CORPORATE PARTICIPANTS

Darin Rayburn
Chief Executive Officer

Jonathan Chia
Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Neil Downey
RBC Capital Markets

Nelson Mah
Laurentian Bank

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Melcor REIT Second Quarter Conference Call. I would now like to turn the meeting over to Mr. Darin Rayburn, Chief Executive Officer of Melcor REIT. Please go ahead, Mr. Rayburn.

Darin Rayburn, Chief Executive Officer

Thank you, Melanie. Good morning, everyone, and thank you for joining our conference call and webcast for the second quarter of fiscal year 2013 on this sunny Western Canadian Monday morning. I hope wherever our callers are today that they get to experience a wonderful start to the week like we're having here in Alberta.

I'm Darin Rayburn. I'm very pleased to welcome you to our first quarterly conference call since the initial public offering of the Melcor REIT on May first earlier this year. With me on today's call is Jonathan Chia, Chief Financial Officer of the Melcor REIT, who will speak in a few moments. I trust you've had an opportunity to review the material related to this call, including the management's discussion and analysis and the financial statements. Just in case some of you haven't, these materials are available on the Investor Relations section of our website at melcorreit.ca and on SEDAR.com.

Before we begin I'd like to point out that certain statements made during the course of this call may be forward looking. These forward-looking statements may include comments regarding our strategic initiatives for 2013 and beyond, future leasing acquisition and financing plans and objectives, targets, expectations of the real estate, financing, and general economic environment, our financial condition, or the future results or outlook of our operation. Actual events or results may differ materially from those expressed or implied. The performance of the Canadian economy and its impact on the REIT's business is a major assumption behind all forward-looking statements we may make. For a complete discussion of items that may cause actual results to differ, please refer to the business environment and risk section of our second quarter MD&A.

With that I'd like to turn the call over to Jonathan Chia to discuss key financial results for the quarter ending June 30, 2013. John?

Jonathan Chia, Chief Financial Officer

Thanks, Darin, and good morning and welcome to everyone on the call this morning.

As I'm sure everyone is aware, we completed the initial public offering of Melcor REIT on May 1, 2013. As part of this transaction, Melcor REIT acquired 27 properties that were previously owned and managed by Melcor Developments in exchange for cash and Class B LP units. After the IPO Melcor Developments continues to own and effectively control 51.1 percent interest in the REIT through the special voting rights assigned to these Class B LP units. Because of this we're required under IFRS to account for Melcor REIT using the continuity of interest method, which means that we include the results for all three months of the second quarter and the full year-to-date numbers in our financial statements along with comparative information as if Melcor REIT existed and operated separately all along under Melcor Developments.

We report our financial results in Canadian dollars and in accordance with International Financial Reporting Standards. We also supplement our financial reporting with non-standard measures, including funds from operations, or FFO; adjusted funds from operations, or AFFO; and net operating income, or NOI. We believe these measures are important in evaluating our performance but caution listeners that they may not be comparable to similar measures presented by their companies. You will find the definitions of these non-standard measures in our MD&A as well as reconciliations to the most comparable IFRS measurement.

I will now walk everybody through the highlights of our results for the second quarter.

Rental revenue was $9.77 million, exceeding forecast by 2 percent and representing growth of 9 percent over Q2 2012. Year-to-date revenue was $19.46 million for growth of 10 percent over 2012. Revenue growth was driven by an increase in base rent and higher average occupancy through the quarter.

Operating expenses are trending slightly lower in comparison to our forecast with a portion of the difference arising from timing differences. Our forecast includes certain maintenance expenses that haven't been incurred yet but at this point we expect these expenses to be incurred as part of our maintenance programs as they continue through the remainder of the year.

Net operating income was $6.38 million, exceeding forecast by 6 percent and representing growth of 7 percent over Q2 2012. Year-to-date NOI was $12.72 million for growth of 7 percent. Our same-asset NOI grew by 9 percent, again as a result of higher base rents achieved through new leasing and a successful tenant renewal program and increased average occupancy.

Adjusted funds from operations was $3.59 million, exceeding forecast by 12 percent, directly as a result of higher NOI. Per unit AFFO was $0.19 for the quarter and $0.37 year to date compared to $0.12 and $0.23 in the same periods last year.

Our debt to gross book value ratio was 47 percent, which is well within our maximum threshold of 60 percent and below our target range of 50 to 55 percent.

We made contributions of $0.0562 per trust unit in May and June for an effective holding period return of 2.13 percent. We also announced distributions of $0.05625 per trust unit for July, August, and September 2013.

The fair value of our portfolio increased by 2 percent compared to year end with a fair value gain of $4.39 million year to date. This increase was driven by our continued investment in asset enhancement projects and increased leasing activity as well as downward pressure on our weighted average capitalization rate, which was 6.41 percent compared to 6.48 percent at December 31, 2012.

Our weighted average interest rate decreased by 47 basis points to 4.1 percent as we have been successful in securing lower interest rates through mortgage refinances completed just prior to the IPO.

I will now turn the call back over to Darin to discuss process against our strategy and some of our operating highlights of the quarter.

Darin Rayburn, Chief Executive Officer

Thanks, John.

We are pleased with our results in this, our first quarter of operation as the Melcor REIT. As John discussed, our second quarter results beat our initial forecast on all significant key performance indicators, including rental revenue, NOI, AFFO, and occupancy.

Our growth strategy is simple: To acquire and to improve. We have a proven track record of doing this both at Melcor Developments pre-REIT and these early results for the REIT demonstrate that nothing has changed. We will continue to deliver and perform. The acquisition side of our growth strategy has two components:

First, our proprietary acquisition pipeline via our right of first offer on Melcor Developments' commercial properties under development. As properties are completed and leased by Melcor Developments, the REIT will consider their fit with the objectives of the REIT. Being that the quarter end is June early in the Western Canadian construction season, to date there have not yet been any opportunities that fit the REIT acquisition criteria.

The second aspect of our acquisition growth strategy focuses on the pursuit of third-party income-producing properties that meet our strategic investment criteria. We target acquisitions that will provide deeper penetration into our existing geographic markets or expand into immediately adjacent areas. We like to keep our properties clustered, as this enables efficient management and we benefit from current detailed market knowledge. We grow in the markets we know.

The improved side of our internal growth strategy is all about optimizing operating efficiency and being the landlord of choice through our signature customer care program. Our operating efficiency objectives are to increase rental income from existing properties. Our base rent has increased on average 5 percent for both the second quarter and the first six months of 2013. To invest in asset upgrades that increase operating efficiency, promote our sustainability and energy reduction strategy, and enhance property attractiveness and desirability. In fact, in the last five years pre REIT Melcor Developments invested just under $20 million in upgrades in what is now the REIT's asset portfolio.

The third operating efficiency objective is to increase occupancy levels across our portfolio. Economic occupancy as of June 30th was 90.4 percent, which is above our forecasted numbers. Our average occupancy rate is up in the quarter with strong leasing activity throughout and subsequent to the quarter. We expect to see continued activity, especially with small- to medium-sized tenants.

Tenant retention is critical to our success. Our signature customer care program seeks to deliver exceptional service to our customers through upgrades and redevelopment of existing assets, continuous client contact, hands-on building management, and responsiveness to our clients. Our client retention rate is up 2 percent to 90 percent compared to December 31, 2012 and 12 percent compared to Q2 2012.

The profile of our expiring leases over the next five years remain balanced and manageable, averaging 12 percent per year with the highest single year being 18 percent of our gross leasable area renewing in 2014. As of June 30th we've renewed 58 percent of the forecasted renewal space and have leased 47 percent of our projection for newly-leased space on a square footage basis.

Overall, we have a strong portfolio of income-producing assets and we will actively seek out suitable acquisitions to expand our asset base. We will also improve existing assets through redevelopment and efficient and effective property management.

I anticipate that the commercial real estate fundamentals will remain healthy in Western Canada with stable to slightly increasing occupancy rates. We see continued stability in activity levels in all of our markets and anticipate growth on average in both rental renewals and rental rates as leases renew.

While we cannot control the recent shakiness seen in the capital markets, we are by nature a bricks-and-mortar company and we'll continue to focus on those real estate fundamentals in our assets and markets that we can control. Only time will tell if the volatility towards the REIT sector seen in the capital markets over the past five weeks or so will be characterized as a market over-reaction to interest rate hike fears.

Prior to taking your questions I want to reiterate how pleased we are with our results in the first quarter of operations as the Melcor REIT. I'm delighted with the performance of Melcor Developments' asset and property management teams providing service to the Melcor REIT clients. I thank the teams for ensuring a smooth and seamless transition for our clients.

Our focus and commitment to customer service remains high. One measure of this commitment is the percentage that we respond to a reported client issue within 30 minutes. In June our teams recorded a 95 percent efficiency rating in customer response through our 1-866-MELCOR1 client response centre.

Our focus continues to be on providing signature customer care, maximizing occupancy and controlling expenses while paying attention to the real estate fundamentals. Coupled with a disciplined approach to executing our growth strategy we are confident in our ability to continue to grow a strong and balanced portfolio and provide sustainable, consistent returns to our unit-holders.

We'd now be happy to take your questions. Melanie, can you please open up the phone lines?

QUESTION AND ANSWER SESSION

Operator

Thank you. We will now take questions from the telephone lines. If you are using a speakerphone, please lift the handset before making your selection. If you have a question, press star one on your telephone keypad. If you would like to cancel your question, please press the pound sign. Please press star one at this time if you have a question. There will be a brief pause while the participants register. Thank you for your patience. The first question is from Neil Downey of RBC Capital Markets. Please go ahead.

Neil Downey, RBC Capital Markets

Hi, guys. Good morning. I think I really only have one probably rather simple question. It appears that NOI versus the forecast in round numbers was favourable by $400,000 and that roughly half that number was at the revenue line and half that number was at the operating expense line. So you did mention that there was timing differences with respect to maintenance expenditures at the operating income line so is that what we really should think about is that $200,000 of operating expense will normalize but the rental revenue in place basically is contractual and therefore continues?

Jonathan Chia, Chief Financial Officer

Neil, this is John. I would say that's a fair assumption. Even on the operating cost though there is a portion that has been realized just from utilities and other fixed operating expense numbers that we've realized savings on. So I mean I don't know if I can provide like real guidance in terms of percentage but I would say the majority, well, probably a third of that is true savings in terms of operating expenses, two-thirds represents things like operating expense maintenance items like elevators and painting and that type of thing that still needs to be incurred for, I guess, over the rest of the summer.

Neil Downey, RBC Capital Markets

Okay. So I guess to summarize, of the $200,000 roughly favourable variance in your operating expenses, two-thirds of that is a timing difference.

Jonathan Chia, Chief Financial Officer

Correct.

Neil Downey, RBC Capital Markets

Okay. Thank you.

Darin Rayburn, Chief Executive Officer

Thanks, Neil.

Operator

Thank you. Once again, please press star one at this time if you have a question. The following question is from Nelson Mah of Laurentian Bank. Please go ahead.

Nelson Mah, Laurentian Bank

Hi. I was just wondering, you know on your development (inaudible), I was wondering like how, like I guess nothing was blended in but I thought maybe that Leduc, like the phase four might be ready. So I was wondering when do you think that'll be ready then?

Darin Rayburn, Chief Executive Officer

Hi, Nelson. It's Darin. Thanks for the call. Nelson, Leduc phase four is not at the point where it's 90 percent occupied and substantially complete, so those are the REIT criteria, so unfortunately—I don't have a crystal ball but I can tell you we're watching it closely and we expect to look at that in the future.

Nelson Mah, Laurentian Bank

Is there a timeline for when it might hit the 90 percent then?

Jonathan Chia, Chief Financial Officer

Nelson, this is John. There's a Sport Chek and a Winners that's on that site right now and there's a pad site for another junior box tenant that hasn't been filled yet, so until that leasing is complete it wouldn't be near that criteria. We don't have a timeline specifically for that asset yet.

Nelson Mah, Laurentian Bank

Okay, got it. And then you know on the Village at Blackmud, like that tire company is in now, right?

Darin Rayburn, Chief Executive Officer

No, the building is not substantially complete yet, Nelson. The sign's on the building and they're not doing tenant (inaudible) as of yet.

Nelson Mah, Laurentian Bank

Okay, got it. And my only other question was on the Melcor building, when does that asbestos come out?

Darin Rayburn, Chief Executive Officer

The asbestos will actually come out on a regular program so as we re-let the space, Nelson, we'll clean out the asbestos. So, for instance, the ninth floor was cleaned out this year, the eighth floor is our next floor that we're working on starting in the next couple of weeks, and we'll work through the building as we replace tenancies.

Nelson Mah, Laurentian Bank

Okay, got it. Okay, thank you.

Darin Rayburn, Chief Executive Officer

Thank you, Nelson.

Operator

Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to Mr. Rayburn.

Darin Rayburn, Chief Executive Officer

Thanks, Melanie. Thanks again for those calling in. John and I look forward to future calls and, as always, if you have any questions beyond this meeting, feel free to contact us directly at our lines in the office. Everyone have a great week and enjoy the rest of your summer.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time. We thank you for your participation.
