Management's Discussion & Analysis

August 6, 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 June 30, 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 second 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") as issued by the International Accounting Standard Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*. 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 August 6, 2020. Disclosure contained in this MD&A is current to August 6, 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.

TABLE OF CONTENTS

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 August 6, 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:

Given our current mandate of conserving cash amid the COVID-19 pandemic, we are not actively seeking third-party acquisitions. We plan to resume this aspect of our growth strategy as conditions allow.

In 2019, we completed 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.

We have continued with our essential capital expenditures while deferring non-essential projects to minimize activity at our properties and improve near term liquidity.

Property Management:

We responded to 99% of calls to our signature customer care line within 30 minutes in Q2-2020, 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 the size of gatherings, 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 begun 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 lease payment 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 few months to conserve cash and place the REIT in a position to support our tenants through these unprecedented times. We continue to monitor the situation and our cash position. These measures include:

- Reducing the April, May, June, July and August 2020 distributions 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. Strategic value-adding asset enhancement and preservation projects remains a cornerstone of the REIT and Melcor's long-term strategy to improve our assets and retain and attract tenants. In the current environment we remain focused on our long-term objectives while balancing near-term needs in establishing our priorities to endure this pandemic.
- Deferring and suspending operating expenses where appropriate, representing approximately 23% of budgeted second quarter expenditures (13% year to date). 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 future results cannot be accurately predicted at this time.

Collections Update

Due to non-essential business closure orders issued by the provincial governments, some of our retail tenants were closed at the beginning of the quarter. Most were allowed to re-open mid May; however, many retailers took a very cautious approach to reopening, including delaying their opening to ensure they could comply with new recommendations and procedures to protect the health and safety of their customers and staff. We have collected 83% of Q2-2020 rent, with $5.15 million outstanding from tenants, of which we have recorded $0.77 million in provisions for doubtful accounts. The majority of tenants are working cooperatively with us in finding mutually acceptable arrangements for arrears.

The following table outlines our rent collections in April, May, June, July and August by asset class.

Collections by Asset Class (% of Total Rent)	April 2020	May 2020	June 2020	July 2020	Aug 2020
Retail	84 %	75 %	68 %	80 %	79 %
Office	90 %	87 %	86 %	89 %	81 %
Industrial	100 %	96 %	94 %	91 %	90 %
Residential	100 %	100 %	100 %	100 %	99 %
Total	88 %	82 %	78 %	85 %	81 %

The federal government, in partnership with the provinces and territories, announced the creation of the Canada Emergency Commercial Rent Assistance (CECRA) program for small businesses that qualify for the months of April, May, June, July and August 2020. Over 97% of retail tenants surveyed in late April and early May let us know that they intend to apply for the CECRA program, provided they qualify. As the deadline to apply for the CECRA program for small businesses who qualify and wish to access funding for April, May and June is August 31, 2020; and those who wish to access funding for July can apply to do so in September, we cannot yet determine the overall impact this program will have on the REIT. To date, we have received requests to apply for the CECRA program from approximately 10% of tenants representing 8% of total GLA. We cannot yet determine how many of these applications will be successful. We believe, based on existing information, that our net exposure to CECRA claims for the Q2 period is approximately $0.50 million.

We caution readers that due to the rapidly changing environment that additional provisions and write-offs related to CECRA and non-CECRA related lease amendments may be required in the future.

Valuation Update

Due to the rapidly evolving and widespread impacts of the pandemic, the REIT's entire portfolio was revalued by our external valuation professionals in Q2-2020, resulting in a fair value losses of $57.30 million, or 7% of our portfolio value. Losses were due to declining stabilized NOI and projected cash flows as well as a 25-50 bps increase in capitalization rates and discount rates. Approximately 89% of the portfolio realized a valuation write-down, with losses ranging from 1% to 17%. A breakdown of the losses by asset class is as follows:

Fair Value Losses by Asset Class		June 30, 2020	
Retail	$	(35.23)	(7)%
Office	$	(18.46)	(11)%
Industrial	$	(3.56)	(6)%
Residential	$	(0.05)	— %
Total	**$**	**(57.30)**	**(7)%**

Q2-2020 Highlights & Key Performance Indicators

Financial Highlights

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Non-standard KPIs						
Net operating income (NOI)	**11,739**	11,382	3 %	**23,703**	22,394	6 %
Same-asset NOI	**10,527**	11,229	(6)%	**21,198**	22,240	(5)%
Funds from operations (FFO)	**6,513**	6,478	1 %	**13,243**	13,009	2 %
Adjusted funds from operations (AFFO)	**4,636**	4,776	(3)%	**9,498**	9,393	1 %
Adjusted cash flow from operations (ACFO)(5)	**4,740**	4,789	(1)%	**9,706**	9,420	3 %
Rental revenue	**18,097**	17,474	4 %	**37,389**	35,418	6 %
Income before fair value adjustments	**4,152**	2,925	42 %	**7,094**	6,177	15 %
Fair value adjustment on investment properties(1)	**(51,109)**	(1,879)	nm	**(57,296)**	(720)	nm
Cash flows from operations	**2,952**	1,112	165 %	**6,405**	3,863	66 %
Distributions to unitholders	**1,174**	2,223	(47)%	**3,390**	4,448	(24)%
Distributions(2)	**$0.09**	$0.17	— %	**$0.26**	$0.34	— %
Per Unit Metrics						
Net income						
Basic	**($4.64)**	$—		**$1.76**	$0.18	
Diluted	**($4.64)**	$—		**($1.50)**	$0.18	
Weighted average number of units for net income (000s):(3)						
Basic	**13,091**	13,173	(1)%	**13,112**	13,180	(1)%
Diluted	**13,091**	13,173	(1)%	**29,237**	13,180	122 %
FFO						
Basic	**$0.22**	$0.23		**$0.45**	$0.46	
Diluted	**$0.21**	$0.23		**$0.43**	$0.46	
Payout ratio	**40 %**	73 %		**57%**	73%	
AFFO						
Basic	**$0.16**	$0.17		**$0.32**	$0.33	
Payout ratio	**57 %**	99 %		**80%**	101%	
ACFO(5)						
Basic	**$0.16**	$0.17		**$0.33**	$0.34	
Payout ratio	**55 %**	99 %		**78%**	101%	
Weighted average number of units for FFO, AFFO and ACFO (000s):(4)						
Basic	**29,216**	28,073	4 %	**29,237**	28,079	4 %
Diluted	**36,384**	32,800	11 %	**36,406**	32,807	11 %

1. *The abbreviation nm is shorthand for not meaningful and is used through this MD&A where appropriate.*
2. *Distributions for the current period have been paid out a rate of $0.05625 per unit for the months of January, February and March and $0.03 per unit for the months of April, May and June. Distributions for the 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			
	Jun 30, 2020	Dec 31, 2019	△%
Total assets ($000s)	**731,280**	783,534	(7)%
Equity ($000s)[(1)]	**289,055**	289,873	— %
Debt ($000s)[(2)]	**454,415**	454,013	— %
Weighted average interest rate on debt	**3.74 %**	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)]	**2.40**	2.45	(2)%
Debt service coverage ratio[(4)]	**2.81**	2.26	24 %

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 24 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 24 for further discussion and analysis.*

Operational Highlights			
	Jun 30, 2020	Dec 31, 2019	△%
Number of properties	**39**	39	— %
Gross leasable area (GLA) (sf)	**3,208,277**	3,208,950	— %
Occupancy (weighted by GLA)	**88.0%**	88.0%	—%
Retention (weighted by GLA)	**79.4%**	59.6%	33%
Weighted average remaining lease term (years)	**4.30**	4.37	(2)%
Weighted average base rent (per sf)	**$16.68**	$16.79	(1)%

Q2-2020 Highlights:

Our portfolio performance remained stable through the first six months of 2020 in spite of the COVID-19 pandemic and already challenging markets. While leasing activity has slowed as a result of the pandemic, we have continued to proactively engage with existing tenants on renewal terms and pursue new tenants, resulting in a healthy retention rate of 79.4% at quarter-end and overall occupancy of 88.0%.

Highlights of our performance in the second quarter include:

FINANCIAL HIGHLIGHTS

- Portfolio growth of 12% (based on sf) via third party acquisitions in 2019 contributed to revenue growth of 4% and net operating income (NOI) growth of 3% compared to Q2-2019.
- Net income in the current and comparative periods is significantly impacted by fair value adjustments on investment properties due to changes in NOI/capitalization rates and by non-cash fair value adjustments on Class B LP Units due to changes in the REIT's unit price. Management believes funds from operations (FFO) is a better reflection of our true operating performance. FFO was $6.51 million or $0.22 per unit, compared to $6.48 million or $0.23 in Q2-2019.
- Year-to-date adjusted cash from operations (ACFO) was up 3% at $9.71 million or $0.33 per unit, compared to $9.42 million or $0.34 per unit in 2019. Adjusted cash flow from operations (ACFO) was down 1% to $4.74 million or $0.16 per unit over Q2-2019. Management believes that ACFO best reflects our cash position and therefore our ability to pay distributions.
- As at June 30, 2020 we had $3.75 million in cash and $8.00 million in additional capacity under our revolving credit facility.

OPERATING HIGHLIGHTS

- Year-to-date same-asset NOI was down 5% compared to Q2-2019 due to a $0.69 million provision for bad debts recorded in the quarter, in addition to the drag from the large tenant that vacated a downtown Edmonton office building on October 1, 2019.
- We continued to execute on our proactive leasing strategy to both retain existing and attract new tenants. We completed lease renewals representing 150,513 sf (including holdovers) for a retention rate of 79.4% at June 30, 2020. New leasing has been steady across the portfolio with 56,539 sf in new deals commencing to date in 2020 and an additional 46,000 sf committed for future occupancy.

CREATING UNITHOLDER VALUE

- We paid distributions of $0.03 per trust unit in April, May and June for a quarterly payout ratio of 55% based on ACFO and 40% based on FFO. Distributions in the second quarter were reduced 47% from the previously paid $0.05625 in order to conserve cash to respond to the current market volatility.
- On April 1, 2020 we commenced a new 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. 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. Under this NCIB, we purchased 59,526 units for $0.21 million at a weighted average cost of $3.50 per unit or 36% of book value.
- Following the expiration of the blackout on May 15, 2020 the REIT suspended its purchases under the NCIB program and cancelled its Automatic Share Purchase Plan (ASPP) in light of continued market volatility and as part of our cash conservation program. The REIT still believes 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.

SUBSEQUENT EVENT

- On July 15, 2020 we declared a distribution of $0.03 per trust unit for the month of July, payable on August 17, 2020 to unitholders on record July 31, 2020. Today the Board declared a distribution of $0.03 per trust unit for the month of August, payable on September 15, 2020 to unitholders' of record on August 31, 2020.

Consolidated Revenue & Net Operating Income

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Base rent	**12,200**	11,298	8 %	**24,379**	22,290	9 %
Recoveries	**5,889**	6,537	(10)%	**13,134**	13,387	(2)%
Other	**658**	593	11 %	**1,342**	1,163	15 %
Amortization of tenant incentives	**(910)**	(1,038)	(12)%	**(1,977)**	(1,803)	10 %
Straight-line rent adjustment	**260**	84	210 %	**511**	381	34 %
Rental revenue	**18,097**	17,474	4 %	**37,389**	35,418	6 %
Operating expenses	**3,303**	3,166	4 %	**7,030**	6,549	7 %
Utilities and property taxes	**3,705**	3,880	(5)%	**8,122**	7,897	3 %
Direct operating expenses	**7,008**	7,046	(1)%	**15,152**	14,446	5 %
Net rental income	**11,089**	10,428	6 %	**22,237**	20,972	6 %
NOI	**11,739**	11,382	3 %	**23,703**	22,394	6 %
Same asset NOI	**10,527**	11,229	(6)%	**21,198**	22,240	(5)%
Operating margin	**61 %**	60 %	2 %	**59 %**	59 %	— %

Revenue

Rental revenue for the three and six-month period ended June 30, 2020 increased $0.62 million or 4% over Q2-2019 and $1.97 million or 6% year to date as a result of properties acquired within the past twelve months: Melcor Crossing (Nov-2019) contributing rental revenue of $1.66 million in the second quarter and $3.51 million year to date (2019 - $nil). Revenues from new property acquisitions were partially offset by a decline in same-asset revenues primarily the result of reduced recovery revenue on account of lower direct operating costs.

Year to date, we signed 207,052 sf of new and renewed leasing (including holdovers) and maintained steady occupancy at 88.0%. In 2020, 104 leases representing 332,622 sf or 10.4% of our portfolio are up for renewal. We have retained 79.4% of expiring leases (representing 150,513 sf) as at June 30, 2020 in spite of the COVID-19 pandemic and challenging market conditions in many of our operating regions. While we continue to see pockets of opportunity, we anticipate the effects of the pandemic to negatively impact the commercial leasing market in the future.

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	(189,495)	$14.74	
Other Terminations	(19,080)	$15.00	
Renewals/Holdovers	150,513	$15.99	
New Leasing	56,539	$14.45	
Lease Amendments	152	$—	
Closing occupancy	**2,823,416**	**$16.68**	**88.0 %**

Weighted average base rent was $16.68, down $0.11 compared to December 31, 2019 and down $0.15 over Q2-2019. Occupancy has remained stable since year end.

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

	Jun 30, 2020	Jun 30, 2019	△%	Dec 31, 2019	△%
Weighted average base rent (per sq. ft.)	**$16.68**	$16.83	(1)%	$16.79	(1)%
Weighted average remaining lease term	**4.30**	4.61	(7)%	4.37	(2)%
GLA	**3,208,277**	2,925,998	10 %	3,208,950	— %
Occupancy %	**88.0%**	89.2%	(1)%	88.0%	— %
Retention %	**79.4%**	78.0%	2 %	59.6%	33 %

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 down 10% in the quarter and 2% year to date while direct operating expenses were down 1% and up 5% respectively. The decline in our recovery ratio is due to $0.69 million provision for bad debts recorded in the second quarter, 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 for the year 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 rent-steps under individual leases.

Direct operating expenses

Direct operating expenses were up 5% year to date largely due to acquisitions made in the past twelve months. On a same-asset basis, direct operating expenses were down 4% in the quarter.

Property taxes and utilities were down 5% in the quarter, with same-assets down 11%. Property taxes declined across the portfolio as a result of lower valuations and were down over Q1-2020 due to the cancellation and reduction of mill rate increases planned in many municipalities. Utilities were down over Q1-2020 and 2019 due to reduced consumption, a direct result of many of our tenants not operating in their space during the quarter. Year to date taxes property taxes and utilities increased 3%, with same-asset down 5%.

Operating expenses were up 4% in the quarter 7% year to date as a result of new property acquisitions. Same-asset operating expenses were down 5% over Q2-2019 and 2% year to date. In response to the COVID-19 pandemic and reduced activity levels at many of our properties we have deferred and suspended where appropriate operating expenses. 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.

Non-recoverable costs, which includes the provision for bad debts, was up $0.78 million in the quarter and $0.83 million year to date. Allowances for doubtful accounts represents 18% of our tenant receivables. We anticipate additional provisions to be required in the future as a result of CECRA applications, lease amendments and tenant failures. At this time the quantum of such write-offs are not known.

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 3% over Q2-2019 and 6% year-to-date due to properties acquired in the last fifteen months. Same-asset NOI was down 6% over Q2-2019 and 5% year-to-date due to lower occupancy on certain properties and higher provision for bad debts. Second quarter same-asset NOI was stable over Q1-2019.

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 June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Same-asset NOI	**10,527**	11,229	(6)%	**21,198**	22,241	(5)%
Acquisitions	**1,212**	153		**2,505**	153	
NOI	**11,739**	11,382	3 %	**23,703**	22,394	6 %
Amortization of operating lease incentives	**(910)**	(1,038)		**(1,977)**	(1,803)	
Straight-line rent adjustment	**260**	84		**511**	381	
Net rental income	**11,089**	10,428	6 %	**22,237**	20,972	6 %

Property Analysis

At June 30, 2020 our portfolio included interests in 39 retail, office and industrial income-producing properties located in western Canada for a total of 3,208,277 sf of GLA, and a land lease community.

The following table summarizes the composition of our properties at June 30, 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 six months ended June 30, 2020 ($000s)**
Retail	14	1,396,927	43.5 %	390,019	12,660
Office	21	1,603,259	50.0 %	274,533	7,590
Industrial	3	208,091	6.5 %	39,503	1,491
Land Lease Community	1	308 lots	n/a	16,200	496
	39	**3,208,277**	**100.0 %**	**720,255**	**22,237**

The following table details key financial and operational metrics for each of our asset classes for the three months ended June 30, 2020:

	Retail		Office		Industrial		Land Lease Community	
	2020	2019	**2020**	2019	**2020**	2019	**2020**	2019
Three months ended June 30 ($000s)								
Rental revenue	**9,195**	7,959	**7,569**	8,228	**991**	947	**342**	340
Net rental income	**6,088**	5,373	**4,007**	4,069	**753**	735	**241**	251
Same-asset NOI	**4,847**	5,324	**4,649**	4,885	**790**	765	**241**	251
Six months ended June 30 ($000s)								
Rental revenue	**19,137**	15,705	**15,632**	17,154	**1,935**	1,883	**685**	676
Net rental income	**12,660**	10,550	**7,590**	8,444	**1,491**	1,467	**496**	511
Same-asset NOI	**10,130**	10,557	**9,019**	9,665	**1,553**	1,507	**496**	511
As at June 30								
Weighted average base rent (sf)	**$19.96**	$20.31	**$13.69**	$14.39	**$14.77**	$14.51	**n/a**	n/a
Occupancy	**91.0 %**	93.6 %	**83.9 %**	84.7 %	**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 16% over Q2-2019 and 22% year to date mainly due to the acquisition of Melcor Crossing (Nov-2019) which contributed $1.66 million to rental revenue in Q2-2020 and $3.51 million year to date.

Occupancy decreased 2.6% from Q2-2019. Same-asset NOI was down 9% over Q2-2019 and 4% year to date due to bad debts recorded in the quarter. Retail has borne the brunt of the pandemic's effects to date with the road to recovery uncertain.

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 Q2-2019 as a result of a decline in operating expense recoveries and 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 Q2-2019 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 5% compared to Q2-2019 and 7% year-to-date due to higher vacancy during the current period and provision for bad debts.

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 quarter and 3% year to date 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 June 30, 2020 (December 31, 2019 and June 30, 2019 – 100%). Revenue on our land lease community was stable in 2020. NOI was down 3% year-to-date as a result of the timing of operating expenses.

Regional Analysis

The following table summarizes the composition of our properties at June 30, 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 six months ended June 30, 2020 ($000s)
Northern Alberta	22	1,955,120	60.9 %	431,477	12,864
Southern Alberta	10	887,413	27.7 %	223,775	7,464
Saskatchewan & British Columbia	7	365,744	11.4 %	65,003	1,909
	39	**3,208,277**	**100.0 %**	**720,255**	**22,237**

The following table details key financial and operational metrics for each of our geographic regions for the three months ended June 30, 2020:

	Northern Alberta		Southern Alberta		Saskatchewan & British Columbia	
	2020	2019	**2020**	2019	**2020**	2019
Three months ended June 30 ($000s)						
Rental revenue	**10,570**	9,862	**5,788**	5,816	**1,739**	1,796
Net rental income	**6,325**	5,590	**3,757**	3,841	**1,007**	997
Same-asset NOI	**5,807**	6,280	**3,650**	3,822	**1,070**	1,125
Six months ended June 30 ($000s)						
Rental revenue	**22,300**	20,044	**11,616**	11,727	**3,473**	3,647
Net rental income	**12,864**	11,371	**7,464**	7,601	**1,909**	2,000
Same-asset NOI	**11,768**	12,323	**7,298**	7,690	**2,132**	2,226
As at June 30						
Weighted average base rent (per sf)	**$17.17**	$17.36	**$16.89**	$17.05	**$13.55**	$13.94
Occupancy	**84.7 %**	86.2 %	**95.6 %**	94.2 %	**87.5 %**	89.3 %

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 Q2-2019 mainly due to the acquisition of Melcor Crossing (Nov-2019) which contributed $1.66 million to rental revenue in Q2-2020 and $3.51 million year to date. Same-asset NOI decreased 5% year-to-date and 8% over Q2-2019 due to lower occupancy in our office portfolio and provision for bad debts.

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 a decline in lease rate and lower operating expense recoveries recoverables. Same-asset NOI was down 5% year-to-date due to provision for bad debts.

Saskatchewan and British Columbia - our Saskatchewan and British Columbia assets are located in Regina, SK and Kelowna, BC. Rental revenue was down by 5% and same-asset NOI was down 4% year-to-date due to lower lease rates and occupancy.

General & Administrative Expenses

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Asset management fee	**479**	442	8 %	**958**	879	9 %
Professional fees	**98**	134	(27)%	**193**	201	(4)%
Public company costs	**40**	78	(49)%	**188**	209	(10)%
Other	**110**	88	25 %	**192**	175	10 %
General & administrative expenses	**727**	742	(2%)	**1,531**	1,464	5%

General & administrative expenses (G&A) were $0.73 million or 4% of rental revenue in Q2-2020 and $1.53 million or 4% of rental revenue year to date. G&A was lower in the quarter compared with Q2-2019 due to cash management measures taken as a result of the pandemic, and timing of expenditures incurred. Year to date G&A was up 5% due to 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

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Interest on mortgages payable and revolving credit facility	**2,840**	2,495	14 %	**5,644**	4,809	17 %
Interest on Class C LP Units	**602**	634	(5)%	**1,210**	1,273	(5)%
Amortization of fair value adjustment on Class C LP Units	**(32)**	(33)	(3)%	**(64)**	(66)	(3)%
Interest on convertible debentures	**889**	777	14 %	**1,777**	1,553	14 %
Accretion on convertible debentures	**136**	46	196 %	**272**	93	192 %
Fair value adjustment on derivative instruments	**772**	59	nm	**(2,051)**	204	nm
Amortization of deferred financing fees	**344**	360	(4)%	**648**	701	(8)%
Finance costs before distributions	**5,551**	4,338	28 %	**7,436**	8,567	(13)%
Distributions on Class B LP Units	**1,451**	2,515	(42)%	**4,172**	5,029	(17)%
Finance costs	**7,002**	6,853	2 %	**11,608**	13,596	(15)%

Finance costs were up $0.15 million or 2% in Q2-2020 and down $1.99 million or 15% year to date as a result of fair value adjustments on our derivative instruments and reduced distributions on Class B LP Units in Q2-2020. Excluding the impact of fair value adjustment on derivative instruments, finance costs were 2% higher year-to-date than Q2-2019.

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. Distributions in the quarter were $0.09 per unit, down by 47% compared to Q1-2020. The reduced distribution payment was offset by the 1,225,822 Class B LP Units issued to Melcor for $10.00 million in Q4-2019.

As at June 30, 2020 the weighted average interest rate on our revolving credit facility, mortgages payable, Class C LP Units and convertible debentures was 3.74% (March 31 - 3.76%).

Income Taxes

As at June 30, 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.

	Three months ended June 30			Six months ended June 30		
($000s, except per unit amounts)	**2020**	2019	△%	**2020**	2019	△%
Net income (loss) for the period	**(60,790)**	(56)		**23,122**	2,422	
Add / (deduct)						
Fair value adjustment on investment properties	**51,109**	1,879		**57,296**	720	
Fair value adjustment on Class B LP Units	**13,061**	1,043		**(71,273)**	2,831	
Amortization of tenant incentives	**910**	1,038		**1,977**	1,803	
Distributions on Class B LP Units	**1,451**	2,515		**4,172**	5,029	
Fair value adjustment on derivative instruments	**772**	59		**(2,051)**	204	
Funds From Operations (FFO)	**6,513**	6,478	1 %	**13,243**	13,009	2 %
Deduct						
Straight-line rent adjustments	**(260)**	(84)		**(511)**	(381)	
Normalized capital expenditures	**(589)**	(588)		**(1,176)**	(1,175)	
Normalized tenant incentives and leasing commissions	**(1,028)**	(1,030)		**(2,058)**	(2,060)	
Adjusted Funds from Operations (AFFO)	**4,636**	4,776	(3)%	**9,498**	9,393	1 %
FFO/Unit	**$0.22**	$0.23		**$0.45**	$0.46	
AFFO/Unit	**$0.16**	$0.17		**$0.32**	$0.33	
Weighted average number of units (000s):(1)	**29,216**	28,073	4 %	**29,237**	28,079	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:

	Three months ended June 30			Six months ended June 30		
($000s, except per unit amounts)	**2020**	2019	**△%**	**2020**	2019	**△%**
Funds From Operations (FFO)	**6,513**	6,478	1 %	**13,243**	13,009	2 %
Convertible debentures interest	**889**	777		**1,777**	1,553	
Amortization of deferred financing fees	**167**	209		**333**	417	
Accretion on convertible debentures	**136**	46		**272**	93	
Funds From Operations - Diluted (FFO - Diluted)	**7,705**	7,510	3 %	**15,625**	15,072	4 %
FFO - Diluted/Unit	**$0.21**	$0.23		**$0.43**	$0.46	
Diluted weighted average number of units (000s):(1)	**36,384**	32,800	11 %	**36,406**	32,807	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)	**Six months ended June 30, 2020**	Year ended, December 31, 2019
Actual capital expenditures	**909**	2,517
Normalized capital expenditures	**1,176**	2,349
Variance	**(267)**	168

Actual capital expenditures were below normalized capital expenditures by $0.27 million for the six-months ended June 30, 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-essential maintenance.

Tenant Incentive & Direct Leasing Expenditures

Tenant incentives and direct leasing expenditures are part of our leasing strategy to attract and retain tenants. 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)	Six months ended June 30, 2020	Year ended, December 31, 2019
Actual tenant incentives and direct leasing expenditures	**1,896**	5,716
Normalized tenant incentives and direct leasing expenditures	**2,058**	4,119
Variance	**(162)**	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 June 30			Six months ended June 30		
($000s)	2020	2019	△%	2020	2019	△%
Cash flows from operations	**2,952**	1,112	165 %	**6,405**	3,863	66 %
Distributions on Class B LP Units	**1,451**	2,515		**4,172**	5,029	
Actual payment of tenant incentives and direct leasing costs	**1,427**	2,082		**2,841**	3,155	
Changes in operating assets and liabilities	**871**	1,058		**170**	1,309	
Amortization of deferred financing fees(1)	**(344)**	(360)		**(648)**	(701)	
Normalized capital expenditures	**(589)**	(588)		**(1,176)**	(1,175)	
Normalized tenant incentives and leasing commissions	**(1,028)**	(1,030)		**(2,058)**	(2,060)	
Adjusted Cash flow from Operations (ACFO)	**4,740**	4,789	(1)%	**9,706**	9,420	3 %
ACFO/Unit	**$ 0.16**	$ 0.17		**$0.33**	$0.34	
Weighted average number of units (000s)(2)	**29,216**	28,073	4 %	**29,237**	28,079	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 first quarter and reduced distributions during Q2-2020 to $0.03 per unit. Distributions to unitholders during the three and six-month period were $1.52 million and $3.74 million (Q2-2019 - $2.22 million and $4.45 million).

Distributions made during the three-months ended June 30, 2020 represent a payout ratio of approximately 55% of ACFO (Q2-2019 - 99%). On an FFO basis, distributions represent a payout ratio of 40% (Q2-2019 - 73%).

We use ACFO in evaluating our ability to continue to fund distributions. The most similar IFRS measure is cash flow from operations. Due to the uncertainty surrounding the full impacts and duration of the COVID-19 pandemic the distribution was reduced 47% in the second quarter to ensure the near-term liquidity and the sustainability of future distributions. Cash flow from operations, which includes Class B LP Unit distributions as a financing charge, exceeded distributions in the quarter and year-to-date as illustrated below. In the comparative period, distributions exceeded cash flows from operations due to the timing of leasing activity and funded through use of the revolving credit facility.

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Cash flows from operations	**2,952**	1,112	165 %	**6,405**	3,863	66 %
Distributions on Class B LP Units	**1,451**	2,515	(42)%	**4,172**	5,029	(17)%
Cash flow from operations before Class B LP Unit Distributions	**4,403**	3,627	21 %	**10,577**	8,892	19 %
Distributions to unitholders	**(1,520)**	(2,223)	(32)%	**(3,736)**	(4,448)	(16)%
Distributions on Class B LP Units	**(1,451)**	(2,515)	(42)%	**(4,172)**	(5,029)	(17)%
Total distributions	**(2,971)**	(4,738)	(37)%	**(7,908)**	(9,477)	(17)%
Cash flow from operations before Class B LP Unit distributions less total distributions	**1,432**	(1,111)	(229)%	**2,669**	(585)	(556)%
Total distributions as a % of cash flow from operations before Class B LP Unit distributions	**67 %**	131 %	(49)%	**75 %**	107 %	(30)%

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:

	Six months ended June 30, 2020	Year ended, December 31, 2019
Number of properties	**39**	39
Total GLA (sf)	**3,338,375**	3,339,030
GLA (REIT owned %) (sf)	**3,208,277**	3,208,950
Fair value of portfolio ($000s)	**720,255**	776,212
Value per square foot	**$224**	$242
NOI ($000s)	**23,703**	45,300
Weighted average capitalization rate	**7.00 %**	6.82 %
Weighted average discount rate	**6.92 %**	6.87 %
Weighted average terminal capitalization rate	**8.02 %**	7.76 %

Due to the rapidly evolving and widespread impacts of the pandemic, the REIT's entire portfolio was revalued by our external valuation professionals in Q2-2020. Approximately 89% of the portfolio realized a valuation write-down, with losses ranging from 1% to 17%. The revaluations resulted in fair value losses of $57.30 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 resulting 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)	**Six months ended June 30, 2020**	Year ended, December 31, 2019
Northern Alberta	**(35,714)**	2,431
Southern Alberta	**(18,477)**	(1,469)
Saskatchewan & British Columbia	**(3,105)**	(2,584)
	(57,296)	(1,622)

The impact of COVID-19 on commercial real estate values has been significant with declining lease rates, longer lease-up assumptions and higher vacancy allowances driving a 5% decrease in stabilized NOI. While continued market uncertainty and economic challenges have resulted in a 25-50 bps increase in capitalization rates and discount rates on many of our assets.

The REIT will continue to monitor its portfolio and the market in assessing fair value changes and cautions readers that further fair value adjustments may be required in the future.

Fair values are most sensitive to changes in capitalization rates.

	June 30, 2020			December 31, 2019		
	Min	**Max**	**Weighted Average**	**Min**	**Max**	**Weighted Average**
Capitalization rate	**5.50%**	**10.00%**	**7.00%**	5.50%	10.50%	6.82%
Terminal capitalization rate	**5.75%**	**9.00%**	**6.92%**	5.75%	9.00%	6.87%
Discount rate	**6.25%**	**9.75%**	**8.02%**	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 $48.12 million (December 31, 2019 - $53.11 million) while a 50 basis points decrease (-0.5%) would increase it by $55.52 million (December 31, 2019 - $61.51 million).

Liquidity & Capital Resources

We employ a range of strategies to fund operations, with current cash conservation strategies ongoing in order to ensure long-term sustainability. 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:

	Three months ended June 30			Six months ended June 30		
($000s)	**2020**	2019	**△$**	**2020**	2019	**△$**
Cash from operating activities	**2,952**	1,112	1,840	**6,405**	3,863	2,542
Cash used in investing activities	**(794)**	(13,326)	12,532	**(909)**	(14,208)	13,299
Cash from (used in) financing activities	**(299)**	12,427	(12,726)	**(4,025)**	10,524	(14,549)
Increase in cash and cash equivalents	**1,859**	213	1,646	**1,471**	179	1,292
Cash and cash equivalents, beginning of the period	**1,892**	1,547	345	**2,280**	1,581	699
Cash and cash equivalents, end of the period	**3,751**	1,760	1,991	**3,751**	1,760	1,991

Operating activities

Cash from operating activities increased compared to the prior periods as a result of lower Class B LP Unit distributions and fluctuations of payments of tenant incentives and direct leasing costs. Changes in operating assets and liabilities was down in the quarter due to uncollected rent and partially offset by deferred payment terms on various obligations.

Our tenant incentives and direct leasing cost investments were $1.43 million in the quarter (2019 - $2.08 million) as we completed 207,052 sf of new and renewed leasing, resulting in period-end occupancy of 88.0%. 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

To date for 2020, we have commenced work on our scheduled maintenance program, with $0.91 million invested (2019 - $1.61 million). Our 2020 capital program is currently suspended in an effort to improve near term liquidity and reduce non-essential activities at our properties due to COVID-19. 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 $3.98 million on our revolving credit facility to date in 2020 in order to fund capital and leasing activities.

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. These arrangements resulted in $2.26 million in reduced payments in the quarter or 36% of our contracted secured debt payments.

On April 1, 2020 we commenced an NCIB which expires on March 31, 2021. During the quarter, we repurchased 59,526 units at a cost of $0.21 million. In light of continued market volatility and as part of our cash conservation program, the REIT suspended its purchases under the NCIB program and cancelled its Automatic Share Purchase Plan (ASPP) following the expiration of its Q1 blackout on May 15. The REIT still believes 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.

Our distribution were reduced $0.02625 in the second quarter to $0.03 for quarterly distributions of $1.52 million (Q2-2019 - $2.22 million). The current cash distribution rate of $0.03 represent 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 June 30, 2020 we had $3.75 million in cash and cash equivalents in addition to $8.00 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 June 30, 2020 (50% excluding convertible debentures).

As at June 30, 2020, our total capitalization was $743.47 million and is comprised of:

($000s)	June 30, 2020	Dec 31, 2019
Revolving credit facility[1]	**27,000**	23,025
Mortgages payable[1]	**291,185**	293,265
Class C LP Units[2]	**67,230**	68,723
Indebtedness, excluding convertible debentures	**385,415**	385,013
Convertible debentures[3]	**69,000**	69,000
Indebtedness	**454,415**	454,013
Class B LP Units[4]	**160,207**	160,207
Trust units	**128,848**	129,666
Equity	**289,055**	289,873
Total capitalization	**743,470**	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 June 30, 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 June 30, 2020 we we are in compliance with all of our 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:

		as at June 30					
($000s)	**Total**	**2020**	**2021**	**2022**	**2023**	**2024**	**Thereafter**
Revolving credit facility	**27,000**	27,000	—	—	—	—	—
Mortgages payable	**291,185**	20,934	39,570	33,762	42,388	43,225	111,306
Class C LP Units	**67,230**	25,405	14,675	1,095	14,932	451	10,672
Convertible debentures	**69,000**	—	—	23,000	—	46,000	—
Total	**454,415**	**73,339**	**54,245**	**57,857**	**57,320**	**89,676**	**121,978**
% 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, five mortgages are up for renewal with an outstanding principal balance of $34.14 million with a weighted average interest rate of 3.05% at June 30, 2020. We also have four 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 $31.01 million and a weighted average interest rate of 3.72% (3.29% including interest rate subsidies) at June 30, 2020. 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. Subsequent to the quarter we obtained new mortgage financing of $5.85 million at a rate of 2.62%, retiring a $2.39 million maturing mortgage. Additional proceeds were the result of the addition of a previously unencumbered building to the loan. The REIT is proactively engaging with its lenders in regards to upcoming maturities.

As a result of the pandemic we engaged with our lending partners in obtaining payment relief on various debts. These arrangements resulted in $2.26 million in reduced payments in the quarter or 36% of our contracted secured debt payments. 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 have good, long standing relationships with our lending partners and we are committed to working with our lenders through this period.

Debt Analysis – our mortgages payable, Class C LP Units and convertible debentures 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	**27,000**	—	27,000	3.54 %	0.92
Mortgages payable	**291,185**	274,946	16,679	3.50 %	4.98
Class C LP Units	**67,230**	67,230	—	3.40 %	2.10
Convertible debentures	**69,000**	69,000	—	5.15 %	3.84
Total	**454,415**	**411,176**	**43,239**	**3.74 %**	**4.14**

The weighted average interest rate on our debts was 3.74% (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. In the second quarter we deferred $1.57 million of scheduled principal payments, resulting in an anomalous increase in our debt service coverage ratio, excluding these deferrals our coverage ratio would have been 2.11. 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)	**Six months ended June 30, 2020**	Year ended, December 31, 2019
FFO	**13,243**	25,581
Principal repayments on Mortgages payable	3,215	7,700
Principal repayments on Class C LP Units	1,493	3,628
Debt service coverage ratio	**2.81**	2.26
FFO plus finance costs	22,730	43,177
Finance costs(1)	9,487	17,596
Finance costs coverage ratio	**2.40**	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. 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. To date we purchased 59,526 units for $0.21 million under the NCIB purchase plan which commenced April 1, 2020. The REIT suspended its purchases under the NCIB program and cancelled its Automatic Share Purchase Plan (ASPP) in light of continued market volatility and as part of our cash conservation program. The REIT still believes 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.

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 June 30, 2020 and December 31, 2019:

	June 30, 2020		December 31, 2019	
Issued and fully paid units ($000s)	**Units**	**$ Amount**	Units	$ Amount
Balance, beginning of period	**13,133,293**	**129,666**	13,186,797	130,194
Repurchase of trust units	**(82,790)**	**(818)**	(53,504)	(528)
Balance, end of period	**13,050,503**	**128,848**	13,133,293	129,666
Dilutive securities				
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	**36,344,191**	**358,055**	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	
($000s except per unit amount)	**Q2**	**Q1**	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	**18,097**	**19,292**	18,273	17,468	17,474	17,944	17,336	17,283
Net income (loss)[1]	**(60,790)**	**83,912**	(5,220)	2,310	(56)	2,478	6,737	3,097
Funds from operations (FFO)	**6,513**	**6,730**	6,002	6,570	6,478	6,531	6,382	6,277
Adjusted funds from operations (AFFO)[2]	**4,636**	**4,862**	4,232	4,860	4,776	4,617	4,792	4,494
Adjusted cash flows from operations (ACFO)[4]	**4,740**	**4,965**	4,315	4,875	4,790	4,630	4,796	4,484
Per unit metrics								
Basic earnings (loss) per unit	**$ (4.64)**	**$ 6.39**	$ (0.35)	$ 0.18	$ —	$ 0.19	$ 0.51	$ 0.23
FFO (basic)	**$ 0.22**	**$ 0.23**	$ 0.21	$ 0.23	$ 0.23	$ 0.23	$ 0.23	$ 0.22
AFFO[2] (basic)	**$ 0.16**	**$ 0.17**	$ 0.15	$ 0.17	$ 0.17	$ 0.16	$ 0.17	$ 0.16
ACFO (basic)[4]	**$ 0.16**	**$ 0.17**	$ 0.15	$ 0.17	$ 0.17	$ 0.16	$ 0.17	$ 0.16
Annualized distribution rate[3]	**$0.439**	**$0.675**	$0.675	$0.675	$0.675	$0.675	$0.675	$0.675
FFO Payout Ratio	**40%**	**73%**	81%	72%	73%	73%	74%	76%
AFFO Payout Ratio	**57%**	**102%**	114%	97%	99%	103%	99%	105%
ACFO Payout Ratio	**55%**	**105%**	112%	97%	99%	102%	99%	106%
Period-end closing unit price	**$3.70**	**$2.89**	$8.12	$7.74	$7.65	$7.58	$7.46	$8.10
Annualized distribution yield on closing unit price (%)[3]	**11.86%**	**23.36%**	8.31 %	8.72%	8.82%	8.91%	9.05%	8.33%

(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. On June 15, 2020 the REIT announced distributions for the month of June 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 June 30, 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, restrictions 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 continually monitor the situation and will take additional measures if necessary. We will continue to transparently communicate our response plans 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 June 30, 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 August 6, 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:

	Three months ended June 30			**Six months ended June 30**		
($000s)	**2020**	2019	△%	**2020**	2019	△%
Net income (loss) for the period	**(60,790)**	(56)		**23,122**	2,422	
Net finance costs	**6,982**	6,820		**11,561**	13,535	
Fair value adjustment on Class B LP Units	**13,061**	1,043		**(71,273)**	2,831	
Fair value adjustment on investment properties	**51,109**	1,879		**57,296**	720	
General and administrative expenses	**727**	742		**1,531**	1,464	
Amortization of operating lease incentives	**910**	1,038		**1,977**	1,803	
Straight-line rent adjustment	**(260)**	(84)		**(511)**	(381)	
NOI	**11,739**	11,382	3 %	**23,703**	22,394	6 %

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 and six-months ended June 30, 2020

(Unaudited)

Condensed Interim Consolidated Statements of Financial Position

As at June 30, 2020

(Unaudited)

($000s)	**June 30, 2020**	**December 31, 2019**
ASSETS		
Current Assets		
Cash and cash equivalents	**3,751**	2,280
Accounts receivable	**4,930**	1,666
Other assets (note 5)	**1,784**	2,303
Loan receivable	**560**	900
	11,025	7,149
Non-Current Assets		
Investment properties (note 4 and 16)	**697,557**	753,483
Other assets (note 5)	**22,698**	22,729
Derivative financial asset (note 16)	**—**	173
	720,255	776,385
TOTAL ASSETS	**731,280**	783,534
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 6)	**26,931**	22,864
Accounts payable	**2,777**	1,433
Distribution payable	**875**	1,646
Accrued liabilities and other payables (note 7)	**9,697**	9,670
Class C LP Units (note 9)	**32,547**	27,146
Mortgages payable (note 8)	**43,764**	23,507
	116,591	86,266
Non-Current Liabilities		
Accrued liabilities and other payables (note 7)	**1,674**	1,641
Class B LP Units (note 10 and 16)	**59,663**	130,936
Class C LP Units (note 9)	**34,717**	41,675
Mortgages payable (note 8)	**245,955**	268,113
Convertible debentures	**63,709**	63,104
Derivative financial liabilities (note 16)	**856**	3,080
TOTAL LIABILITIES	**523,165**	594,815
UNITHOLDERS' EQUITY	**208,115**	188,719
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	**731,280**	783,534

See accompanying notes to the condensed interim consolidated financial statements.

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

For the three and six-months ended June 30

(Unaudited)

	Three months ended June 30		Six months ended June 30	
($000s)	**2020**	**2019**	**2020**	**2019**
Rental revenue (note 12 and 14)	**18,097**	17,474	**37,389**	35,418
Direct operating expenses (note 14)	**(7,008)**	(7,046)	**(15,152)**	(14,446)
Net rental income	**11,089**	10,428	**22,237**	20,972
General and administrative expenses (note 14)	**(727)**	(742)	**(1,531)**	(1,464)
Fair value adjustment on investment properties (note 4 and 16)	**(51,109)**	(1,879)	**(57,296)**	(720)
Fair value adjustment on Class B LP Units (note 10 and 16)	**(13,061)**	(1,043)	**71,273**	(2,831)
Income (loss) before finance costs	**(53,808)**	6,764	**34,683**	15,957
Interest income	**20**	33	**47**	61
Finance costs (note 13 and 14)	**(7,002)**	(6,853)	**(11,608)**	(13,596)
Net finance costs	**(6,982)**	(6,820)	**(11,561)**	(13,535)
Net income (loss) and comprehensive income (loss)	**(60,790)**	(56)	**23,122**	2,422
Basic income (loss) per trust unit (note 11)	**($4.64)**	$—	**$1.76**	$0.18
Diluted income (loss) per trust unit (note 11)	**($4.64)**	$—	**($1.50)**	$0.18

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Changes in Unitholders' Equity

As at June 30, 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)	(82,790)	(818)	482	—	(336)
Net income for the period	—	—	—	23,122	23,122
Distributions to unitholders	—	—	—	(3,390)	(3,390)
Balance at June 30, 2020	13,050,503	117,473	41,275	49,367	208,115

($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
Trust units repurchased (note 11)	(19,140)	(189)	44	—	(145)
Net income for the period	—	—	—	2,422	2,422
Distributions to unitholders	—	—	—	(4,448)	(4,448)
Balance at June 30, 2019	13,167,657	118,630	40,580	36,979	196,189

See accompanying notes to the condensed interim consolidated financial statements.

Condensed Interim Consolidated Statements of Cash Flows

For the three and six-months ended June 30

(Unaudited)

	Three months ended June 30		Six months ended June 30	
($000s)	**2020**	**2019**	**2020**	**2019**
CASH FLOWS FROM (USED IN)				
OPERATING ACTIVITIES				
Net income (loss) for the period	**(60,790)**	(56)	**23,122**	2,422
Non cash items:				
Amortization of tenant incentives (note 5 and 12)	**910**	1,038	**1,977**	1,803
Straight-line rent adjustments (note 12)	**(260)**	(84)	**(511)**	(381)
Fair value adjustment on investment properties (note 4 and 16)	**51,109**	1,879	**57,296**	720
Fair value adjustment on Class B LP Units (note 10 and 16)	**13,061**	1,043	**(71,273)**	2,831
Amortization of fair value adjustment on Class C LP Units (note 13)	**(32)**	(33)	**(64)**	(66)
Accretion on convertible debenture (note 13)	**136**	46	**272**	93
Fair value adjustment on derivative instruments (note 13 and 16)	**772**	59	**(2,051)**	204
Amortization of deferred financing fees (note 13)	**344**	360	**648**	701
	5,250	4,252	**9,416**	8,327
Payment of tenant incentives and direct leasing costs	**(1,427)**	(2,082)	**(2,841)**	(3,155)
Changes in operating assets and liabilities	**(871)**	(1,058)	**(170)**	(1,309)
	2,952	1,112	**6,405**	3,863
INVESTING ACTIVITIES				
Additions to investment properties	**—**	(12,603)	**—**	(12,603)
Investment in property improvements (note 4)	**(794)**	(723)	**(909)**	(1,605)
	(794)	(13,326)	**(909)**	(14,208)
FINANCING ACTIVITIES				
Proceeds from loan receivable	**340**	—	**340**	—
Change in revolving credit facility	**2,228**	9,548	**3,975**	19,500
Proceeds from mortgages payable (note 8)	**440**	15,036	**440**	15,036
Repayment of mortgages payable (note 8)	**(1,014)**	(8,896)	**(3,215)**	(17,630)
Repayment on Class C LP Units (note 9)	**(565)**	(893)	**(1,493)**	(1,789)
Units repurchased (note 11)	**(208)**	(145)	**(336)**	(145)
Distributions to unitholders	**(1,520)**	(2,223)	**(3,736)**	(4,448)
	(299)	12,427	**(4,025)**	10,524
INCREASE IN CASH & CASH EQUIVALENTS DURING THE PERIOD	**1,859**	213	**1,471**	179
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	**1,892**	1,547	**2,280**	1,581
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	**3,751**	1,760	**3,751**	1,760

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 August 6, 2020, Melcor, through an affiliate, holds an approximate 55.3% 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 August 6, 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 the following 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)	Six months ended June 30, 2020	Year ended December 31, 2019
Balance - beginning of period	**753,483**	683,768
Additions		
Direct acquisition	**—**	68,175
Property improvements	**909**	2,517
Direct leasing costs	**461**	645
Fair value adjustment on investment properties (note 16)	**(57,296)**	(1,622)
Balance - end of period	**697,557**	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. During the quarter, all investment properties were valued by qualified independent external valuation professionals. Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 16.

Presented separately from investment properties is $15,174 (December 31, 2019 - $15,716) in tenant incentives and $7,524 (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)	June 30, 2020	December 31, 2019
Current Assets		
Prepaid expense, and other	**1,784**	2,303
Non-Current Assets		
Straight-line rent adjustments	**7,524**	7,013
Tenant incentives	**15,174**	15,716
	22,698	22,729

During the six-month period, we recorded tenant incentives of $1,435 (2019 - $2,553) and recorded $1,977 (2019 - $1,803) 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

($000s)	June 30, 2020	December 31, 2019
Amount drawn on facility	**27,000**	23,025
Unamortized transaction fees	**(56)**	(63)
Unamortized discount on bankers acceptance	**(13)**	(98)
	26,931	22,864

7. ACCRUED LIABILITIES AND OTHER PAYABLES

($000s)	June 30, 2020	December 31, 2019
Current Liabilities		
Tenant security deposits and pre-payments	**3,051**	3,213
Accrued finance costs	**739**	739
Other accrued liabilities and payables	**5,907**	5,718
	9,697	9,670
Non-Current Liabilities		
Decommissioning obligation	**1,674**	1,641

8. MORTGAGES PAYABLE

($000s)	June 30, 2020	December 31, 2019
Mortgages amortized over 15-25 years at fixed interest rates	**274,506**	276,745
Mortgage amortized over 25 years at a fixed interest rate (via a floating for fixed interest rate swap)	**16,239**	16,520
Mortgage amortized over 1 year at floating interest rate of prime plus 1%	**440**	—
Unamortized deferred financing fees	**(1,466)**	(1,645)
	289,719	291,620
Current portion of mortgages payable	**(43,764)**	(23,507)
	245,955	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)	June 30, 2020	December 31, 2019
Balance - beginning of period	**291,620**	259,586
Principal repayments:		
Scheduled amortization on mortgages	**(3,215)**	(7,700)
Mortgage repayments	**—**	(36,718)
New mortgages	**440**	76,616
Mortgage interest payments deferred	**695**	—
Deferred financing fees capitalized	**(33)**	(626)
Amortization of deferred financing fees	**212**	462
Balance - end of period	**289,719**	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 June 30, 2020, mortgage amending agreements had been entered into related to twenty-three mortgages with an outstanding principal balance of $232,560. 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 a term up to the remaining term of the mortgage. No changes were made as to the maturity date, interest rate, amortization period or security provided. The REIT has accounted for these agreements as debt modifications, with the impact of these modifications being insignificant.

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.

During the quarter, amending mortgage agreements were entered into with various financial institutions, including those encumbered by Class C LP Units. These amendments have been entered into in order to provide the REIT with temporary relief periods related to the payment of principal on these 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 principal, but the term and interest rate related to the mortgage will not change. Deferred payments are subject to interest and repayable over the remaining term of the mortgage. The REIT has accounted for these agreements as debt modifications, with the impact of these modifications being insignificant.

($000s)	June 30, 2020	December 31, 2019
Class C LP Units amortized over 15-25 years at fixed interest rates	**67,230**	68,723
Unamortized fair value adjustment	**34**	98
	67,264	68,821
Current portion of Class C LP Units	**(32,547)**	(27,146)
	34,717	41,675
Effective interest rate	**3.40 %**	3.40 %

As at June 30, 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)	June 30, 2020	December 31, 2019
Balance - beginning of period	**68,821**	72,580
Principal repayments:		
Scheduled amortization on Class C LP Units	**(1,493)**	(3,628)
Amortization of fair value adjustment on Class C LP Units (note 13)	**(64)**	(131)
Balance - end of period	**67,264**	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 June 30, 2020 and recognized a fair value gain of $71,273 during the six-month period (2019 - fair value loss of $2,831). Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 16.

At June 30, 2020 there were 16,125,147 Class B LP Units issued and outstanding at a fair value of $3.70 per unit or $59,663 (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:

	June 30, 2020		December 31, 2019	
	# of units	**($000's)**	# of units	($000's)
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)	**—**	**(71,273)**	—	9,922
Balance - end of period	**16,125,147**	**59,663**	16,125,147	130,936

11. UNITHOLDERS' EQUITY

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 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.

During the six-month period we purchased 82,790 units (2019 - 19,140) for cancellation at a cost of $336 (2019 -$145), pursuant to the NCIB. Trust units were reduced by $818 (2019 - $189) and contributed surplus increased by $482 (2019 - $44).

At June 30, 2020, our issued and outstanding trust units were 13,050,503 (December 31, 2019 - 13,133,293).

($000's except unit and per unit amounts)	**Three months ended June 30**		**Six months ended June 30**	
	2020	**2019**	**2020**	**2019**
Net income (loss) - basic	**(60,790)**	(56)	**23,122**	2,422
Impact of Class B LP Units fair value adjustment and distributions	**—**	—	**(67,101)**	—
Impact of convertible debentures interest, fair value adjustment, amortization and accretion	**—**	—	**—**	—
Net income (loss) - diluted	**(60,790)**	(56)	**(43,979)**	2,422
Basic weighted average trust units outstanding	**13,090,574**	13,173,444	**13,112,052**	13,180,121
Impact of conversion of Class B LP Units	**—**	—	**16,125,147**	—
Impact of conversion of convertible debentures	**—**	—	**—**	—
Diluted weighted average trust units outstanding	**13,090,574**	13,173,444	**29,237,199**	13,180,121
Basic income (loss) per trust unit	**(4.64)**	—	**1.76**	0.18
Diluted income (loss) per trust unit*	**(4.64)**	—	**(1.50)**	0.18

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

12. RENTAL REVENUE

The components of rental revenue are as follows:

($000s)	**Three months ended June 30**		**Six months ended June 30**	
	2020	**2019**	**2020**	**2019**
Lease revenue	**12,856**	11,886	**25,733**	23,504
Variable lease revenue	**3,217**	3,374	**7,010**	6,666
Service revenue	**2,674**	3,168	**6,112**	6,670
Amortization of tenant incentives (note 5)	**(910)**	(1,038)	**(1,977)**	(1,803)
Straight-line adjustments	**260**	84	**511**	381
	18,097	17,474	**37,389**	35,418

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 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. During 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 up to 50% of four 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. Applications for this program are due to be submitted subsequent to the quarter in August 2020, therefore at this time it is too early to determine with certainty how many of the REITs tenants will qualify for this program.

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

13. FINANCE COSTS

The components of finance costs are as follows:

(0000s)	Three months ended June 30		Six months ended June 30	
	2020	**2019**	**2020**	**2019**
Interest on mortgages payable and revolving credit facility	**2,840**	2,495	**5,644**	4,809
Interest on Class C LP Units	**602**	634	**1,210**	1,273
Amortization of fair value adjustment on Class C LP Units	**(32)**	(33)	**(64)**	(66)
Distributions on Class B LP Units	**1,451**	2,515	**4,172**	5,029
Interest on convertible debenture	**889**	777	**1,777**	1,553
Accretion on convertible debentures	**136**	46	**272**	93
Fair value adjustment on derivative instruments	**772**	59	**(2,051)**	204
Amortization of deferred financing fees	**344**	360	**648**	701
	7,002	6,853	**11,608**	13,596

Total finance costs paid during the three and six-month period were $7,063 and $13,167 (2019 - $7,158 and $12,580).

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:

	Three months ended June 30		Six months ended June 30	
	2020	**2019**	**2020**	2019
Asset Management Agreement				
Base Annual Management Fee	**479**	442	**958**	879
Acquisition Fee	**—**	125	**—**	125
Property Management Agreement				
Monthly Fee	**563**	515	**1,111**	1,012
Lease Fee	**274**	178	**442**	293
	1,316	1,260	**2,511**	2,309

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 June 30, 2020 there was $698 (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 and six-month period ended June 30, 2020, $1,451 and $4,172 in distributions were recorded on Class B LP Units held by Melcor (2019 - $2,515 and $5,209). These distributions were recorded as finance costs (note 13). As at June 30, 2020 there was $484 payable to Melcor for the June distribution (December 31, 2019 - $907 for the December distribution).

Also during the three and six-month period ended June 30, 2020, Melcor, as holder of all Class C LP Units, was paid $1,168 and $2,703 to fund principal and interest payments on the retained debt (2019 - $1,536 and $3,071).

c) Rental Revenue

For the three and six-month period ended June 30, 2020 we collected $260 and $492 in rental revenue from Melcor and an affiliate for use of office space (2019 - $140 and $387). 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 the current expected credit loss at $878.

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 $269 (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.

		June 30, 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	**697,557**	**—**	**697,557**	**697,557**	753,483	753,483
Financial liabilities							
Mortgages payable	Level 3	**—**	**289,719**	**289,719**	**296,828**	291,620	296,828
Class B LP Units	Level 2	**59,663**	**—**	**59,663**	**59,663**	130,936	130,936
Class C LP Units	Level 3	**—**	**67,264**	**67,264**	**67,264**	68,821	68,821
Convertible debentures	Level 2	**—**	**63,709**	**63,709**	**46,370**	63,104	67,990
Derivative financial liability							
Interest rate swap	Level 3	**89**	**—**	**89**	**89**	—	—
Conversion feature on convertible debentures	Level 3	**767**	**—**	**767**	**767**	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.

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

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

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

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

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

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

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

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

All Investment properties were valued by qualified independent external valuation professionals as at June 30, 2020 of which 53 investment properties (of 53 legal phases) with a fair value of $697,557 were valued during the period. Valuations performed during the six-month period resulted in fair value losses of $57,296. 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 $1,613 (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.

	June 30, 2020			December 31, 2019		
	Min	**Max**	**Weighted Average**	Min	Max	Weighted Average
Capitalization rate	5.50%	10.00%	7.00%	5.50%	10.50%	6.82%
Terminal capitalization rate	5.75%	9.00%	6.92%	5.75%	9.00%	6.87%
Discount rate	6.25%	9.75%	8.02%	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 $48,116 (December 31, 2019 - $53,109). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $55,515 (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.

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

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 June 30, 2020 the fair value of the interest rate swap contract is $89 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 June 30, 2020, the fair value of the conversion feature on our convertible debentures was $767 (December 31, 2019 - $3,080).

Valuations performed during the six-month period resulted in fair value gains of $2,051 (2019 - fair value losses of $204).

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 June 30, 2020 the fair value of the Class B LP Units was $59,663, resulting in a fair value gain of $71,273 for the six-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

Distributions

On July 15, 2020 we declared a distribution of $0.03 per unit for the month of July 2020. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
July 2020	July 31, 2020	August 17, 2020	$0.03 per unit

On August 6, 2020 we declared a distribution of $0.03 per unit for the month of August 2020. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
August 2020	August 31, 2020	September 15, 2020	$0.03 per unit