Management's Responsibility for Financial Reporting

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

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

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

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

Darin Rayburn
Chief Executive Officer

Jonathan Chia, CA
Chief Financial Officer

Edmonton, Alberta
March 10, 2014

Auditors' Report to Unitholders

We have audited the accompanying consolidated financial statements of Melcor Real Estate Investment Trust and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012 and the consolidated statements of income and comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Melcor Real Estate Investment Trust and its subsidiaries as at December 31, 2013 and December 31, 2012 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants
Edmonton, Alberta
March 10, 2014

Consolidated Statements of Financial Position

($000s)	2013	2012
ASSETS		
Current Assets		
Cash and cash equivalents	5,932	689
Accounts receivable	1,478	2,457
Other assets (note 9)	1,015	238
	8,425	3,384
Non-Current Assets		
Restricted cash	5,969	—
Investment properties (note 8 and 26)	429,117	382,381
Other assets (note 9)	11,232	11,080
	446,318	393,461
TOTAL ASSETS	454,743	396,845
LIABILITIES		
Current Liabilities		
Revolving credit facility (note 10)	23,748	—
Accounts payable	1,989	2,098
Distribution payable	1,050	—
Accrued liabilities and other payables (note 11)	3,690	5,101
Class C LP Units (note 13)	3,059	—
Mortgages payable (note 12)	19,911	54,291
	53,447	61,490
Non-Current Liabilities		
Accrued liabilities and other payables (note 11)	1,459	1,052
Class B LP Units (note 14 and 26)	99,120	—
Class C LP Units (note 13)	91,188	—
Deferred income taxes (note 18)	—	40,261
Mortgages payable (note 12)	78,911	125,711
TOTAL LIABILITIES	324,125	228,514
UNITHOLDERS' EQUITY	130,618	168,331
TOTAL LIABILITIES AND UNITHOLDERS' EQUITY	454,743	396,845

See accompanying notes to the consolidated financial statements

On behalf of the REIT's Board of Trustees

Brian Hunt
Audit Committee Chair

Andrew Melton
Executive Chairman

Consolidated Statements of Income & Comprehensive Income

($000s)	2013	2012
Rental revenue (note 16 and 21)	39,325	37,485
Direct operating expenses (note 21)	(15,930)	(15,423)
Net rental income	23,395	22,062
General and administrative expenses (note 21)	(1,728)	(1,369)
Fair value adjustment on investment properties (note 8 and 26)	16,953	30,163
Fair value loss on Class B LP Units (note 14 and 26)	(3,812)	—
Income before finance costs and income taxes	34,808	50,856
Interest income	61	23
Finance costs (note 17 and 21)	(12,411)	(8,575)
Net finance costs	(12,350)	(8,552)
Net income before income taxes	22,458	42,304
Current income tax expense (note 18)	—	(846)
Deferred income tax recovery (expense) (note 18)	40,261	(5,968)
Income tax recovery (expense)	40,261	(6,814)
Net income and comprehensive income	62,719	35,490

See note 20 for basic and diluted earnings per trust unit.

See accompanying notes to the consolidated financial statements

Consolidated Statements of Changes in Unitholders' Equity

($000s except unity amounts)	Number of Trust Units	Trust Units	Contributed Surplus	Divisional Surplus	Retained Earnings	Total Unitholders' Equity
Balance at December 31, 2011	—	—	—	149,185	—	**149,185**
Net income	—	—	—	35,490	—	**35,490**
Net distributions to Melcor Developments Ltd.	—	—	—	(16,344)	—	**(16,344)**
Balance at December 31, 2012	—	—	—	168,331	—	**168,331**
Net income for the period January 1, 2013 to April 30, 2013 (note 19)	—	—	—	47,524	—	**47,524**
Net distributions to Melcor Developments Ltd.	—	—	—	(7,447)	—	**(7,447)**
Balance at April 30, 2013	—	—	—	208,408	—	208,408
Reorganization and recapitalization (note 6 and 15)	8,300,000	74,409	36,823	(208,408)	—	(97,176)
Conversion of Class B LP Units (note 6 and 14)	830,000	8,300	—	—	—	8,300
Net income for the period May 1, 2013 to December 31, 2013 (note 19)	—	—	—	—	15,195	15,195
Distributions to unitholders	—	—	—	—	(4,109)	(4,109)
Balance at December 31, 2013	9,130,000	82,709	36,823	—	11,086	130,618

See accompanying notes to the consolidated financial statements

Consolidated Statements of Cash Flows

($000s)	2013	2012
CASH FLOWS FROM (USED IN)		
OPERATING ACTIVITIES		
Net income for the year	62,719	35,490
Non cash items:		
Amortization of tenant incentives (note 16)	2,297	2,447
Straight-line rent adjustments (note 16)	(397)	(449)
Fair value adjustment on investment properties (note 8 and 26)	(16,953)	(30,163)
Fair value loss on Class B LP Units (note 14 and 26)	3,812	—
Amortization of fair value adjustment on Class C LP Units (note 17)	(293)	—
Amortization of deferred financing costs (note 17)	108	—
Accretion on decommissioning obligation	60	60
Deferred income tax (recovery) expense (note 18)	(40,261)	5,968
	11,092	13,353
Changes in operating assets and liabilities (note 3o)	(590)	569
	10,502	13,922
INVESTING ACTIVITIES		
Additions to investment properties (note 7 and 8)	(25,851)	(2,760)
Payment of tenant incentives (note 9)	(2,052)	(2,632)
Investment property improvements and development (note 8)	(3,823)	(7,529)
Change in restricted cash	(3,141)	—
	(34,867)	(12,921)
FINANCING ACTIVITIES		
Proceeds from issuing units, net of costs (note 15)	74,409	—
Acquisition of Initial Properties (note 6)	(66,016)	—
Proceeds from revolving credit facility (note 10)	24,000	—
Proceeds from mortgages payable	67,000	29,400
Repayment of mortgages payable	(53,435)	(14,241)
Repayment on Class C LP Units	(1,966)	—
Change in restricted cash	(2,828)	—
Net distribution to Melcor Developments Ltd.	(7,447)	(16,344)
Distributions to unitholders	(4,109)	—
	29,608	(1,185)
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS DURING THE YEAR	5,243	(184)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	689	873
CASH AND CASH EQUIVALENTS, END OF THE YEAR	5,932	689

See accompanying notes to the consolidated financial statements

1. DESCRIPTION OF THE TRUST

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

The REIT began operations on May 1, 2013 when its trust units were issued for cash pursuant to the initial public offering ("IPO" or "Offering").

The REIT issued 8,300,000 trust units at a price of $10.00 per unit for total gross proceeds of $83,000. The REIT used the proceeds of the Offering to indirectly acquire, through a subsidiary of the REIT (the "Partnership"), interests in a portfolio of 27 income producing properties located in Western Canada (the "Initial Properties"). On May 10, 2013, the underwriters exercised, in full, their over-allotment option to purchase an additional 830,000 trust units from Melcor Developments Ltd. ("Melcor"), at a price of $10.00 per unit, for gross proceeds of $8,300. The over-allotment was fulfilled through conversion of Class B LP Units, owned by Melcor, into trust units.

Following closing of the over-allotment option, Melcor, through an affiliate, holds an approximate 51.1% effective interest in the REIT through ownership of all remaining 9,530,798 Class B LP Units of the Partnership. The Class B LP Units are economically equivalent to, and exchangeable for, trust units.

The principal business of the REIT is to acquire, own and manage office, retail and industrial properties in select target markets in Western Canada.

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

2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standard Board ("IASB").

As the REIT is a newly formed entity and Melcor retained control over the REIT, the Offering and acquisition of the Initial Properties is accounted for as a reorganization and recapitalization using the continuity of interests method. Financial information for the pre-acquisition period, including the comparative period are presented based on historical combined financial information for the Initial Properties as previously reported by Melcor.

These consolidated financial statements are presented in Canadian dollars, which is the presentation and functional currency of the REIT; and were authorized for issue by the Board of Trustees on March 10, 2014.

3. SIGNIFICANT ACCOUNTING POLICIES

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

a. Basis of measurement

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

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

b. Basis of consolidation

i. Subsidiaries

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

ii. Joint arrangements

These arrangements are undivided interests in the assets, liabilities, revenues and expenses under arrangement and we record our proportionate share in accordance with the agreements as joint operations. These consolidated financial statements include investments in 3 joint arrangements (2012 – 3) with 50% interests. Refer to note 22 for additional details on our joint arrangements.

All intercompany transactions and balances are eliminated on consolidation.

c. Cash and cash equivalents

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

d. Restricted cash

Restricted cash can only be used for specified purposes. The REIT's restricted cash represents subsidies funded by Melcor as part of the Offering to subsidize finance costs on assumed debt and Class C LP Units, and to fund capital expenditures, environmental expenditures, tenant incentives and lease costs.

e. Investment properties

Investment properties include commercial and industrial properties, and a manufactured home community held for the long term to earn rental income or for capital appreciation, or both.

Acquired investment properties are measured initially at cost, including transaction costs associated with the acquisition when the acquisition is accounted for as an asset purchase.

After initial recognition, investment properties are recorded at their fair value, which is determined by either a direct capitalization or discounting projected future cash flows approach based on property specific capitalization rates. Valuations are performed as of the period end date by independent, external professional valuators who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued. The fair value of investment property reflects, among other things, rental income from current leases and assumptions about rental income from future leases based on current market conditions. The value also reflects any cash outflows that could be expected in respect of the property. Changes in fair value are recognized in the consolidated statement of income.

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

Initial direct leasing costs incurred in negotiating and arranging tenant leases are added to the carrying amount of investment properties.

f. Other assets

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

g. Provision for decommissioning obligation

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

h. Class B LP Units

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

i. Unit capital

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

j. Distributions

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

k. Recognition of revenue

Tenant leases are accounted for as operating leases given that we have retained substantially all of the risks and benefits of the ownership of our investment properties. Revenue from investment properties includes base rents, recoveries of operating expenses including property taxes, parking revenue and incidental income. Revenue recognition under a lease commences when the tenant has a right to use the leased asset. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease; a straight-line rent receivable, which is included in other assets, is recorded for the difference between the rental revenue recognized and the contractual amount received. When incentives are provided to our tenants, the cost of these incentives is recognized over the lease term, on a straight-line basis, as a reduction to rental revenue. Recoveries from tenants are recognized as revenues in the period in which the corresponding costs are incurred. Other revenues are recorded as earned.

l. Finance costs

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

m. Income taxes

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

n. Financial instruments

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

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans to third parties and receivables are initially recognized at fair value plus transaction costs. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less a provision for impairment, if necessary. Loans and receivables are comprised of accounts receivable, cash and cash equivalents and restricted cash.

At each reporting date, we assess whether there is objective evidence that a financial asset is impaired, considering delinquencies in payments and financial difficulty of the debtor. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through use of an allowance account. The amount of any losses is recognized in income.

Financial liabilities

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

o. Statements of cash flows

Operating assets and liabilities is defined as the net change of accounts receivable, prepaid expense, and other, accounts payable, distribution payable and accrued liabilities and other payables. Excluded from operating assets and liabilities are investment property additions that are unpaid and included in accounts payable at period end.

4. SIGNIFICANT JUDGEMENTS AND CRITICAL ACCOUNTING ESTIMATES

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

Significant judgments

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

a. Business combinations under common control

Business combinations under common control ("BCUCC") are business combinations involving entities or businesses under common control, in which all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination. BCUCC are not within the scope of IFRS 3, Business combinations.

As the REIT is a newly formed entity and Melcor retained control over the REIT, the Offering and acquisition of the Initial Properties is accounted for as a reorganization and recapitalization using the continuity of interests method. Under this method, the REIT records the assets acquired and liabilities assumed at their carrying amounts on the closing date of the transaction. The difference between the consideration given and the aggregate value of the net assets acquired is recorded as an adjustment to unitholders' equity. Refer to note 6 for details of the accounting treatment for the acquisition of the Initial Properties. Financial information for the pre-acquisition period, including the comparative periods are presented based on historical combined financial information for the Initial Properties as previously reported by Melcor. Refer to note 19 for statements of income and comprehensive income and statements of cash flows for the period disaggregated by the activities of the REIT, and its predecessor, Melcor.

b. Investment properties

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

c. Classification of tenant incentives

Payments are often made to, or on behalf of, tenants of our commercial properties when new leases are signed. When the payments add future value to the space independent of the lease in place, such costs are capitalized to the investment property. If the costs incurred are specific to the lessee, and do not have stand-alone value, these costs are treated as tenant incentives and amortized on a straight-line basis to revenue over the lease term in accordance with SIC 15, Operating leases – incentives.

d. Compliance with REIT exemption under ITA

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

Critical accounting estimates

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

Valuation of investment properties

Investment properties are valued using either a direct capitalization or discounted cash flow approach, as completed by qualified external professional valuators with key assumptions reviewed and updated quarterly. Key estimates and assumptions include expected occupancy rates and lease payments, expenditures for operating costs and capital expenditures as well as discount and capitalization rate. Refer to note 8 and 26 for further information about methods and assumptions used in determining fair value.

5. NEW STANDARDS NOT YET ADOPTED

IFRIC 21, Levies is an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets'. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. This standard is required to be applied for accounting periods beginning on or after January 1, 2014, with earlier adoption permitted.

IFRS 9, Financial instruments addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The standard also results in one impairment method replacing the numerous impairment methods in IAS 39 that arise from the different classification categories. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted.

($000s except unit and per unit amounts)

We are currently assessing the impact of adopting these standards on our consolidated financial statements.

6. ACQUISITION OF INITIAL PROPERTIES

On May 1, 2013, the REIT completed the purchase of 27 income-producing properties located in Western Canada, comprised primarily of retail, office and industrial properties (the "Initial Properties") from Melcor Developments Ltd. ("Melcor") with a carrying value of $397,896. As part of the acquisition of the Initial Properties, the REIT also assumed mortgages on certain properties totaling $92,360 at April 30, 2013. Deferred financing fees of $97 were netted against the assumed mortgages. In addition, the working capital, which is comprised of cash balances, accounts receivable, prepaid expenses, accounts payable and accrued liabilities, and other liabilities were transferred on closing. The purchase price was satisfied with cash consideration of $66,016 and issuance of 10,360,798 Class B LP Units of the Partnership. Melcor retained the debt on certain properties (the "Retained Debt") with a fair value of $96,506 at April 30, 2013. In consideration of the Retained Debt, Melcor received Class C LP units of the Partnership on which it will receive priority distributions.

The allocation of the purchase price to the assets acquired and liabilities assumed, based on their carrying values at the date of acquisition, is as follows:

Net assets acquired:	
Real estate properties	397,896
Working capital, net	(2,680)
Assumed mortgages	(92,263)
	302,953
Distributions to Melcor	
Class C LP Units	96,506
Class B LP Units	103,608
Cash paid out by the REIT	66,016
	266,130
Net contribution by Melcor	**36,823**

On May 10, 2013, the underwriters exercised, in full, their over-allotment option to purchase an additional 830,000 trust units from Melcor. The transaction resulted in an increase in unitholders' equity of $8,300 (underwriters' fee was paid by Melcor) and a decrease in Class B LP Units of $8,300.

Following closing of the over-allotment option, Melcor, through an affiliate, holds an approximate 51.1% effective interest in the REIT through ownership of all remaining 9,530,798 Class B LP Units. As Melcor will retain control over the REIT, the transaction constitutes a business combination under common control which is outside the scope of IFRS 3 – Business combinations. The IPO and acquisition of the Initial Properties by the REIT is accounted for as a reorganization and recapitalization using the continuity of interests method, where by the REIT recorded the assets acquired and liabilities assumed at their carrying amounts. The difference between the consideration given and the aggregate value of the net assets acquired is recorded as an adjustment to unitholders' equity.

Transaction costs directly related to the Offering and acquisition of the Initial Properties were $8,591 and were charged directly to unitholders' equity.

7. INVESTMENT PROPERTY ACQUISITIONS

On September 12, 2013, the REIT completed the purchase of Coast Home Centre ("Coast"), located in Edmonton, Alberta. We acquired 100% interest in the property for total consideration of $12,462 (including transaction costs).

On December 24, 2013, the REIT acquired Liberty Crossing ("Liberty"), located in Red Deer, Alberta. We acquired 100% interest in the property for total consideration of $13,389 (including transaction costs).

The acquisitions were funded through the REIT's line of credit and available cash.

The purchases have been accounted for as asset purchases, in accordance with our policy, as detailed in note 3e.

8. INVESTMENT PROPERTIES

	2013	2012
Balance - beginning of period	382,381	345,246
Additions		
Direct acquisition (note 7)	25,851	2,760
Property improvements	3,035	3,566
Property development activities	—	3,574
Direct leasing costs	788	389
Fair value adjustment on investment property (note 26)	16,953	30,163
Change in provision (note 11)	109	(3,317)
Balance - end of period	429,117	382,381

In accordance with our policy, as detailed in note 3e, we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized net operating income ("NOI"). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 26.

The cost of investment properties as at December 31, 2013 totalled $205,992 (December 31, 2012 - $176,318).

Presented separately from investment properties is $10,386 (December 31, 2012 - $10,631) in tenant incentives and $846 (December 31, 2012 - $449) in straight-line rent adjustments (note 9). The fair value of investment properties has been reduced by these amounts.

($000s except unit and per unit amounts)

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

	2013	2012
Within one year	23,683	21,798
Later than one year but not later than 5 years	67,490	59,761
Later than 5 years	40,386	45,984
	131,559	127,543

9. OTHER ASSETS

	2013	2012
Current Assets		
Prepaid expense, and other	1,015	238
Non-Current Assets		
Straight-line rent adjustments	846	449
Tenant incentives	10,386	10,631
	11,232	11,080
	12,247	11,318

During the year we provided tenant incentives of $2,052 (December 31, 2012 - $2,632) and recorded $2,297 (December 31, 2012 - $2,447) 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.

10. REVOLVING CREDIT FACILITY

On April 20, 2013, we entered into a revolving term facility credit agreement with two major Canadian chartered banks. Under the terms of the agreement the REIT has an available credit limit based upon the carrying values of specific investment properties, as calculated quarterly, up to a maximum of $25,000 for general purposes. The agreement also provides the REIT with $5,000 in available letters of credit which bear interest at 2.25%. The facility matures on May 1, 2015, with a one year extension period at the discretion of the lenders. Depending on the form under which the credit facility is accessed, rates of interest will vary between prime plus 1.25% or bankers acceptance plus 2.25% stamping fee. Interest payments are due and payable based upon the form of the facility drawn upon, and principal is due and payable upon maturity. The agreement also bears a standby fee of 0.50% for the unused portion of the revolving facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the facility. As at December 31, 2013, the carrying value of pledged properties was $66,700. We capitalized $252 in transaction costs associated with the facility, of which $170 was unamortized at December 31, 2013 and is presented net of the outstanding balance.

As at December 31, 2013 we had an available credit limit of $25,000, of which $24,000 was drawn; and posted letters of credit of $nil. The weighted average effective interest rate on borrowings, based on period end balances, is 3.72%. The following table summarizes the components of the balance at December 31, 2013:

	2013
Amount drawn on facility	24,000
Unamortized transaction fees	(170)
Unamortized discount on bankers acceptance	(82)
	23,748

11. ACCRUED LIABILITIES AND OTHER PAYABLES

	2013	2012
Current Liabilities		
Accrued liabilities and other payables	3,508	4,353
Decommissioning obligation	182	748
	3,690	5,101
Non-Current Liabilities		
Decommissioning obligation	1,459	1,052
	5,149	6,153

The REIT's decommissioning obligation relates to one of our commercial properties. The total decommissioning obligation is estimated based on the future obligation and timing of these expenditures to be incurred. We estimate the net present value of the obligation based on an undiscounted total future provision of $2,298 (2012 - $2,428). At December 31, 2013, a discount rate of 4.0% (2012 - 4.5%) and an inflation rate of 2.0% (2012 - 2.0%) were used to calculate the net present value of the obligation. Due to uncertainty surrounding the nature and timing of this obligation amounts are subject to change.

12. MORTGAGES PAYABLE

	2013	2012
Mortgages amortized over 15-25 years at fixed interest rates	99,023	172,502
Variable rate mortgage, due on demand	—	7,500
Unamortized deferred financing fees	(201)	—
	98,822	180,002
Current portion of mortgages payable	(19,911)	(54,291)
	78,911	125,711
Interest rate ranges	(3.01%-5.86%)	(2.90%-6.16%)

Specific investment properties with a carrying value of $197,866 (December 31, 2012 - $375,061) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above mortgages. The weighted average effective interest rate for the above mortgages, based on period end balances, is 4.20% (December 31, 2012 – 4.57%).

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

($000s except unit and per unit amounts)

	Principal Instalment Repayments	Balance Maturing	Total
2014	2,972	16,939	19,911
2015	2,593	19,533	22,126
2016	1,921	11,901	13,822
2017	1,516	—	1,516
2018	1,574	32,506	34,080
Thereafter	414	7,154	7,568
	10,990	88,033	99,023

13. CLASS C LP UNITS

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

As at December 31, 2013 the carrying value of the Class C LP Units, included in the consolidated statement of financial position, were as follows:

	2013	2012
Class C LP Units amortized over 2-6 years at fixed interest rates	92,578	—
Unamortized fair value adjustment	1,669	—
	94,247	—
Current portion of Class C LP Units	(3,059)	—
	91,188	—
Effective interest rate	3.84%	—

Specific investment properties with a carrying value of $169,500 (December 31, 2012 - $nil) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above Class C LP Units, along with a guarantee by the Partnership.

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

	Principal Instalment Repayments	Balance Maturing	Total
2014	3,059	—	3,059
2015	2,780	23,045	25,825
2016	2,150	9,030	11,180
2017	2,006	2,578	4,584
2018	1,687	11,421	13,108
Thereafter	4,213	30,609	34,822
	15,895	76,683	92,578

During the year $2,428 was recognized in finance costs and $2,259 was recognized as a reduction in the Class C LP Units liability related to these distributions.

At December 31, 2013 there were 9,257,820 Class C LP Units issued and outstanding.

14. CLASS B LP UNITS

On closing of the Offering, Melcor received 10,360,798 Class B LP Units of the Partnership as partial consideration for the Initial Properties. The Class B LP Units are exchangeable at the option of the holder for one trust unit of the REIT and accompanied by one special voting unit (note 15b). Distributions on Class B LP Units are recorded and paid to holders equal to those declared on trust units. On May 10, 2013, Melcor exchanged 830,000 Class B LP Units for an equal number of trust units, which were then used to fulfill the over-allotment option held by the underwriters pursuant to the Offering. Distributions on Class B LP Units for the year were $4,289, and are included in finance costs.

In accordance with our policy, as detailed in note 3h, we record Class B LP Units at fair value. We remeasured the Class B LP Units at December 31, 2013 and recognized a fair value loss of $3,812 during the year. Supplemental information on fair value measurement, including valuation technique and the key input, is included in note 26.

At December 31, 2013 there were 9,530,798 Class B LP Units issued and outstanding at a fair value of $10.40 per unit or $99,120.

15. UNITHOLDERS' EQUITY

a. Trust Units

The REIT is authorized to issue an unlimited number of trust units and an unlimited number of special voting units. Each trust unit represents a holder's proportionate undivided beneficial ownership interest in the REIT and will confer the right to one vote at any meeting of the Unitholders and to participate pro rata in any distributions by the REIT.

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

b. Special Voting Units

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

c. Units Outstanding

The following table summarizes the changes in trust units for the period May 1, 2013 to December 31, 2013.

($000s except unit and per unit amounts)

Issued and fully paid units	Units	Amount
Balance, May 1, 2013	—	—
Issuance of Units - IPO, net of $8,591 in costs	8,300,000	74,409
Conversion of Class B LP Units	830,000	8,300
Balance, December 31, 2013	9,130,000	82,709

16. RENTAL REVENUE

The components of rental revenue are as follows:

	2013	2012
Rental revenue	41,225	39,483
Amortization of tenant incentives	(2,297)	(2,447)
Straight-line adjustment	397	449
	39,325	37,485

17. FINANCE COSTS

The components of finance costs are as follows:

	2013	2012
Interest on mortgages payable and revolving credit facility	5,586	8,575
Interest on Class C LP Units	2,721	—
Amortization of fair value adjustments on Class C LP Units	(293)	—
Distributions on Class B LP Units	4,289	—
Amortization of deferred financing costs	108	—
	12,411	8,575

Total finance costs paid during the year were $12,060 (2012 - $8,575).

18. INCOME TAXES

As at December 31, 2013 the REIT qualifies as a mutual fund trust within the meaning of the Tax Act and as a real estate investment trust eligible for the 'REIT Exception' under the Specified Investment Flow-Through ("SIFT"); accordingly, no current or deferred income tax expense has been recognized on income earned or capital gains recognized subsequent to the formation of the REIT. In addition, we recorded a deferred income tax recovery of $40,585 on May 1, 2013 related to the de-recognition of a deferred income tax liability as a result of qualifying for the REIT Exception at the time of the IPO.

The components of income tax (recovery) expense are as follows:

	2013	2012
Current tax expense	—	846
Deferred tax expense		
Origination and reversal of temporary differences	324	5,968
Reversal of deferred taxes upon reorganization and recapitalization and allocation of taxable income to Unitholders (note 3m and 6)	(40,585)	—
	(40,261)	5,968
	(40,261)	6,814

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

	2013	2012
Net income before income taxes	22,458	42,304
Statutory rate	25%	25%
	5,615	10,576
Non-deductible expenses	79	2
Non-taxable portion of capital gains and fair value adjustments	(2,119)	(3,764)
Allocation of taxable income to unitholders (note 3m)	(3,251)	—
Reversal of current and deferred taxes upon reorganization and recapitalization (note 3m and 6)	(40,585)	—
	(40,261)	6,814

The movement of deferred tax balances for the year are as follows:

	December 31, 2013		
	Opening	**Recognized in net income**	**Closing**
Investment properties	37,993	(37,993)	—
Tenant incentives	2,658	(2,658)	—
Straight-line rent adjustment	60	(60)	—
Provision for decommissioning obligation	(450)	450	—
	40,261	(40,261)	—

	December 31, 2012		
	Opening	**Recognized in net income**	**Closing**
Investment properties	32,971	5,022	37,993
Tenant incentives	2,612	46	2,658
Straight-line rent adjustment	—	60	60
Provision for decommissioning obligation	(1,290)	840	(450)
	34,293	5,968	40,261

($000s except unit and per unit amounts)

19. RESULTS OF THE REIT AND ITS PREDECESSOR

The following consolidated statement of income and comprehensive income and consolidated statement of cash flows disaggregate the financial results of the REIT for the year ended December 31, 2013 between the activities of the REIT, subsequent to April 30, 2013, and those of Melcor, prior to May 1, 2013.

	Melcor 1-Jan to 30-Apr	REIT 1-May to 31-Dec	Year ended 31-Dec
Rental revenue (note 16 and 21)	12,942	26,383	39,325
Direct operating expenses (note 21)	(5,037)	(10,893)	(15,930)
Net rental income	7,905	15,490	23,395
General and administrative expenses (note 21)	(507)	(1,221)	(1,728)
Fair value adjustment on investment properties (note 8 and 26)	2,594	14,359	16,953
Fair value loss on Class B LP Units (note 14 and 26)	—	(3,812)	(3,812)
Income before finance costs and income taxes	9,992	24,816	34,808
Interest income	8	53	61
Finance costs (note 17 and 21)	(2,737)	(9,674)	(12,411)
Net finance costs	(2,729)	(9,621)	(12,350)
Net income before income taxes	7,263	15,195	22,458
Current income tax expense (note 18)	—	—	—
Deferred income tax recovery (note 18)	40,261	—	40,261
Income tax recovery	40,261	—	40,261
Net income and comprehensive income	47,524	15,195	62,719

	Melcor 1-Jan to 30-Apr	REIT 1-May to 31-Dec	Year ended 31-Dec
CASH FLOWS FROM (USED IN)			
OPERATING ACTIVITIES			
Net income for the year	47,524	15,195	62,719
Non cash items:			
Amortization of tenant incentives (note 16)	773	1,524	2,297
Straight-line rent adjustments (note 16)	(125)	(272)	(397)
Deferred income tax (recovery) expense (note 18)	(40,261)	—	(40,261)
Fair value adjustment on investment properties (note 8 and 26)	(2,594)	(14,359)	(16,953)
Fair value loss on Class B LP Units (note 14 and 26)	—	3,812	3,812
Amortization of fair value adjustment on Class C LP Units (note 17)	—	(293)	(293)
Amortization of deferred financing costs (note 17)	—	108	108
Accretion on decommissioning obligation	20	40	60
	5,337	5,755	11,092
Changes in operating assets and liabilities (note 3o)	(1,975)	1,385	(590)
	3,362	7,140	10,502
INVESTING ACTIVITIES			
Additions to investment properties (note 7 and 8)	—	(25,851)	(25,851)
Payment of tenant incentives (note 9)	(743)	(1,309)	(2,052)
Investment property improvements and development (note 8)	(1,746)	(2,077)	(3,823)
Change in restricted cash	—	(3,141)	(3,141)
	(2,489)	(32,378)	(34,867)
FINANCING ACTIVITIES			
Proceeds from issuing units, net of costs (note 15)	—	74,409	74,409
Acquisition of Initial Properties (note 6)	—	(66,016)	(66,016)
Proceeds from revolving credit facility (note 10)	—	24,000	24,000
Proceeds from mortgages payable	55,000	12,000	67,000
Repayment of mortgages payable	(48,195)	(5,240)	(53,435)
Repayment on Class C LP Units	—	(1,966)	(1,966)
Change in restricted cash	—	(2,828)	(2,828)
Net distribution to Melcor	(7,447)	—	(7,447)
Distributions to unitholders	—	(4,109)	(4,109)
	(642)	30,250	29,608
INCREASE IN CASH & CASH EQUIVALENTS DURING THE PERIOD	231	5,012	5,243
CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR	689	920	689
CASH AND CASH EQUIVALENTS, END OF THE YEAR	920	5,932	5,932

20. INCOME PER UNIT

Basic and diluted earnings per trust unit for the period May 1, 2013 to December 31, 2013 are calculated as follows:

	1_May-13 to 31-Dec-13
Income and comprehensive income - basic ($000s) (note 19)	15,195
Impact of Class B LP Unit fair value adjustment and distributions ($000s)	8,101
Income and comprehensive income - diluted ($000s)	23,296
Basic weighted average trust units outstanding during the period	9,099,385
Impact of conversion of Class B LP Units	9,530,798
Diluted weighted average trust units outstanding during the period	18,630,183
Basic earnings per trust unit	$1.67
Diluted earnings per trust unit	$1.25

21. RELATED PARTY TRANSACTIONS

Pursuant to the transaction as detailed in note 6, the consolidated financial statements of the REIT include the following related party transactions with Melcor, and its affiliates, as the controlling Unitholder of the REIT:

a. Property and Asset Management Agreements

Effective May 1, 2013, the REIT and Melcor entered into a Property Management Agreement and an Asset Management Agreement which set forth the terms and conditions under which the REIT is managed, administered and operated.

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

Property Management Agreement – we pay a monthly fee which is comprised of the following: (a) a base fee of 1/12 of 3% of gross property revenue; (b) a leasing fee equal to 5% of aggregate base rent for new leases for the first 5 years and 2.5% thereafter, and 2.5% of aggregate base rent for lease renewals and expansions for the first 5 years.

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

For the year ended December 31	2013
Asset Management Agreement	
Base Annual Management Fee	676
Capital Expenditure Fee	—
Acquisition Fee	256
Financing Fee	—
Property Management Agreement	
Monthly Fee	746
Lease Fee	511
	2,189

The Base Annual Management Fee is included in general and administrative expenses. Monthly Fees are included in direct operating expenses. In accordance with our policy (3e), Acquisition Fees and Lease Fees are capitalized to investment properties. As at December 31, 2013 there was $447 payable to Melcor related to these fees.

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

From May 1, 2013 to December 31, 2013, $4,289 in distributions were recorded on Class B LP Units held by Melcor. These distributions were recorded as finance costs. As at December 31, 2013 there was $536 payable to Melcor for the September distribution.

Also during the same period, Melcor, as holder of all Class C LP Units, was paid $4,687 to fund principal and interest payments on the Retained Debt. These redemptions were recorded as a reduction of the Class C LP Unit liability and as finance costs.

c. Rental Revenue

From the period of May 1, 2013 to December 31, 2013 the REIT collected $470 in rental revenue from Melcor and an affiliate for use of office space. 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.

All related party transactions occurred in the normal course of operations, at market rates and under normal commercial terms.

($000s except unit and per unit amounts)

22. JOINT ARRANGEMENTS

The table below discloses our rights to and share of the assets, liabilities, revenues, and earnings of three joint arrangements (2012 – three) that are recorded in these consolidated financial statements:

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

	Assets	Liabilities	Revenue	Earnings
2013	48,712	22,472	3,741	4,138
2012	45,476	21,747	3,526	4,484

23. SEGMENTED INFORMATION

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

24. MANAGEMENT OF CAPITAL RESOURCES

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

Pursuant to the DOT, the REIT may not incur or assume any indebtedness if, after incurring or assuming such indebtedness, the total indebtedness of the REIT would be more than 60% of Gross Book Value ("GBV") ("Degree of Leverage Ratio") (65% including any convertible debentures). At December 31, 2013, and throughout the period, we were in compliance with the Degree of Leverage Ratio and had a ratio of 51% as at December 31, 2013.

We are also subject to financial covenants on our $25,000 revolving credit facility. The covenants include a maximum debt to total capital ratio of 60%, a minimum interest coverage ratio of 1.50, and a minimum net book value of unitholders' equity of $140,000. As at December 31, 2013, we were in compliance with our financial covenants with a debt to total capital ratio of 51%, interest coverage ratio of 1.71, and a net book value of unitholders equity, based on the definition of unitholders equity in our revolving credit facility agreement, of $220,715. We also have financial covenants on certain mortgages for investment properties. At December 31, 2013, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

25. FINANCIAL RISK MANAGEMENT

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

a. Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents, restricted cash and accounts receivable. Our maximum exposure to credit risk is the carrying amount of these instruments.

We invest our cash and cash equivalents and restricted cash in bank accounts with major Canadian chartered banks. Accounts receivable balances include amounts due from tenants and other joint arrangement participants for their portion of management fees due to us. There have been no impairment adjustments made to these accounts.

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. Management has reviewed outstanding receivable balances at December 31, 2013 and expect full payment of balances outstanding. No allowance for doubtful accounts has been recorded.

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, and make monthly distributions on Class B LP Units and trust units. We monitor rolling forecasts of our liquidity, which includes cash, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against capital requirements and maintain on-going debt financing plans. We believe that we have access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

Refer to notes 12 and 13 for the maturity analysis of mortgages payable and Class C LP Units. Amounts drawn under the revolving credit facility are due upon the maturity of the facility, on or before May 1, 2015. Accounts payable are expected to be repaid in the next twelve months. Distributions declared on trust units and Class B LP Units are paid one month following the date of declaration.

c. Market Risk

We are subject to interest rate cash flow risk as our revolving credit facility bears interest at rates that vary in accordance with borrowing rates in Canada. For each 1% change in the rate of interest on our revolving credit facility, the change in annual finance costs is approximately $240 (2012 - n/a) based upon applicable period end debt balances. We are also subject to interest rate risk on refinancing of our fixed rate debts in the year of maturity. We are not subject to other significant market risks pertaining to our financial instruments.

26. FAIR VALUE MEASUREMENT

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

($000s except unit and per unit amounts)

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

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables, revolving credit facility, accounts payable and distribution payable approximate their fair values based on the short term maturities of these financial instruments.
- fair values of mortgages payable and Class C LP Units are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of Class B LP Units are estimated based on the closing trading price of the REIT's trust units (Level 1).

In addition, the REIT carries its investment properties at fair value, as detailed in note 3e, which is determined by either the direct capitalization approach or by discounting future cash flows at a property specific discount rate (Level 3).

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

	December 31, 2013			
	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
Non-financial assets				
Investment properties	429,117	—	429,117	429,117
Financial liabilities				
Mortgages payable	—	99,023	99,023	105,165
Class B LP Units	99,120	—	99,120	99,120
Class C LP Units	—	94,247	94,247	94,247

	December 31, 2012			
	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
Non-financial assets				
Investment properties	382,381	—	382,381	382,381
Financial liabilities				
Mortgages payable	—	180,002	180,002	197,387
Class B LP Units	—	—	—	—
Class C LP Units	—	—	—	—

The table below analyzes assets and liabilities carried at fair value in the consolidated statement of financial position, by the levels in the fair value hierarchy. The fair 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 year.

	Level 1	Level 2	Level 3	Level 4
Non-financial assets				
Investment properties	—	—	429,117	429,117
Financial liabilities				
Class B LP Units	99,120	—	—	99,120

Investment properties

Investment properties are remeasured to fair value on a recurring basis and categorized as Level 3 in the fair value hierarchy. Investment properties were valued by qualified independent external valuation professionals as at December 31, 2013 and 2012 which resulted in fair value gains of $16,953 (2012 - $30,163) recorded as fair value adjustment on investment properties in income during the year. Fair values are primarily determined by discounting the expected future cash flows over ten years plus a terminal value determined by applying a discount rate to estimated year eleven cash flows, or by applying a capitalization rate to the estimated future net operating income under the direct capitalization approach. 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 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 including verifying all major inputs included in the valuation and reviewing the results with the independent valuator. Melcor's management, along with the REIT's Audit Committee, discuss the valuation process and key inputs on a quarterly basis.

Weighted average stabilized net operating income for investment properties is $1,176 (2012 - $1,161). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

($000s except unit and per unit amounts)

	December 31, 2013			December 31, 2012		
	Min	**Max**	**Weighted Average**	Min	Max	Weighted Average
Capitalization rate	5.50%	9.00%	6.41%	5.50%	9.00%	6.48%
Terminal capitalization rate	5.75%	9.25%	6.69%	5.75%	9.25%	6.72%
Discount rate	6.50%	10.00%	7.57%	6.50%	10.00%	7.59%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by $31,881 (2012 - $28,095). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by $37,278 (2012 - $32,793).

Class B LP Units

Class B LP Units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the trust units at the period end date. At December 31, 2013 the fair value of the Class B LP Units was $99,120, resulting in a fair value loss of $3,812 in income for the year.

27. SUBSEQUENT EVENTS

On January 10, 2014 we completed the acquisition of an industrial property, LC Industrial, located in Lethbridge, Alberta for $5,934 (excluding closing costs). The purchase has been accounted for as an asset purchase, in accordance with our policy, as detailed in note 3e.

On January 16, 2014 we declared a distribution of $0.05625 per unit for the months of January, February and March 2014. The distributions will be payable as follows:

Month	**Record Date**	**Distribution Date**	**Distribution Amount**
January	January 31, 2014	February 17, 2014	$0.05625 per unit
February	February 28, 2014	March 17, 2014	$0.05625 per unit
March	March 31, 2014	April 15, 2014	$0.05625 per unit