR at www.sedar.com and is available on request to all unitholders. At May 14, 2020, the REIT was in compliance with all investment guidelines and operating policies stipulated in the DOT.

Non-standard Measures

Throughout this MD&A, we refer to terms that are not specifically defined in the CPA Canada Handbook or in IFRS. These non-standard measures may not be comparable to similar measures presented by other companies. We use REALpac definitions for FFO, ACFO and AFFO.

We believe these non-standard measures will assist investors in understanding components of our financial results.

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

Calculations

We use the following calculations in measuring our performance.

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

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

(\$000s)	Three months ended March 31				
	2020	2019	△%	31-Dec-19	△%
Net income (loss) for the period	83,912	2,478		(5,220)	
Net finance costs	4,579	6,715		8,128	
Fair value adjustment on Class B LP Units	(84,334)	1,788		5,750	
Fair value adjustment on investment properties	6,187	(1,159)		1,364	
General and administrative expenses	804	722		707	
Amortization of operating lease incentives	1,067	765		870	
Straight-line rent adjustment	(251)	(297)		(153)	
NOI	11,964	11,012	9%	11,446	5%

Same-asset NOI: this measure compares the NOI on assets that have been owned for the entire current and comparative period and are classified for continuing use.

Funds from operations (FFO): FFO is defined as net income in accordance with IFRS, excluding: (i) fair value adjustments on investment properties; (ii) gains (or losses) from sales of investment properties; (iii) amortization of tenant incentives; (iv) fair value adjustments, interest expense and other effects of redeemable units classified as liabilities; (v) acquisition costs expensed as a result of the purchase of a property being accounted for as a business combination; and (vi) fair value adjustment on derivative instrument, after adjustments for equity accounted entities, joint ventures and non-controlling interests calculated to reflect FFO on the same basis as consolidated properties.

FFO per unit: FFO per unit is defined as FFO divided by weighted average trust units and weighted average Class B LP Units outstanding. Dilutive FFO includes the effect of the convertible debentures.

Adjusted funds from operations (AFFO): AFFO is defined as FFO subject to certain adjustments, including: (i) adjusting for any differences resulting from recognizing property revenues on a straight-line basis; (ii) deducting a reserve for normalized maintenance capital expenditures, tenant inducements and leasing costs, as determined by us. Other adjustments may be made to AFFO as determined by the Board in its discretion.

AFFO per unit: AFFO per unit is defined as AFFO divided by weighted average trust units and weighted average Class B LP Units outstanding.

Adjusted cash flows from operations (ACFO): ACFO is defined as cash flows from operations subject to certain adjustments, including: (i) fair value adjustments and other effects of redeemable units classified as liabilities; (ii) payments of tenant incentives and direct leasing costs; (iii) changes in operating assets and liabilities which are not indicative of sustainable cash available for distribution; (iv) amortization of deferred financing fees; and (v) deducting a reserve for normalized maintenance capital expenditures, tenant inducements and leasing costs, as determined by us. Other adjustments may be made to ACFO as determined by the Board in its discretion.

FFO, AFFO and ACFO Payout ratio: is calculated as per unit distributions divided by basic per unit FFO, AFFO and ACFO.

Finance costs coverage ratio: is calculated as FFO plus finance costs for the period divided by finance costs expensed during the period excluding distributions on Class B LP Units and fair value adjustment on derivative instruments.

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

Debt to Gross Book Value: is calculated as the sum of total amount drawn on revolving credit facility, mortgages payable, Class C LP Units, excluding unamortized fair value adjustment on Class C LP Units, liability held for sale (as applicable) and convertible debentures, excluding unamortized discount and transaction costs divided by Gross Book Value (GBV). GBV is calculated as the total assets acquired in the Initial Properties, subsequent asset purchases and development costs less dispositions.



MELCOR REAL ESTATE INVESTMENT TRUST

Condensed Interim Consolidated Financial Statements

For the three-months ended March 31, 2020

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at March 31, 2020

(Unaudited)

(\$000s)	March 31, 2020	December 31, 2019
ASSETS		
Current Assets		
Cash and cash equivalents	1,892	2,280
Accounts receivable	2,449	1,666
Other assets (note 5)	2,017	2,303
Loan receivable	900	900
	7,258	7,149
Non-Current Assets		
Investment properties (note 4 and 16)	747,585	753,483
Other assets (note 5)	22,592	22,729
Derivative financial asset (note 16)	—	173
	770,177	776,385
TOTAL ASSETS	777,435	783,534
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 6)	24,677	22,864
Accounts payable	2,115	1,433
Distribution payable	1,644	1,646
Accrued liabilities and other payables (note 7)	9,618	9,670
Class C LP Units (note 9)	26,876	27,146
Mortgages payable (note 8)	25,935	23,507
	90,865	86,266
Non-Current Liabilities		
Accrued liabilities and other payables (note 7)	1,657	1,641
Class B LP Units (note 10 and 16)	46,602	130,936
Class C LP Units (note 9)	40,985	41,675
Mortgages payable (note 8)	263,549	268,113
Convertible debentures (note 16)	63,406	63,104
Derivative financial liabilities (note 16)	84	3,080
TOTAL LIABILITIES	507,148	594,815
UNITHOLDERS' EQUITY	270,287	188,719
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	777,435	783,534

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Income and Comprehensive Income

For the three-months ended March 31

(Unaudited)

(\$000s)	2020	2019
Rental revenue (note 12 and 14)	19,292	17,944
Direct operating expenses (note 14)	(8,144)	(7,400)
Net rental income	11,148	10,544
General and administrative expenses (note 14)	(804)	(722)
Fair value adjustment on investment properties (note 4 and 16)	(6,187)	1,159
Fair value adjustment on Class B LP Units (note 10 and 16)	84,334	(1,788)
Income before finance costs	88,491	9,193
Interest income	27	28
Finance costs (note 13 and 14)	(4,606)	(6,743)
Net finance costs	(4,579)	(6,715)
Net income and comprehensive income	83,912	2,478
Basic income per trust unit (note 11)	\$6.39	\$0.19
Diluted income per trust unit (note 11)	\$0.08	\$0.19

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at March 31, 2020

(Unaudited)

(\$000s except unit amounts)	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 11)	(23,264)	(230)	102	—	(128)
Net income for the period	—	—	—	83,912	83,912
Distributions to unitholders	—	—	—	(2,216)	(2,216)
Balance at March 31, 2020	13,110,029	118,061	40,895	111,331	270,287

(\$000s except unit amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2018	13,186,797	118,819	40,536	39,005	198,360
Net income for the period	—	—	—	2,478	2,478
Distributions to unitholders	—	—	—	(2,225)	(2,225)
Balance at March 31, 2019	13,186,797	118,819	40,536	39,258	198,613

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Cash Flows

For the three months ended March 31

(Unaudited)

(\$000s)	2020	2019
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income for the period	83,912	2,478
Non cash items:		
Amortization of tenant incentives (note 5 and 12)	1,067	765
Straight-line rent adjustments (note 12)	(251)	(297)
Fair value adjustment on investment properties (note 4 and 16)	6,187	(1,159)
Fair value adjustment on Class B LP Units (note 10 and 16)	(84,334)	1,788
Amortization of fair value adjustment on Class C LP Units (note 13)	(32)	(33)
Accretion on convertible debenture (note 13)	136	47
Fair value adjustment on derivative instruments (note 13 and 16)	(2,823)	145
Amortization of deferred financing fees (note 13)	304	341
	4,166	4,075
Payment of tenant incentives and direct leasing costs	(1,414)	(1,073)
Changes in operating assets and liabilities	701	(251)
	3,453	2,751
INVESTING ACTIVITIES		
Investment in property improvements (note 4)	(115)	(882)
	(115)	(882)
FINANCING ACTIVITIES		
Change in revolving credit facility	1,747	9,952
Repayment of mortgages payable (note 8)	(2,201)	(8,734)
Repayment on Class C LP Units (note 9)	(928)	(896)
Units repurchased (note 11)	(128)	—
Distributions to unitholders	(2,216)	(2,225)
	(3,726)	(1,903)
DECREASE IN CASH & CASH EQUIVALENTS DURING THE PERIOD	(388)	(34)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	2,280	1,581
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	1,892	1,547

See accompanying notes to the condensed interim consolidated financial statements.

1. DESCRIPTION OF THE TRUST

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

Our principal business is to acquire, own and manage office, retail and industrial properties in select markets across Western Canada. The properties are externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the Property Management Agreement and Asset Management Agreement (note 14).

As at May 14, 2020, Melcor, through an affiliate, holds an approximate 55.2% 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.

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

2. BASIS OF PRESENTATION

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standard Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*.

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2019, which have been prepared in accordance with IFRS as issued by the IASB. These condensed interim consolidated financial statements were authorized for issue by the Board of Trustees on May 14, 2020.

The condensed interim consolidated financial statements have been prepared using the same significant accounting policies and methods as those used in our annual consolidated financial statements for the year ended December 31, 2019.

3. SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

Significant accounting policies

The accounting policies followed in these condensed interim consolidated financial statements are consistent with those of the previous financial year. There were no new or amended standards adopted during the current quarter.

Critical accounting estimates

The outbreak of the novel strain of coronavirus, specifically identified as "COVID-19", has resulted in the federal and provincial governments enacting emergency measures to combat the spread of the virus. These emergency measures have resulted in negative impacts to our economy, and the REIT recognizes that areas of significant estimates may be impacted by the uncertainty surrounding future economic activity.

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 cost 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.

4. INVESTMENT PROPERTIES

(\$000s)	Three months ended March 31, 2020	Year ended December 31, 2019
Balance - beginning of period	753,483	683,768
Additions		
Direct acquisition	—	68,175
Property improvements	115	2,517
Direct leasing costs	174	645
Fair value adjustment on investment properties (note 16)	(6,187)	(1,622)
Balance - end of period	747,585	753,483

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

Presented separately from investment properties is \$15,328 (December 31, 2019 - \$15,716) in tenant incentives and \$7,264 (December 31, 2019 - \$7,013) in straight-line rent adjustments (note 5). The fair value of investment properties has been reduced by these amounts.

5. OTHER ASSETS

(\$000s)	March 31, 2020	December 31, 2019
Current Assets		
Prepaid expense, and other	2,017	2,303
Non-Current Assets		
Straight-line rent adjustments	7,264	7,013
Tenant incentives	15,328	15,716
	22,592	22,729

During the three-month period, we recorded tenant incentives of \$679 (2019 - \$748) and recorded \$1,067 (2019 - \$765) of amortization expense respectively.

In accordance with SIC 15, *Operating leases - incentives*, amortization of tenant incentives is recorded on a straight-line basis over the term of the lease against rental revenue.

6. REVOLVING CREDIT FACILITY

As at March 31, 2020 we had \$24,772 (December 31, 2019 - \$23,025) drawn from the facility; and letters of credit posted of \$150 (December 31, 2019 - \$150).

The following table summarizes the components of the balance:

(\$000s)	March 31, 2020	December 31, 2019
Amount drawn on facility	24,772	23,025
Unamortized transaction fees	(57)	(63)
Unamortized discount on bankers acceptance	(38)	(98)
	24,677	22,864

7. ACCRUED LIABILITIES AND OTHER PAYABLES

(\$000s)	March 31, 2020	December 31, 2019
Current Liabilities		
Tenant security deposits and pre-payments	2,790	3,213
Accrued finance costs	1,627	739
Other accrued liabilities and payables	5,201	5,718
	9,618	9,670
Non-Current Liabilities		
Decommissioning obligation	1,657	1,641

8. MORTGAGES PAYABLE

(\$000s)	March 31, 2020	December 31, 2019
Mortgages amortized over 15-25 years at fixed interest rates	274,684	276,745
Mortgage amortized over 25 years at a fixed interest rate (via a floating for fixed interest rate swap)	16,380	16,520
Unamortized deferred financing fees	(1,580)	(1,645)
	289,484	291,620
Current portion of mortgages payable	(25,935)	(23,507)
	263,549	268,113
Interest rate ranges	(2.58%-4.91%)	(2.58%-4.91%)

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

(\$000s)	March 31, 2020	December 31, 2019
Balance - beginning of period	291,620	259,586
Principal repayments:		
Scheduled amortization on mortgages	(2,201)	(7,700)
Mortgage repayments	—	(36,718)
New mortgages	—	76,616
Deferred financing fees capitalized	(35)	(626)
Amortization of deferred financing fees	100	462
Balance - end of period	289,484	291,620

During the quarter, the REIT entered into mortgage amending agreements with various lenders in order to obtain temporary payment relief as a result of COVID-19. As of March 31, 2020, mortgage amending agreements had been entered into related to four mortgages with an outstanding principal balance of \$47,553. The terms of the agreements vary 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 are subject to interest and repayable over the remaining term of the mortgage. No changes were made as to the maturity date, interest rate, amortization period or security provided. The REIT has accounted for these agreements as debt modifications.

9. CLASS C LP UNITS

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

(\$000s)	March 31, 2020	December 31, 2019
Class C LP Units amortized over 15-25 years at fixed interest rates	67,795	68,723
Unamortized fair value adjustment	66	98
	67,861	68,821
Current portion of Class C LP Units	(26,876)	(27,146)
	40,985	41,675
Effective interest rate	3.40%	3.40%

As at March 31, 2020 we had 10,785,613 Class C LP Units issued and outstanding (December 31, 2019 - 10,785,613).

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

(\$000s)	March 31, 2020	December 31, 2019
Balance - beginning of period	68,821	72,580
Principal repayments:		
Scheduled amortization on Class C LP Units	(928)	(3,628)
Amortization of fair value adjustment on Class C LP Units (note 13)	(32)	(131)
Balance - end of period	67,861	68,821

10. CLASS B LP UNITS

Class B LP Units are held by Melcor and are exchangeable at the option of the holder for one trust unit and, therefore, are considered a puttable instrument and are required to be accounted for as a financial liability. Each unit is accompanied by one special voting unit which entitles the holder to one vote at any meeting of the unitholders. Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units and are included in finance costs.

In accordance with our policy, we record Class B LP units at fair value. We remeasured the Class B LP Units at March 31, 2020 and recognized a fair value gain of \$84,334 during the three-month period (2019 - fair value loss of \$1,788). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 16.

At March 31, 2020 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of \$2.89 per unit or \$46,602 (December 31, 2019 - 16,125,147 at \$8.12 per unit or \$130,936). The REIT notes that the economic uncertainty surrounding COVID-19 has created volatility in the equity markets which has significantly impacted the fair value of these units.

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

(\$000s except unit amounts)	March 31, 2020		December 31, 2019	
Balance - beginning of period	16,125,147	130,936	14,899,325	111,149
Issuance of Class B LP Units	—	—	1,225,822	9,865
Fair value adjustment on Class B LP Units (note 16)	—	(84,334)	—	9,922
Balance - end of period	16,125,147	46,602	16,125,147	130,936

11. UNITHOLDERS' EQUITY

On April 1, 2019 we commenced a normal course issuer bid ("NCIB") which allows the REIT to purchase up to 659,339 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 2,908. 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 on March 31, 2020, and was renewed subsequent to the quarter. Refer to note 17 for terms of the renewed NCIB program.

In connection with the NCIB, the REIT 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.

During the quarter we purchased 23,264 units for cancellation at a cost of \$128, pursuant to the NCIB. Trust units were reduced by \$230 and contributed surplus increased by \$102.

At March 31, 2020, our issued and outstanding trust units were 13,110,029 (December 31, 2019 - 13,133,293).

<i>(\$000's except unit amounts)</i>	March 31, 2020	March 31, 2019
Net income - basic	83,912	2,478
Impact of Class B LP Units fair value adjustment and distributions	(81,613)	—
Impact of convertible debentures interest, fair value adjustment, amortization and accretion	—	—
Net income - diluted	2,299	2,478
Basic weighted average trust units outstanding	13,130,127	13,186,797
Impact of conversion of Class B LP Units	16,125,147	—
Impact of conversion of convertible debentures	—	—
Diluted weighted average trust units outstanding	29,255,274	13,186,797
Basic earnings per trust unit	\$ 6.39	\$ 0.19
Diluted earnings per trust unit*	\$ 0.08	\$ 0.19

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

12. RENTAL REVENUE

The components of rental revenue are as follows:

For the three-months ended March 31 (000s)	2020	2019
Lease revenue	12,877	11,618
Variable lease revenue	3,793	3,292
Service revenue	3,438	3,502
Amortization of tenant incentives (note 5)	(1,067)	(765)
Straight-line adjustments	251	297
	19,292	17,944

13. FINANCE COSTS

The components of finance costs are as follows:

For the three-months ended March 31 (\$000s)	2020	2019
Interest on mortgages payable and revolving credit facility	2,804	2,314
Interest on Class C LP Units	608	639
Amortization of fair value adjustment on Class C LP Units	(32)	(33)
Distributions on Class B LP Units	2,721	2,514
Interest on convertible debenture	888	776
Accretion on convertible debentures	136	47
Fair value adjustment on derivative instruments	(2,823)	145
Amortization of deferred financing fees	304	341
	4,606	6,743

Total finance costs paid during the three-month period were \$6,104 (2019 - \$5,422).

14. RELATED PARTY TRANSACTIONS

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

a) Property and Asset Management Agreements

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

For the three-months ended March 31 (000s)	2020	2019
Asset Management Agreement		
Base Annual Management Fee	479	437
Property Management Agreement		
Monthly Fee	548	497
Lease Fee	168	115
	1,195	1,049

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. Acquisition Fees, Capital Expenditure Fees and Lease Fees are capitalized to investment properties. As at March 31, 2020 there was \$691 (December 31, 2019 - \$744) payable to Melcor related to these fees.

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

During the three-month period ended March 31, 2020, \$2,721 in distributions were recorded on Class B LP Units held by Melcor (2019 - \$2,514). These distributions were recorded as finance costs (note 13). As at March 31, 2020 there was \$907 payable to Melcor for the March distribution (December 31, 2019 - \$907 for the December distribution).

Also during the three-month period ended March 31, 2020, Melcor, as holder of all Class C LP Units, was paid \$1,535 to fund principal and interest payments on the retained debt (2019 - \$1,535).

c) Rental Revenue

For the three-month period ended March 31, 2020 we collected \$232 in rental revenue from Melcor and an affiliate for use of office space (2019 - \$140). This amount is included in rental revenue.

d) Key Management Remuneration

The REIT does not directly or indirectly pay any compensation to named executive officers of the REIT. The REIT has no employees and is externally managed, administered and operated by Melcor pursuant to the Asset Management Agreement and Property Management Agreement.

15. FINANCIAL RISK MANAGEMENT

As a result of COVID-19, the REIT's exposure to risks as a result of holding financial instruments could be impacted. The impact on these risks is as follows:

a) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents, accounts receivable and a loan 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 and loan receivable, we apply the simplified credit loss approach, which requires us to recognize lifetime expected credit losses for all accounts receivables and loan receivable balances by applying an expected loss rate based on historical credit losses adjusted for current and forward looking information which may affect the ability of the customers to settle receivables. Accounts receivables and loan receivable have been grouped based on shared credit risk characteristics. At this time, based on current economic outlook, government assistance programs and the expected time-line impact of COVID-19, management has assessed that the change to our expected loss rate is not considered material. Please refer to note 17.

b) Liquidity Risk

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We manage liquidity risk to ensure that we have sufficient liquid financial resources to finance operations, meet long-term mortgage repayments, Class C LP Unit redemptions, convertible debenture payments and make monthly distributions on Class B LP Units and trust units. We monitor rolling forecasts of our liquidity, which includes cash, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against capital requirements and maintain on-going debt financing plans. We believe that based on the 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 economic uncertainty cause by COVID-19, the REIT has entered into several amending agreements to obtain relief periods in which payments of interest and principal will be suspended temporarily. These relief periods will 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 the refinancing of maturing debt.

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 \$247 (December 31, 2019 - \$229). Due to the volatility resulting from the uncertainty surrounding COVID-19, there is risk that these rates will fluctuate significantly. We are not subject to other significant market risks pertaining to our financial instruments with the exception of our Class B LP Units (note 10).

16. FAIR VALUE MEASUREMENT

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

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

- the carrying amounts of cash and cash equivalents, accounts receivable, loan receivable, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.
- fair values of mortgages payable, Class C LP Units and 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 derivative financial liabilities, the conversion features on our convertible debentures, are estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units and the fair value of convertible debenture is estimated based on the closing trading price of the REIT's debenture (Level 2).

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

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

- Level 1: 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.

		March 31, 2020				December 31, 2019	
(\$000s)		Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value	Total Carrying Value	Total Fair Value
Non-financial assets							
Investment properties	Level 3	747,585	—	747,585	747,585	753,483	753,483
Financial liabilities							
Mortgages payable	Level 3	—	289,484	289,484	296,828	291,620	296,828
Class B LP Units	Level 2	46,602	—	46,602	46,602	130,936	130,936
Class C LP Units	Level 3	—	67,861	67,861	67,861	68,821	68,821
Convertible debentures	Level 2	—	63,406	63,406	35,675	63,104	67,990
Derivative financial liability							
Interest rate swap	Level 3	75	—	75	75	—	—
Conversion feature on convertible debentures	Level 3	9	—	9	9	3,080	3,080
Derivative financial asset							
Interest rate swap	Level 3	—	—	—	—	173	173

Investment properties

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

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

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

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

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

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

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

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

Investment properties were valued by Melcor's internal valuation team as at March 31, 2020 of which 4 investment properties (of 53 legal phases) with a fair value of \$55,050 were valued by qualified independent external valuation professionals during the period. Valuations performed during the three-month period resulted in fair value losses of \$6,187. During the year ended December 31, 2019 Melcor's internal valuation team valued investment properties of which 32 investment properties (of 53 legal phases valued) with a fair value of \$444,700 were valued by qualified independent external valuation professionals during the year. Valuations performed during the year ended December 31, 2019 resulted in fair value losses of \$1,622.

Weighted average stabilized net operating income for investment properties is \$1,699 (December 31, 2019 - \$1,719) per property. Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	March 31, 2020			December 31, 2019		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.50%	6.80%	5.50%	10.50%	6.82%
Terminal capitalization rate	5.75%	9.00%	6.86%	5.75%	9.00%	6.87%
Discount rate	6.25%	9.50%	7.73%	6.50%	9.50%	7.76%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by \$53,366 (December 31, 2019 - \$53,109). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by \$61,834 (December 31, 2019 - \$61,511). 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 instruments

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. Due to the volatility resulting from uncertainty surrounding COVID-19, interest rates have declined significantly, which has had a negative impact on the fair value of mortgages payable and Class C LP Units. The REIT is expecting to continue to experience significant volatility as the situation evolves.

Derivative financial instruments

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

The fair value of the interest rate swap is calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at March 31, 2020 the fair value of the interest rate swap contract is \$75 in a liability position (December 31, 2019 - \$173 asset position).

The significant unobservable inputs used in the fair value measurement of the conversion features on the convertible debentures are volatility and credit spread. As at March 31, 2020, the fair value of the conversion feature on our convertible debentures was \$9 (December 31, 2019 - \$3,080).

Valuations performed during the three-month period resulted in fair value gains of \$2,823 (2019 - fair value losses of \$145).

Due to the volatility in the equity and debt markets resulting from uncertainty surrounding COVID-19, the REIT trust units and convertible debentures have been negatively impacted which has had a significant impact on the fair value of the conversion features on our convertible debentures. The REIT is expecting to continue to experience significant volatility as the situation evolves.

Class B LP Units

Class B LP Units are remeasured to fair value on a recurring basis and categorized as Level 2 in the fair value hierarchy. The units are fair valued based on the trading price of the trust units at the period end date. At March 31, 2020 the fair value of the Class B LP Units was \$46,602, resulting in a fair value gain of \$84,334 for the three-month period (December 31, 2019 - fair value loss of \$9,922). The REIT notes that the economic uncertainty surrounding COVID-19 has created volatility in the equity markets which has significantly impacted the fair value of these units.

17. SUBSEQUENT EVENTS

Normal Course Issuer Bid

On April 1, 2020 we commenced a normal course issuer bid ("NCIB") which allows 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 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 ends one year from commencement, on March 31, 2021.

In connection with the commencement of the NCIB, 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.

As of May 14, 2020 there were 49,905 trust units purchased for cancellation by the REIT pursuant to the NCIB at a cost of \$176.

Distributions

On May 14, 2020 we declared a distribution of \$0.03 per unit for the month of May 2020. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
May 2020	May 29, 2020	June 15, 2020	\$0.03 per unit

Impact of COVID-19

Subsequent to the quarter, the continued government measures to combat the spread of COVID-19 have resulted in further impact. While it is still early enough that the full duration and economic impact of the COVID-19 pandemic cannot be predicted with certainty, we remain confident that we will weather this pandemic.

Events that have taken place subsequent to March 31, 2020 as a result of this pandemic are as follows:

Rental Revenue

As a result of COVID-19 and the direct impact on many of the REIT's tenants, the REIT has proactively engaged with lessees in order to provide temporary rent relief. The amount and duration of relief provided is dependent on the tenant's situation and include full or partial deferral of lease payments for periods of one to four months or on a month to month basis. Deferred amounts remain owing and are repayable over a fixed term.

Subsequent to the quarter, the government announced the Canada Emergency Commercial Rent Assistance (CECRA) for small businesses. The program will provide forgivable loans to qualifying commercial property owners to cover 50% of three monthly rent payments that are payable by eligible small business tenants, requiring the tenant to pay 25% and the landlord to forgive the remaining 25% of the lease payments. At this time it is too premature to determine with certainty how many of the REITs tenants will qualify for this program.

As a result of rent relief and non-payment of rents the REIT collected 79% of April rent and 71% of May rent as of May 14, 2020.

The REIT remains committed to supporting its tenants while ensuring the REIT remains financially strong in order to navigate through this period of uncertainty.

Class B LP Units

Due to the volatility in the equity markets the REIT continues to experience significant fluctuations in the fair value of these units. As at May 14, 2020 the market value of these units was \$3.09. The REIT expects to continue to experience significant volatility as the situation evolves.

Mortgages Payable and Class C LP Units

Subsequent to March 31, 2020 and in connection with COVID-19, amending mortgage agreements have been entered into with various financial institutions related to REIT mortgages, including those encumbered by Class C LP Units, where the underlying mortgage is held by Melcor. These amendments have been entered into in order to provide the REIT with temporary relief periods related to the payment of principal and interest, or just interest, on these mortgages and Class C LP Units in an effort to conserve cash. These amendments will result in a period of time in which the REIT will not be required to make payments of interest or principal, but the term and interest rate related to the mortgage will not change. Accrued interest and principal payments during the relief period will be added proportionally to the remainder of the mortgage term which will not change.