LANESBOROUGH REIT

# 2009 ANNUAL REPORT

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**Unitholder Returns**

| | Year Ended December 31, 2009 (Per unit) | Year Ended December 31, 2008 (Per unit) |
|---|---|---|
| Cash distribution | $0.09 | $0.56 |
| Unit distribution | $1.09 | - |
| Opening price | $2.30 | $4.99 |
| Closing price | $0.81 | $2.30 |

The trust units of Lanesborough Real Estate Investment Trust are listed on the Toronto Stock Exchange under the symbol "LRT.UN". The Series F and Series G convertible debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.F" and "LRT.DB.G", respectively. The 5 year 9% second mortgage bonds due March 10, 2015 and the trust unit purchase warrants expiring March 9, 2015 are listed on the Toronto Stock Exchange under the symbol "LRT.NT" and "LRT.WT", respectively.

*Foreword*

*The operating results and cash flows of LREIT's portfolio of income-producing properties are disclosed under "continuing operations" in the financial statements of LREIT. As of December 31, 2009, the portfolio of income-producing properties consists of 21 properties, 13 of which are located in Fort McMurray, Alberta.*

*The operating results and cash flows for properties which were sold or classified as "held for sale" are disclosed under "discontinued operations" in the financial statements of LREIT. The 2008 results for all sold or "held for sale" properties are also restated under "discontinued operations", for comparative purposes.*

## PRESIDENT'S MESSAGE

The impact of the recession in Fort McMurray, Alberta due to the slowdown of construction activity in the oil sands industry was the overriding variable affecting the operations of LREIT in 2009. As LREIT's portfolio of income-producing properties is concentrated in Fort McMurray and as the Fort McMurray properties were achieving high rates of return during the booming economic period which preceded the market downturn, the recession resulted in a sharp decline in the operating income of specific properties in Fort McMurray and a corresponding decline in LREIT's overall results from continuing operations.

During 2009, LREIT incurred a loss from continuing operations, before taxes, of $12.8 Million, compared to a loss from continuing operations, before taxes, of $6.5 Million in 2008. Cash provided by operating activities from continuing operations decreased from $8.8 Million in 2008, to $3.4 Million in 2009.

Other events related directly or indirectly to the decline in market conditions in Fort McMurray in 2009, include the suspension of cash distributions by LREIT in March 2009, the ongoing delay in completing financing for the closing of a 160-suite apartment development in Fort McMurray (Parsons Landing) and the breach of debt service coverage requirements on 4 mortgage loans for 10 of the 13 income properties in Fort McMurray. The mortgage loan for one other income-producing property was also in breach of the debt service coverage requirement as of December 31, 2009.

In order to address the reduction in operating cash flow and the constraints on working capital which resulted from the economic downturn, LREIT initiated a divestiture program in 2009, with the ultimate objective of generating gross proceeds of $250 Million from the sale of selected properties. After undertaking the process of finalizing the terms of purchase offers and obtaining unconditional sale agreements, LREIT successfully completed the sale of 13 properties in the fourth quarter of 2009, at a total gross selling price of $90.4 Million. The 13 property sales generated net proceeds of $29.6 Million, after accounting for the repayment, assumption or take-back of mortgage loan debt.

The positive impact of the divestiture program is reflected in the income and cash flow results for discontinued operations. During 2009, LREIT generated income from discontinued operations of $19.0 Million, compared to a loss from discontinued operations of $2.8 Million in 2008. The income in 2009 includes a gain on the sale of properties of $21.1 Million. During 2009, cash provided by discontinued operations amounted to $7.8 Million, after accounting for the net proceeds from property sales and the retirement of $17.1 Million of interim mortgage loan debt.

The cash provided by discontinued operations (i.e., from property sales) also enabled LREIT to temporarily repay the $9.8 Million utilization of its bank line of credit and revolving loan facility. As of December 31, 2009, the cash balance of LREIT, net of bank indebtedness, was $4.3 Million, compared to $3.5 Million as of December 31, 2008.

In summary, notwithstanding the negative impact of the recession on operating results, the Trust maintained liquidity during 2009, while also focusing on the longer-term objective of ensuring that the Trust has the financial capability to meet its funding commitments.

The main funding commitment at the outset of 2010 was the obligation of LREIT to repay $11.95 Million of principal on maturity of the Series E convertible debentures on February 17, 2010. The amount owing was paid from existing cash resources and by utilizing $9.8 Million of funds from the bank line of credit and revolving loan facility.

The cash resources which were used for the repayment of the Series E convertible debentures were effectively replenished at the beginning of March 2010 from the proceeds of two additional property sales and from the completion of a public offering of investment units comprised of bonds and warrants. The property sales generated net proceeds of $6.4 Million, while the gross proceeds from the public offering of investment units amounted to $6.8 Million. Details of the property sales and investment unit offering are provided in the accompanying MD&A.

The completion of the debt offering is a positive indicator of the ability of LREIT to arrange financing and the anticipated sale of additional properties should enable LREIT to further improve its financial position. It is also anticipated that the financing of Parsons Landing and the breach of debt service coverage requirements will be satisfactorily resolved.

ARNI C. THORSTEINSON, CFA
Chief Executive Officer
March 23, 2010

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("MD&A") of Lanesborough Real Estate Investment Trust ("LREIT" or the "Trust") should be read in conjunction with the consolidated financial statements of LREIT for the year ended December 31, 2009 and with reference to the quarterly reports for 2009.

**Forward-Looking Information**

Certain statements contained in this MD&A and in certain documents incorporated by reference herein are "forward-looking statements" that reflect the expectations of management regarding the future growth, results of operations, performance, prospects and opportunities of LREIT. Readers are cautioned not to place undue reliance on forward-looking information. All statements other than statements of historical fact contained or incorporated by reference herein are forward-looking statements including, without limitation, statements regarding the timing and amount of distributions and the future financial position, business strategy, potential acquisitions, plans and objectives of LREIT. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in forward-looking statements including risks associated with the going concern, assumption breaches of debt service coverage covenants under financing documents, debt financing, availability of cash for distributions, the taxation of trusts, public markets, real property ownership, liquidity, interest and financing risk, credit risk, concentration of portfolio in one market, future property acquisitions, dependence on natural resources industries, reliance on single or anchor tenants, availability of suitable investments, land leases, general uninsured losses, interest rate fluctuations, Unitholder liability, potential conflicts of interest, changes in legislation and investment eligibility, conversion to international financial reporting standards, multi-family residential sector risk, environmental risks, other tax-related risk factors, supply risk, utility and property tax risk, government regulation, nature of Units, dilution, competition, general economic conditions, current economic conditions, relationship with the property manager, reliance on key personnel and additional risks associated with convertible debentures. Although the forward-looking statements contained or incorporated by reference herein are based upon what management believes to be reasonable assumptions, LREIT cannot assure investors that actual results will be consistent with these forward-looking statements.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. Forward-looking statements are made as of the date hereof, or such other date specified in such statements, and neither LREIT nor any other person assumes any obligation to update or revise such forward-looking statements to reflect new information, events or circumstances, except as expressly required by applicable securities law.

**Purchase Price Information**

All purchase prices set forth herein are disclosed prior to closing costs, other adjustments on closing and GST, where applicable.

**Divestiture Program**

In 2009, LREIT commenced a divestiture program with the objective of generating minimum gross proceeds of $250 Million from the sale of selected properties.

During 2009, LREIT sold 13 properties, while an additional 10 properties are classified as "properties held for sale" as of December 31, 2009. Since December 31, 2009, two of the properties held for sale have been sold. The operating results for the "sold" and "held for sale" properties, as well as the sale results for the "sold" properties are reported separately in the consolidated financial statements under "discontinued operations", in accordance with generally accepted accounting principles (refer to Note 7 to the consolidated financial statements). The carrying value of "properties held for sale", as reported in accordance with generally accepted accounting principles, in the consolidated financial statements, differ from the projected sale price of the properties as disclosed in the MD & A. The number of properties actually sold by LREIT may differ from the number of properties which are classified as "held for sale".

Assets, liabilities, revenues, expenses and cash flows reflected in this MD&A are in regard to the remaining 21 properties which are classified as continuing operations, unless otherwise indicated.

**Estimated Current Value**

In this management discussion and analysis, references are made to the estimated current value of LREIT's property portfolio, which is an estimate of the current value of LREIT's property portfolio as at December 31, 2009 made by management of LREIT.

In summary, the total estimated current value of the total property portfolio is $594,575,000, of which $427,465,000 relates to continuing operations. The total estimated current value of $427,465,000 from continuing operations is 8.7% less than the total appraised value of $467,990,000. For 12 properties, representing $258,965,000 or 61% of total estimated current value, the estimated current value is equal to the appraised value of the applicable properties. For 10 properties, representing $168,500,000 or 39% of total estimated current value, the estimated current value is 19.4% less than the appraised value of the applicable properties.

**There can be no assurance that the estimated current value of a property is an accurate reflection of the value of such property as at the date that the estimated current value is established or on any other date, including on December 31, 2009. In addition, there can be no assurance that the valuation method or the capitalization rate(s) used in creating the estimated current value for the property was appropriate for such property as at the date that the estimated current value is established or on any other date, including on December 31, 2009.**

**LREIT undertakes no obligation to update the appraised value of its properties from time to time.**

**Appraised Value**

The appraised value is based on appraisals prepared by independent appraisers. The appraisals are estimates only, are made effective as at the date set forth in the appraisal and are subject to a number of assumptions, qualifications and limiting conditions, including but not limited to those described in such appraisals. Such assumptions, qualifications and limiting conditions generally include, among other things: (i) that title to the property is good and marketable; (ii) there are no encroachments, encumbrances, restrictions, leases or covenants that would in any way affect valuation, except as noted in the appraisal; (iii) the existing use of the property is legal and may be continued by any purchaser of the property; (iv) there has been no delinquency in the payment of taxes relating to the property; (v) that environmental laws have been complied with and there are no potentially hazardous materials on the property or any adjoining property; and (vi) that there are no patent or latent defects in the buildings located on the property.

**There can be no assurance that appraised value of a property is an accurate reflection of the value of such property as at the effective date set forth in the appraisal or on any other date, including on December 31, 2009. In addition, there can be no assurance that the valuation method or the capitalization rate(s) used in appraising a property was appropriate for such property as at the effective date set forth in the appraisal or on any other date, including on December 31, 2009.**

**LREIT undertakes no obligation to update the appraised value of its properties from time to time.**

## FINANCIAL SUMMARY

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **DISTRIBUTIONS** | | |
| Distributions paid in cash | $ 1,530,736 | $ 8,104,253 |
| Value of trust units issued under DRIP | 104,343 | 1,725,598 |
| Distributions paid in units | 19,504,206 | - |
| Distributions paid on LP units | 33,285 | 199,705 |
| | $ 21,172,570 | $ 10,029,556 |
| Per unit | $ 1.18 | $ 0.56 |
| **BALANCE SHEET** | | |
| Total Assets | $ 537,144,566 | $ 605,508,331 |
| Total face value of mortgage loans payable and convertible debentures | $ 434,576,262 | $ 507,554,133 |
| **KEY FINANCIAL PERFORMANCE INDICATORS (1)** | | |
| **Operating Results** | | |
| Total revenue | $ 41,812,005 | $ 43,004,699 |
| Net operating income * | $ 28,429,241 | $ 30,661,044 |
| Loss from continuing operations, before future income tax * | $ (12,779,925) | $ (6,542,200) |
| Income (loss) and comprehensive income (loss) | $ 3,497,073 | $ (9,607,056) |
| **Cash Flows** | | |
| Cash flow from operating activities, including discontinued operations | $ 2,601,301 | $ 12,415,514 |
| Funds from Operations (FFO) * | $ (2,205,439) | $ 3,155,394 |
| Adjusted Funds from Operations (AFFO) * | $ 2,117,945 | $ 8,050,405 |
| Distributable income * | $ 5,247,368 | $ 11,461,370 |
| **Per Unit** | | |
| Net operating income * | | |
| - basic | $ 1.621 | $ 1.754 |
| - diluted | $ 1.146 | $ 1.200 |
| Loss from continuing operations, before future income tax* | | |
| - basic | $ (0.729) | $ (0.374) |
| - diluted | $ (0.729) | $ (0.374) |
| Income (loss) and comprehensive income (loss) | | |
| - basic | $ 0.199 | $ (0.549) |
| - diluted | $ 0.199 | $ (0.549) |
| Distributable income * | | |
| - basic | $ 0.299 | $ 0.656 |
| - diluted | $ 0.299 | $ 0.592 |
| Funds from Operations (FFO) * | | |
| - basic | $ (0.126) | $ 0.180 |
| - diluted | $ (0.126) | $ 0.172 |
| Adjusted Funds from Operations (AFFO) * | | |
| - basic | $ 0.121 | $ 0.461 |
| - diluted | $ 0.121 | $ 0.437 |

(1) Non-GAAP Measurements

Items marked with an asterisk represent measurements which are not calculated or presented in accordance with Canadian generally accepted accounting principles ("GAAP") or which do not have a standardized meaning as prescribed by GAAP. The non-GAAP measurements may not be comparable to the measurements which are provided by other entities and should not be used as an alternative to the measurements which are determined in accordance with GAAP for purposes of assessing the performance of LREIT. LREIT believes, however, that the non-GAAP measurements are useful in supplementing the reader's understanding of the performance of the Trust. Details regarding the calculation of the non-GAAP measurements and a reconciliation to GAAP measurements, where applicable, are provided in the report.

# SUMMARY

## Core Business and Strategy

LREIT was established in order to create a portfolio of income-producing real estate investments. The core business activities of LREIT include investment, development, management and divestiture activities which are focused on maximizing the return on the real estate portfolio.

Prior to 2009, the primary business strategy of LREIT was to achieve growth through the acquisition of new properties. As of December 31, 2008, the real estate portfolio of LREIT consisted of 44 properties with an acquisition cost of approximately $597 Million, including 13 properties located in Fort McMurray, Alberta.

In 2009, the recession and, in particular, the slow down of economic activity in Fort McMurray resulted in a significant reduction in the operating income and operating cash flows of LREIT. Recessionary influences, combined with the reduced operating cash flows, also negatively impacted the overall financing capabilities of LREIT. In response, LREIT initiated a divestiture strategy in 2009 with the objective of generating $250 Million of gross proceeds from property sales in order to create funds for the pay down of mortgage loan and convertible debenture debt and to restore working capital.

A more detailed description of the operations and business strategy of LREIT is provided in the section of the MD&A titled, "Overview of Operations and Business Strategy".

## Highlights of 2009 Results and Key Issues/Events

### 1. Real Estate Portfolio

***Summary of Changes to Property Portfolio***

| | Year Ended December 31 | | | |
|---|---|---|---|---|
| | 2009 | | 2008 | |
| **Income-producing** | | | | |
| Number of income-producing properties, beginning of year | 43 | | 39 | |
| New income-producing properties | 1 | ** | 4 | * |
| Less: | | | | |
| Properties sold | (13) | | - | |
| Properties held for sale | (10) | | - | |
| Number of income-producing properties, end of year | 21 | | 43 | |
| Properties under development, end of year | - | | 1 | ** |

*  *Comprised of Siena Apartments, Parsons Landing, Laird's Landing and Colony Square.*
**  *Clarington Seniors Residence*

***Status of Parsons Landing***

Although LREIT acquired full possession of Parsons Landing on September 1, 2008, the purchase agreement provided for a portion of the purchase price to be paid by February 28, 2009. As LREIT has experienced delays in completing financing, the vendor has agreed to multiple extensions of the payment deadline, subject to certain conditions, including the remittance of monthly interest payments of $300,000 and a lump-sum principal payment of $500,000. Most recently, the payment deadline has been extended from December 15, 2009 to May 31, 2010.

On closing, the vendor has also agreed to forgive interest in excess of $300,000 per month and provide second mortgage loan financing of $12 Million.

More specific details regarding the acquisition of Parsons Landing are provided in the following sections of the MD&A.

## 2. Divestiture Program

| | Properties Sold in 2009 | Properties sold year to date 2010 | Total |
|---|---|---|---|
| Number of properties | 13 | 2 | 15 |
| Gross proceeds | $ 90,392,000 | $ 19,170,000 | $ 109,562,000 |
| Net proceeds | $ 29,631,650 | $ 6,394,969 | $ 36,026,619 |

Net proceeds are calculated after deducting vendor take-back financing of $7,050,000 for properties sold in 2009 and $3,000,000 for year to date sales in 2010.

## 3. Liquidity

| | As of December 31 2009 | As of December 31 2008 |
|---|---|---|
| Cash | $ 4,287,864 | $ 3,549,892 |
| Working capital deficit | $ 10,468,086 | $ 2,141,026 |

Working capital deficit at December 31, 2009 includes the face value of the Series E debentures which were repaid on February 17, 2010.

***Key subsequent events affecting liquidity***

- As noted above, LREIT generated net proceeds of $6,394,969 from the sale of two properties in March 2010.
- On February 17, 2010, Series E convertible debenture debt of $11.95 Million matured. The debt was retired utilizing $5 Million from the revolving loan with 2668921 Manitoba Ltd. and $4.8 Million from the line of credit with the Royal Bank of Canada, with the balance paid in cash.
- On March 4, 2010, LREIT generated gross proceeds of $6,780,000 from a public offering of investment units, with each investment unit consisting of a 5-year, 9% second mortgage bond in the principal amount of $1,000 and 1,000 trust unit purchase warrants. The proceeds were used to retire the revolving loan from 2668921 Manitoba Ltd.

## 4. Financial

| | Year Ended December 31 2009 | Year Ended December 31 2008 | Increase (Decrease) |
|---|---|---|---|
| Net operating income from continuing operations | | | |
| Fort McMurray properties | $ 22,936,293 | $ 25,095,421 | $ (2,159,128) |
| Other properties | 5,466,085 | 5,115,854 | 350,231 |
| Trust | 26,863 | 449,769 | (422,906) |
| Total | $ 28,429,241 | $ 30,661,044 | $ (2,231,803) |
| Loss from continuing operations | $ (15,478,729) | $ (6,796,592) | $ (8,682,137) |
| Income (loss) from discontinued operations | 18,975,802 | (2,810,464) | 21,786,266 |
| Income (loss) and comprehensive income (loss) | $ 3,497,073 | $ (9,607,056) | $ 13,104,129 |
| Cash provided by operating activities in continuing operations | $ 3,438,285 | $ 8,782,082 | $ (5,343,797) |

A summary of the key financial performance indicators of LREIT is provided in the section of the MD&A which precedes this "Summary".

## 5. Operations

| | Year Ended December 31 | |
|---|---|---|
| | 2009 | 2008 |
| ***Income Properties:*** | | |
| Average vacancy loss | | |
| Total - all Income Properties | 18 % | 3 % |
| Income Properties - Fort McMurray | 22 % | 4 % |
| Average rental rate | | |
| Total - all Income Properties | $ 2,308 | $ 2,357 |
| Income Properties - Fort McMurray | $ 2,806 | $ 2,913 |

## 6. Financing

| **Key Variables** | As of December 31 | |
|---|---|---|
| | 2009 | 2008 |
| Total mortgage loan debt to estimated current value - Income Properties | 75 % | 60 % |
| Weighted average interest rate of mortgage loan debt - Income Properties | 5.86 % | 5.52 % |

| **Debt Reduction** | Continuing Operations | Discontinued Operations | Total |
|---|---|---|---|
| Mortgage proceeds | $ 5,000,000 | $ 4,400,000 | $ 9,400,000 |
| Mortgage repaid | (2,100,000) | (4,492,566) | (6,592,566) |
| | 2,900,000 | (92,566) | 2,807,434 |
| Regular debt repayments | (5,316,733) | (2,535,641) | (7,852,374) |
| Line of credit | (3,320,000) | - | (3,320,000) |
| Mortgage debt eliminated on sale | - | (51,851,742) | (51,851,742) |
| Interim debt repaid on sale | - | (17,094,997) | (17,094,997) |
| Total debt repaid/eliminated - 2009 | $ (5,736,733) | $ (71,574,946) | $ (77,311,679) |
| Gross book value of properties sold | | $ 74,039,552 | $ 74,039,552 |

**Key Financing Issues**

- As of December 31, 2009, LREIT is in breach of the debt service coverage covenant for five mortgage loans totaling $124,161,746. In the event that any of the lenders demand repayment of the mortgage loans, the Series F convertible debentures with a face value of $13.68 Million may become payable, on demand, as a result of cross-default clauses. LREIT is pursuing a resolution of the loan breaches with the lenders and, to date, the breaches have not resulted in an acceleration of the repayment of any of the loans.

## 7. Special Distribution

On December 31, 2009, LREIT paid a "special" distribution in the form of additional trust units. In total, 17,893,767 trust units were issued under the distribution with a value of approximately $19.5 Million or $1.09 per unit, representing the closing market price of the units on December 31, 2009.

The distribution was followed by an immediate consolidation of units, resulting in Unitholders holding the same number of units after the distribution as were held, prior to the distribution.

The distribution served to reduce the taxable income of LREIT to nil.

## Outlook for 2010

The main factors affecting operating results for 2010 are:

(i) the extent to which rental market conditions improve in Fort McMurray;

(ii) the ability of LREIT to secure the necessary mortgage loan financing for Parsons Landing and thereby achieve a reduction in financing costs for the property;

(iii) the ability of LREIT to renew the maturing mortgage loan debt of income properties at an overall interest rate which is not significantly higher than the existing interest rates; and

(iv) the extent to which LREIT generates additional cash from property sales for the pay down of debt associated with continuing operations.

## Risks and Uncertainties

The key risks and uncertainties affecting the current operations of LREIT include:

- As disclosed in note 1 of the audited Financial statements, there are a number of variables and risk factors affecting the operations of LREIT including:
  - the net losses sustained by LREIT in 2009 and 2008
  - the breach of the debt service coverage requirements on five mortgage loans
  - the working capital deficiency of the Trust
  - the cross-default clauses of the Series F convertible debentures and the 5 year 9% second mortgage bonds
  - and the impact of increased vacancy rates and reduced rental rates in Fort McMurray on the ability of the Trust to secure mortgage loan financing.

  As a result of the steps which have been taken to address the risk factors, and after considering events which have occurred subsequent to December 31, 2009, including the repayment of the Series E debentures in February 2010; the issue of mortgage bonds; the renewal or refinancing of all mortgage loans which have matured to the date of this report in 2010; the completion of additional property sales in 2010 and the resulting pay-down of additional debt, management believes that LREIT has the financial capacity to maintain stability.

- Other key risks factors include:
  - the significant concentration of properties in Fort McMurray and the uncertainty regarding the timing and extent of the economic recovery in Fort McMurray
  - successful completion of the divestiture program
  - ability of the Trust to obtain mortgage financing for Parsons Landing and other projects
  - potential breach of debt service coverage requirements for other mortgage loans due to a decline in net operating income.

A more detailed description of key risks is provided in the "Risks and Uncertainties" section of this report and certain additional risks are described in the Annual Information Form.

## PARSONS LANDING FINANCING

Parsons Landing is an apartment property in the Timberlea area of Fort McMurray, Alberta, consisting of a four-storey apartment building, with a total of 160 suites. The completion of Parsons Landing occurred in two phases upon the issuance of occupancy certificates. LREIT acquired possession of Phase I on May 14, 2008 and possession of Phase II effective September 1, 2008.

The purchase price of Parsons Landing was $63.2 Million, including GST, of which $15 Million was paid as of December 31, 2008. The purchase agreement for Parsons Landing allowed for the remaining balance of $48.2 Million to be paid by February 28, 2009. The intent of LREIT was to fund the balance owing with new mortgage loan financing.

As the new mortgage loan financing arrangements were delayed, the vendor agreed to extend the deadline for payment of the balance owing until May 29, 2009, with subsequent extensions to July 31, 2009, October 1, 2009, December 15, 2009 and, most recently, to May 31, 2010. Each payment extension date has also encompassed an extension of the deadline date for LREIT to obtain a commitment for the mortgage loan financing for the property and a condition that LREIT submit payments of $300,000 per month on account of interest. The $300,000 monthly interest payments have been submitted by LREIT from March 2009 to February 2010, inclusive. LREIT was also required to remit a principal payment of $500,000 on May 12, 2009.

The current payment extension date of May 31, 2010 is conditional upon the Trust obtaining a commitment for mortgage financing of $30,000,000 by April 30, 2010. The vendor has agreed to provide a credit of $1,440,000 for furniture purchased by LREIT and also a second mortgage loan on closing, to a maximum of $12 Million, for a term of 15 months, at an interest rate of 8% per annum for the first eight months, 12% for the next four months and 24% thereafter.

Although accrued interest on the balance owing amounted to $9,918,409 during 2009, the Vendor has forgiven all interest in excess of the $300,000 monthly interest payments for the period from March 1, 2009 to December 31, 2009. In total, $5,841,638 of interest was forgiven by the Vendor during 2009, resulting in interest charges on the balance owing being reduced to $4,076,771.

Subject to the attainment of the required mortgage funding, the Vendor has also agreed to forgive interest in excess of the $300,000 monthly interest payment for the period from January 1, 2010 to May 31, 2010, in the amount of $3.4 Million.

As of December 31, 2009, the amount payable in regard to the acquisition of Parsons Landing, including GST, is $47.7 Million.

The forgiveness of interest by the Vendor initially occurred during the third quarter of 2009 at which time the previous agreement to reduce the purchase price by $3,100,000 on closing was rescinded.

The vendor is permitted to sell the property and the Trust may list the property for sale. In the event of the sale of Parsons Landing, the Trust will be liable to the vendor for any shortfall between the net proceeds of the sale and the balance owing on the property.

## OVERVIEW OF OPERATIONS AND INVESTMENT STRATEGY

### General

LREIT is an unincorporated closed-end real estate trust which was established on April 23, 2002, under the laws of the Province of Manitoba. LREIT became a publicly traded entity on August 30, 2002. The trust units of LREIT are listed on the Toronto Stock Exchange under the symbol "LRT.UN" and the Series F and Series G convertible debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.F" and "LRT.DB.G", respectively. The 5 year 9% second mortgage bonds due March 10, 2015 and the trust unit purchase warrants expiring March 9, 2015, which were issued on March 9, 2010, are listed on the Toronto Stock Exchange under the symbols "LRT.NT" and "LRT.WT", respectively.

The primary investment objectives of LREIT are to maximize unit values and provide stable cash distributions to the Unitholders by creating a large diversified portfolio of quality real estate investments through the ongoing acquisition and development of multi-unit residential properties.

The investment policies and operations of LREIT are subject to the overall control and direction of the Trustees, pursuant to the terms of the Declaration of Trust. Shelter Canadian Properties Limited ("Shelter Canadian") provides asset management services to LREIT, pursuant to the terms of a Services Agreement. Shelter Canadian is also responsible for the property management function for the income properties of LREIT, pursuant to the terms of a Property Management Agreement.

The core business activities of LREIT includes acquisition, development, financing, management and divestiture activities pertaining to real estate properties in Canada. As of December 31, 2009, the real estate portfolio of LREIT consists of 20 multi-family residential properties and one commercial property. Rental revenue from the leasing of the properties is the primary source of revenue for LREIT.

### Investment in Properties

Prior to 2009, the primary investment strategy of LREIT was to expand its income base by acquiring income-producing properties. In 2006 and 2007, LREIT focused its investment activities on the acquisition and development of new residential rental properties in Fort McMurray, Alberta due to the high level of economic growth and the favourable rate of return which was being generated by real estate investments in Fort McMurray prior to the economic downturn in 2008.

The new income-producing properties which were acquired or developed by LREIT in Fort McMurray during 2007 and 2008 were primarily responsible for the significant growth in operating income and operating cash flow that was achieved by LREIT in 2008. The decline in economic conditions in Fort McMurray in 2009 has resulted in a reduction in the profitability of the Fort McMurray property portfolio and decrease in the overall investment returns of the Trust.

The financial statements of LREIT provide segmented results for the income properties, with "Fort McMurray and "Other" representing the segments. Operating results pertaining to general Trust operations are disclosed separately in the segmented financial information.

**Operations**

LREIT maximizes the operating income of its property portfolio through the implementation of financial management practices, operating procedures, responsive management services and proactive leasing strategies. LREIT also completes capital improvements and upgrades to its properties on an ongoing basis and undertakes major renovation programs or expansion projects at selected properties, as deemed appropriate.

The most comprehensive renovation program or expansion projects have occurred at two properties (Elgin Lodge and Highland Tower) and less extensive renovation programs have been completed at other properties.

An analysis of the segmented operating results of the portfolio of "same" properties is one of the key analysis which is used by LREIT to assess the overall performance of properties which have been in the income-producing stage for at least 24 consecutive months.

This report includes an analysis of the segmented operating results for the portfolio of same properties for 2009, compared to 2008 and for the fourth quarter of 2009, compared to the third quarter of 2009.

**Financing**

The purchase price of new property acquisitions is typically funded from the proceeds of mortgage loans with the remaining balance, or the equity component, funded from other investment capital. The investment capital of LREIT has been primarily raised through the completion of trust unit and convertible debenture offerings, although LREIT also utilizes second and third mortgage loans, bridge financing and an operating line of credit as a source of investment capital. The upward refinancing of mortgage loan debt has also served as a source of investment capital.

Pursuant to the terms of the Declaration of Trust, the total mortgage indebtedness of LREIT shall not exceed 75% of the appraised value of LREIT's total property portfolio. As of December 31, 2009, the total mortgage indebtedness of LREIT was less than 75% of the appraised value of LREIT's total property portfolio.

The ratio of net operating income to mortgage loan debt service costs is one of the measures utilized to assess the overall financial position of the Trust. During 2009, the mortgage loan debt service coverage ratio for continuing properties was 1.38, compared to 1.70 during 2008.

**Divestiture Program**

LREIT is pursuing a divestiture program targeting the sale of assets, with estimated proceeds in excess of $250 Million, by early 2011. The objective of the divestiture program is to reduce total debt, including convertible debenture debt, and in particular, higher cost interim mortgage loan financing.

In addition to generating funds for the repayment of debt, the projected sale of properties under the divestiture program will enable LREIT to improve its working capital position.

During 2009, LREIT sold 13 properties at a combined gross selling price of $90.4 Million. The total net proceeds from sale were approximately $29.6 Million, after accounting for expenses, the repayment or assumption of debt and the provision of take-back financing to some purchasers. The net proceeds permitted the repayment of $17.1 Million of interim financing.

Between January 1, 2010 and the date of this report, LREIT has sold an additional two properties at a combined gross selling price of $19.2 Million. The total net proceeds from sale are approximately $6.4 Million, after accounting for expenses, the repayment or assumption of mortgage debt and the provision of take-back financing to a purchaser.

**Distributions**

In March 2009, after paying a distribution of $0.04667 per unit for January 2009 and February 2009, LREIT implemented a change in its distribution policy from monthly distributions to quarterly distributions. Under the revised distribution policy, The Trust planned to pay quarterly distributions of $0.06 per unit ($0.24 per unit annualized) on July 15, October 15 and December 31 to the Unitholders of record as of June 30, September 30 and December 15, respectively. Due to the continued weakness of rental market conditions in Fort McMurray, LREIT did not proceed with the planned distribution for the second quarter of 2009 and since then, cash distributions have been suspended.

As a result of the extent of property sales, LREIT incurred significant recaptured income and taxable capital gains in 2009, which resulted in a corresponding increase in taxable income, before deducting distributions. As a result of its taxable income position, LREIT paid a "special" distribution in the form of additional trust units on December 31, 2009. The distribution was calculated to reduce the taxable income of LREIT to nil, based on the best estimates of the income tax position of LREIT as of December 31, 2009. The distribution was followed by an immediate consolidation of units, resulting in Unitholders holding the same number of units after the distribution as were held, prior to the distribution.

## REAL ESTATE PORTFOLIO

**Portfolio Summary - December 31, 2009**

As of December 31, 2009, the property portfolio of LREIT consists of 21 income-producing properties, and 10 properties which are classified as "held for sale". (The 10 "held for sale" properties are disclosed under "Assets held for sale" on the balance sheet of the Trust.) The entire property portfolio, including "held for sale" properties, has a total purchase price of approximately $526 Million and encompasses 2,854 suites and 204,526 square feet of leasable area.

The following changes occurred to the property portfolio during 2009:

- 23 properties which were classified as "income-producing" properties as of December 31, 2008, were reclassified to "held for sale" during 2009, of which 13 were sold as of December 31, 2009. All of the reclassified income-producing properties were acquired by LREIT prior to 2008, with the exception of Colony Square which was acquired on October 1, 2008; and

- the Clarington Seniors Residence and the building addition to Elgin Lodge were reclassified from "properties under development" to "held for sale" during 2009. The effective date of reclassification was February 1, 2009 for the Clarington Seniors Residence and October 1, 2009, for the building addition to Elgin Lodge.

A list of all of the properties in the LREIT investment portfolio is provided in Schedule I of this report.

***Composition of Income-Producing Property Portfolio***

The 21 properties which are classified as income-producing properties in continuing operations consist of a commercial property in Burlington, Ontario, 13 multi-family residential properties in Fort McMurray, Alberta, three multi-family properties in Yellowknife, Northwest Territories, and four multi-family properties located in each of, Thompson, Manitoba; Moose Jaw, Saskatchewan; Edson, Alberta and Peace River, Alberta.

The revenue base of the Fort McMurray property portfolio was proportionately higher in 2009 than in 2008 as a result of three properties which were added to the income-producing portfolio part way through 2008. The effective dates on which the three properties were added to the income-producing portfolio are as follows:

- Laird's Landing (189 suites) - June 1, 2008
- Siena Apartments (66 suites) - July 2, 2008
- Parsons Landing (160 suites) - September 1, 2008

Aside from the reclassification of properties as held for sale, there were no other changes to the income-producing portfolio during the year ended December 31, 2009.

**Properties Sold During 2009**

As previously disclosed, LREIT sold 13 properties during 2009 at a combined gross selling price of $90.4 Million. After accounting for expenses, the repayment or assumption of mortgage debt and the provision of take-back financing to some purchasers, the sales resulted in net cash proceeds of approximately $29.6 Million. The 13 properties which were sold are listed below:

| Property | Location |
|---|---|
| Kenaston | Winnipeg |
| Nova Ridge Estates | Spruce Grove |
| Nova Villa | Edmonton |
| Village West | Saskatoon |
| Broadview Meadows | Sherwood Park |
| Greenwood Gardens | Surrey |
| Sir Robert Borden Place | Saskatoon |
| Borden Estates | Prince Albert |
| Cedar Village | Prince Albert |
| Carlton Manor | Prince Albert |
| Riverside Apartments | Prince Albert |
| MGM Apartments | Prince Albert |
| Marquis Towers | Prince Albert |

**Properties Held for Sale**

A property is classified by the Trust as held for sale when the property is available for immediate sale; management has committed to a plan to sell the asset and is actively locating a buyer for the asset at a sales price that is reasonable in relation to current fair value of the asset; and the sale is probable and expected to be completed within a one-year period. As of December 31, 2009, the following 10 properties are classified as "held for sale".

| Property | Location |
|---|---|
| Chancellor Gate * | Winnipeg |
| Chateau St. Michael's | Moose Jaw |
| Clarington Seniors Residence | Bowmanville |
| Colony Square | Winnipeg |
| 156 / 204 East Lake Blvd. | Airdrie |
| Elgin Lodge | Port Elgin |
| McIvor Mall * | Winnipeg |
| Nova Manor | Edmonton |
| Riverside Terrace | Saskatoon |
| Willowdale Gardens | Brandon |

*Sold on March 1, 2010.

***Analysis of Operating Results for Properties Held For Sale***

The operating results for all properties which are being held for sale as of December 31, 2009 are disclosed separately on the Consolidated Statements of Income (Loss) under the line "Income (loss) from discontinued operations".

Accordingly, in this report, the analysis of operating results excludes the revenues and expenses of the properties which are being held for sale, except where noted.

## Mortgage Loans Receivable

As of December 31, 2009, the mortgage loans receivable of LREIT amounted to $7.05 Million comprised of a 5%, second mortgage loan of $500,000 which was provided on a property sale on October 1, 2009 and a 3%, second mortgage loan in the amount of $6.55 Million which was provided on a property sale on December 1, 2009.

During 2008, mortgage loans receivable consisted solely of an 8%, $10 Million loan receivable which was fully applied toward the purchase price of Parsons Landing. As of December 31, 2008, the "mortgage loan receivable" balance of LREIT was nil.

# CAPITAL STRUCTURE

**Capital Structure - December 31, 2009**

| | December 31, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Mortgage loans payable - principal amount | $ 282,552,251 | 64.9 % | $ 284,968,987 | 68.5 % |
| Convertible debentures - face value | 51,362,000 | 11.8 % | 51,362,000 | 12.3 % |
| Trust units (net of issue costs) | 101,503,281 | 23.3 % | 79,750,666 | 19.2 % |
| Total capitalization | $ 435,417,532 | 100.0 % | $ 416,081,653 | 100.0 % |

## Mortgage Loans Payable

### Change in Total Mortgage Loan Debt during 2009

The mortgage loans payable of LREIT are comprised of two components, namely mortgage loans payable for continuing operations and mortgage loans payable for properties "held for sale". The mortgage loans payable for continuing operations are disclosed on the balance sheet of LREIT as "Mortgage Loans Payable", while the mortgage loans payable for properties "held for sale" are included in "Liabilities of properties held for sale" on the balance sheet. The mortgage loans payable component of "Liabilities of properties held for sale" is disclosed in note 7 of the financial statements.

In total, the mortgage loan debt of LREIT was reduced by $72.1 Million during 2009, of which $2.1 Million pertains to continuing operations. An analysis of the total debt reduction in 2009 is included in the following chart.

| | Year Ended December 31, 2009 | | |
|---|---|---|---|
| | Total | Continuing Operations | Discontinued Operations |
| Proceeds of mortgage loan financing | $ 9,400,000 | $ 5,000,000 | $ 4,400,000 |
| Repayment of mortgage loans on refinancing | (6,592,566) | (2,100,000) | (4,492,566) |
| Net proceeds (repayment) | 2,807,434 | 2,900,000 | (92,566) |
| Repayment of principal on mortgage loans | (7,852,374) | (5,316,733) | (2,535,641) |
| Interim financing loans retired from sale proceeds | (17,094,997) | - | (17,094,997) |
| Mortgage loans retired or assumed by purchasers | (51,851,742) | - | (51,851,742) |
| Total debt repaid/eliminated | (73,991,679) | (2,416,733) | (71,574,946) |
| Transaction cost/market interest rate adjustments* | 1,909,395 | 287,401 | 1,621,994 |
| Total debt reduction | (72,082,284) | (2,129,332) | (69,952,952) |
| Total mortgage and interim loans payable - December 31, 2008 | 453,927,161 | 283,503,730 | 170,423,431 |
| Total mortgage and interim loans payable - December 31, 2009 | $ 381,844,877 | $ 281,374,398 | $ 100,470,479 |

* Consists of the change in unamortized transaction costs and the change in the difference between contractual and market interest rates on mortgage loans assumed.

## Debt Retirement from Property Sales Subsequent to December 31, 2009

Between January 1, 2010 and the date of this report, December 31, 2009 mortgage loan debt has been reduced by approximately $9.4 Million as a result of the sale of additional properties.

**Summary of Mortgage Loans Payable - Continuing Operations**

| Year of Maturity | Weighted Average Interest Rate | Amount December 31, 2009 | Percentage of Total |
|---|---|---|---|
| Fixed rate | | | |
| 2010 | 5.6 % | $ 27,580,558 | 9.8 % |
| 2011 | 12.0 % | 4,500,000 | 1.6 % |
| 2012 | 5.6 % | 32,863,022 | 11.6 % |
| 2013 * | 5.8 % | 44,163,431 | 15.6 % |
| 2014 | 6.3 % | 35,599,671 | 12.6 % |
| 2015 | 4.9 % | 7,123,153 | 2.5 % |
| 2016 | 5.2 % | 35,808,223 | 12.7 % |
| 2018 * | 5.8 % | 22,147,455 | 7.8 % |
| | | 209,785,513 | 74.2 % |
| Demand/floating rate | 5.9 % | 72,766,738 | 25.8 % |
| Principal amount | | 282,552,251 | 100.0 % |
| Unamortized transaction costs | | (1,177,853) | |
| | | $ 281,374,398 | |

* Includes floating interest rate mortgages of $22,147,455 and $20,171,559, with interest rates fixed at 5.82% and 5.74% respectively by use of interest rate swap arrangements.

**Mortgage Loan Debt Summary ***

| | 2009 Q 4 | 2009 Q 3 | 2009 Q 2 | 2009 Q 1 |
|---|---|---|---|---|
| Weighted average interest rate | | | | |
| Fixed rate mortgage loans | 5.8% | 5.9% | 5.9% | 5.9% |
| Floating rate mortgage loans | 5.9% | 3.7% | 3.7% | 4.0% |
| Ratio of mortgage loans payable, compared to: Purchase price of income-producing properties * | 85% | 84% | 85% | 85% |
| Ratio of total mortgage loans payable, compared to: Total estimated current value of property portfolio | 71% | 74% | 65% | 62% |
| Ratio of mortgage loans payable and convertible debenture debt (at face value), compared to acquisition cost of income-producing properties * | 100% | 99% | 100% | 101% |

| | 2008 Q 4 | 2008 Q 3 | 2008 Q 2 | 2008 Q 1 |
|---|---|---|---|---|
| Weighted average interest rate | | | | |
| Fixed rate mortgage loans | 5.8% | 5.8% | 5.9% | 5.9% |
| Floating rate mortgage loans | 4.6% | 4.6% | 5.8% | 6.3% |
| Ratio of mortgage loans payable, compared to: Purchase price of income-producing properties * | 85% | 86% | 81% | 79% |
| Ratio of mortgage loans payable, compared to: Total estimated current value of property portfolio | 63% | 63% | 59% | 60% |
| Ratio of mortgage loans payable and convertible debenture debt (at face value), compared to acquisition cost of income-producing properties * | 101% | 101% | 98% | 98% |

* Excludes debt and property values for "held for sale" properties and Parsons Landing.

**Debt Maturities**

All of the mortgage loans which matured during 2009 were renewed, refinanced or repaid/eliminated on sale as of December 31, 2009.

As of December 31, 2009, the mortgage loan debt of LREIT included $194.7 Million of mortgage loans which mature during the first quarter of 2010. After excluding $72.8 Million of demand loans with terms which extend beyond March 31, 2010 and $46.3 Million of mortgages in breach of debt service coverage requirements, the amount of debt which has matured or is maturing during the first quarter of 2010 is $75.8 Million (the "first quarter" debt). Renewal terms have been finalized for all of the "first quarter" debt.

A more detailed analysis of mortgage loan debt obligation is provided in the section of this report titled "Capital Resources and Liquidity".

**Debt Service Coverage Covenants**

There are thirteen income-producing properties in Fort McMurray, twelve of which are encumbered by mortgage loan debt. The only exception is Parsons Landing.

Of the twelve properties in Fort McMurray which are encumbered by mortgage loan debt, 10 of the properties have mortgage loans which are in breach of the debt service coverage requirements. The breach of the debt service coverage requirement for the 10 Fort McMurray properties is a result of the negative impact of the slow down of development activity in the oil sands industry and the associated decline in rental market conditions in Fort McMurray. The first mortgage loan for the property in Moose Jaw, Saskatchewan is also in breach of the debt service coverage requirement. The Moose Jaw property was reclassified as held for sale in the first quarter of 2010.

The status of the mortgage loans which are in breach of the debt service coverage requirements is provided below.

| Property | Debt Service Coverage Requirement | Type of Mortgage | Mortgage Balance December 31, 2009 | Status |
|---|---|---|---|---|
| Fort McMurray | | | | |
| Gannet Place, Lunar Apartments, Parkland Apartments, Skyview Apartments, Snowbird Manor, Whimbrel Terrace | 1.4 | First | $ 24,146,332 | (1) |
| Millennium Village | 1.4 | First | 22,147,455 | (1) |
| | | | 46,293,787 | |
| Laird's Landing | 1.2 | First | 55,000,000 | (2) |
| Woodland Park, Nelson Ridge Estates | 1.2 | Second | 17,766,738 | (2) |
| | | | 72,766,738 | |
| Moose Jaw | | | | |
| Chateau St. Michael's | 1.3 | First | 5,101,221 | (3) |
| | | | $ 124,161,746 | |

(1) Notice received from lender that breach must be cured.
(2) Forbearance letter received from lender with an expiry date of April 20, 2010.
(3) Forbearance letter to be requested from lender.

LREIT is continuing to communicate with the lenders and management believes that all of the covenant breaches will be resolved. As rental market conditions in Fort McMurray may not improve substantially in the near future, all of the affected properties may not attain income levels in 2010 which satisfy the existing debt service coverage requirements. LREIT intends to sell the property in Moose Jaw in 2010.

In general terms, the cross-default clauses of the Trust indenture relating to the Series F secured convertible debentures provides that, if any debt of LREIT is in default for more than ten days and the default results in an amount in excess of $200,000 becoming due and payable and if the default pertains to debt which has a term in excess of 18 months, the Series F convertible debentures may become payable, on demand.

Based on the above, there is a risk that the Series F convertible debentures, with a face value of $13,680,000, will become payable on demand in the event that the lender demands the repayment of the two first mortgage loans which are in breach of the debt service coverage requirement.

The breach of the debt service covenant requirements has not resulted in an acceleration of the repayment of the mortgage loans. There is no assurance that the lender will not accelerate payment of the mortgage loans. There are no cross-default covenants with respect to the other mortgage loans of the Trust, except under the bond indenture dated March 4, 2010 (the "Bond Indenture") and the second mortgages provided by LREIT to the bond trustee as security for the obligation of LREIT under the bond indenture, as discussed below.

The Bond Indenture governs the 5 year 9 % second mortgage bonds of LREIT issued on March 9, 2010 in the aggregate principal amount of $6,780,000. The Bond Indenture provides that it is an event of default if, among other things, an event of default as defined under any of the first mortgages on Beck Court, Nova Court, Norglen Terrace, Three Lakes Village or Westhaven Manor, or under the Trust Indenture relating to the Series F or Series G Debentures and any such indebtedness shall be accelerated and remain uncured for 10 days. Accordingly, there is a risk that the 5 year 9% second mortgage bonds, with a face value of $6,780,000, will become payable on demand in the event of an event of default under the financing documents noted above.

**Discontinued Operations - Composition of Year End Debt**

As disclosed in the analysis at the beginning of the "mortgage loans payable" section of this report, the mortgage loan debt for discontinued operations was reduced by $69,952,952 during 2009, resulting in a balance of $100,470,479 as of December 31, 2009.

The total balance of $100,470,479 is comprised of first and second mortgage loan debt of $84,707,141 and interim loans payable of $15,763,338. The first and second mortgage loan debt has a weighted average of 7.33% as of December 31, 2009.

The interim loans payable are comprised of the following loans:

| Approximate Amount | Maturity Date | Interest Rate |
|---|---|---|
| $2.0 Million | September 1, 2010 | 11.50% |
| $12.0 Million | October 30, 2010 | 11.00% |
| $1.9 Million | November 1, 2010 | 11.75% |
| $15.9 Million | | |

The interim mortgage loans are secured by charges registered against two or more income properties, aside from the $2 Million loan which is registered against one income property. All of the interim mortgage loans require monthly payments of interest only.

The weighted average interest rate of all of the interim mortgage loan debt is 7.7%.

**Acquisition Payable**

As previously advised, the amount payable in regard to the acquisition of Parsons Landing is $45.2 Million, excluding GST. Interest charges in excess of $300,000 per month totaling $5,841,638 were forgiven by the vendor for the period from March 1, 2009 to December 31, 2009 and will continue to be forgiven for the period January 1 to May 31, 2010 in the amount of $2,848,105 provided that the extended payment deadline of May 31, 2010 is achieved. Interest charges of $300,000 per month represent an effective interest rate of 8%.

**Vendor Take-Back Mortgages**

Mortgage loans payable include a $4 Million interest-only vendor take-back mortgage, bearing interest at a rate of 5%, which was obtained upon the acquisition of Siena Apartments in July 2008. The loan matures on July 1, 2010.

A $1,600,000 vendor take-back mortgage, bearing interest at a rate of 6.25%, which was obtained upon the purchase of Westhaven Manor in May 2007, was repaid on September 3, 2009.

**Revolving Line of Credit**

The Trust utilizes a revolving line of credit from a Canadian chartered bank with an authorized limit of $5 Million. The line of credit bears interest at the Royal Bank of Canada Prime rate plus 3.5%. The amount available under the line of credit at December 31, 2009 was $4,875,000 representing the full balance of the line of credit less a $125,000 amount which is securing a letter of credit.

**Financing from 2668921 Manitoba Ltd.**

*Second Mortgage Loan*

On June 30, 2009, LREIT obtained a second mortgage loan in the amount of $500,000 from 2668921 Manitoba Ltd, the parent company of Shelter Canadian. The loan bears interest at 7.5%, is due on June 1, 2010 and is secured by a second mortgage charge on an income property. The loan is included in mortgage loans payable at December 31, 2009. A processing fee of $15,000 was paid to 2668921 Manitoba Ltd. in regard to the loan. The fee was included in transaction costs.

The proceeds of the loan were used to reduce the first mortgage loan of an income property in conjunction with the renewal of the first mortgage loan for a one year term, effective June 1, 2009.

*Revolving Loan*

On June 30, 2009, LREIT obtained a $2.7 Million revolving loan commitment from 2668921 Manitoba Ltd. for general operating purposes. In September 2009, the loan commitment was increased to $5 Million. The advances bear interest at 7.5%, is due on June 30, 2010 and is unsecured.

The amount available under the revolving loan at December 31, 2009 was $5,000,000.

Additional information regarding the financing arrangements with 2668921 Manitoba Ltd. are provided in the section of this report titled "Related Party Transactions".

## Convertible Debentures

The Declaration of Trust for LREIT does not impose any limitations on the amount of convertible debt which may be issued by the Trust. The following is a summary of the debenture offerings which have been undertaken by LREIT, as of December 31, 2009.

**Summary of Debenture Offerings**

| | | | | Repayments/Unit Conversions | | |
|---|---|---|---|---|---|---|
| Issue Date/Maturity Date | Series | Interest Rate | Amount Issued | Year Ended December 31 2009 | As of December 31 2008 | Net Amount Outstanding December 31 2009 |
| Aug. 30/02/Aug. 30/07 | A | 10.0 % | $ 3,000,000 | $ - | $ (3,000,000) | $ - |
| Aug. 30/02/Aug. 30/05 | B | 8.0 % | 1,000,000 | - | (1,000,000) | - |
| Jan. 30/04/Jan. 30/06 | C | 8.0 % | 10,131,000 | - | (10,131,000) | - |
| Mar. 16/04/Mar. 16/08 | D | 8.0 % | 4,000,000 | - | (4,000,000) | - |
| Feb. 17/05/Feb. 17/10 | E | 8.0 % | 12,000,000 | - | (50,000) | 11,950,000 |
| Mar. 10/06/Mar. 11/11 | F | 7.5 % | 13,680,000 | - | - | 13,680,000 |
| Dec. 8/06/Dec. 31/11 | G | 7.5 % | 25,732,000 | - | - | 25,732,000 |
| Face value | | | $ 69,543,000 | $ - | $ (18,181,000) | 51,362,000 |
| Net accumulated accretion | | | | | | 8,686,324 |
| Unamortized transaction costs | | | | | | (1,002,844) |
| Book value, December 31, 2009 | | | | | | $ 59,045,480 |
| Allocation of book value | | | | | | |
| Debt component | | | | | | $ 46,943,687 |
| Equity component | | | | | | 13,104,637 |
| Unamortized transaction costs | | | | | | (1,002,844) |
| | | | | | | $ 59,045,480 |

As disclosed in the preceding chart, the Series E convertible debentures matured on February 17, 2010. The debentures were retired from the proceeds of a $5 Million revolving loan with 2668921 Manitoba Ltd. and a $4.8 Million withdrawal on the bank line of credit, with the balance paid in cash.

The Series F debentures provide for the outstanding amount of the debentures to become payable on demand, upon default and acceleration, under certain terms and conditions, of a mortgage loan or a convertible debenture. As previously disclosed in this report, the Series F debentures may become payable on demand in the event that the lender demands repayment of the five mortgage loans which are in default of the debt service coverage covenant. See "Debt Service Coverage Covenants".

## Investment Units

On March 9, 2010, LREIT completed a public offering of investment units, under which 6,780 investment units were sold at a price of $1,000 per unit for aggregate gross proceeds of $6.78 Million. Each Unit is comprised of one five year 9% second mortgage bond in the principal amount of $1,000 and 1,000 trust unit purchase warrants. Each Warrant entitles the holder thereof to purchase one trust unit of LREIT at a price of $1.00 per Trust Unit at any time for a period of five years from March 9, 2010.

The bonds mature on March 9, 2015. Interest is payable semi-annually in arrears on May 31 and November 30 in each year, as well as on the maturity date, with the first interest payment occurring on May 31, 2010. The bonds are secured by second mortgage security and collateral security registered against five income properties.

## Trust Units

### Units Outstanding

| | |
|---|---|
| Authorized | unlimited |
| Issued as of, | |
| - December 31, 2009 | 17,893,767 |
| - March 23, 2010 | 17,893,767 |

As of December 31, 2009, LREIT had 17,893,767 units outstanding, representing a increase of 305,686 units or 1.7%, compared to the number of units outstanding as of December 31, 2008.

As disclosed on the following chart, the change in units has originated from transactions under the Distribution Reinvestment Plan (DRIP), the Normal Course Issuer Bid (NCIB) and the dissolution of LREIT Village West Limited Partnership.

| | Units | Amount |
|---|---|---|
| Units outstanding, December 31, 2008 | 17,588,081 | $ 79,750,666 |
| Units issued under DRIP | 48,576 | 108,517 |
| Issue costs | - | (6,502) |
| Units purchased and cancelled under normal course issuer bid | (99,507) | (275,757) |
| Unit-based compensation | - | 282,449 |
| Issue of units on exchange of LP units of Village West LP | 356,617 | 2,139,702 |
| Units issued on payment of distributions | - | 19,504,206 |
| Units outstanding, December 31, 2009 | 17,893,767 | $ 101,503,281 |

Details of the Distribution Reinvestment Plan (DRIP), the Normal Course Issuer Bid (NCIB) and LREIT Village West Limited Partnership, as well as the Unit Option Plan and Deferred Unit Plan are provided on Schedule II.

As disclosed in Schedule II, LREIT Village West Limited Partnership was dissolved on December 1, 2009 and all of the outstanding limited partnership units were exchanged for trust units of LREIT, on a one for one basis, resulting in the issuance of 356,617 trust units.

# ANALYSIS OF INCOME/LOSS

## Overall Results

**Analysis of Income (Loss)**

| | Year Ended December 31 | | Increase (decrease) | |
|---|---|---|---|---|
| | 2009 | 2008 | Amount | % |
| Rental revenue | $ 41,415,408 | $ 42,235,692 | $ (820,284) | (1.9)% |
| Interest and other income | 396,597 | 769,007 | (372,410) | (48.4)% |
| Property operating costs | 13,382,764 | 12,343,655 | 1,039,109 | 8.4 % |
| Net operating income (NOI) * | 28,429,241 | 30,661,044 | (2,231,803) | (7.3)% |
| Trust expense | 2,760,536 | 2,622,973 | 137,563 | 5.2 % |
| Income before financing expense, amortization, and taxes (EBITDA) * | 25,668,705 | 28,038,071 | (2,369,366) | (8.5)% |
| Financing expense | 29,584,709 | 27,492,765 | 2,091,944 | 7.6 % |
| Income before amortization and taxes * | (3,916,004) | 545,306 | (4,461,310) | (818.1)% |
| Amortization | 8,863,921 | 7,087,506 | 1,776,415 | 25.1 % |
| Loss before future income tax * | (12,779,925) | (6,542,200) | (6,237,725) | 95.3 % |
| Future income tax expense (recovery) | 2,698,804 | 254,392 | 2,444,412 | 960.9 % |
| Income (loss) from continuing operations | (15,478,729) | (6,796,592) | (8,682,137) | 127.7 % |
| Income (loss) from discontinued operations | 18,975,802 | (2,810,464) | 21,786,266 | (775.2)% |
| Income (loss) and comprehensive income (loss) | $ 3,497,073 | $ (9,607,056) | $ 13,104,129 | (136.4)% |

* The analysis of loss for the year represents the re-formatting of balances from the Consolidated Statements of Operations in order to provide a summarized analysis of the financial performance of the Trust. All of the lines in the analysis agree to amounts in the financial statements. Accordingly, the analysis consists entirely of GAAP measurements, aside from the four sub-totals (see asterisks).

### *Continuing Operations*

As disclosed on the preceding chart, LREIT incurred a loss from continuing operations before taxes of $12,779,925 during 2009, compared to a loss from continuing operations before taxes of $6,542,200 during 2008, representing an increase in the loss from continuing operations before taxes of approximately $6.2 Million. The increase in the loss mainly reflects a decrease in NOI of $2.2 Million, an increase in financing expense of approximately $2.1 Million, and an increase in amortization charges of approximately $1.8 Million.

The decrease in operating income mainly reflects the decrease in operating income from the "same property" portfolio, partially offset by the incremental operating income associated with the three Fort McMurray properties which were added to the income-producing portfolio during 2008.

The increase in financing expense during 2009 is mainly due to three factors as follows:

(i) an increase in interest expense associated with the amount payable for Parsons Landing of approximately $2.3 Million, and

(ii) an increase in mortgage loan interest of approximately $1.6 Million mainly due to incremental interest on the mortgage loans for Laird's Landing and Siena Apartments and an overall increase in the amount of interim financing for the income property portfolio, partially offset by

(iii) a decrease in financing charges related to the change in the market value of interest rate swap agreements of approximately $1.7 Million.

The increase in amortization charges mainly reflects the incremental amortization charges on the three Fort McMurray properties which were added to the income-producing portfolio during 2008.

After including income from discontinued operations and future income tax expense, LREIT generated income of $3,497,073 during 2009, compared to a loss of  $9,607,056 during 2008.

***Discontinued Operations***

As disclosed in the preceding chart, LREIT generated income from discontinued operations of $18,975,802 during 2009, compared to a loss of $2,810,464 during 2008. The income from discontinued operations includes revenues, operating costs, financing expenses, and amortization charges for all properties which are held for sale as of December 31, 2009; revenues, operating costs, financing expenses, and amortization charges for the 13 properties which were sold during 2009, and the gain on sale in regard to the 13 properties which were sold during 2009.

Amortization charges for a specific property are discontinued, effective on the date in which the property was classified under discontinued operations. As a result, amortization charges have a significant effect on the comparative results for discontinued operations.

In total, the income from discontinued operations for 2009 includes amortization charges of $2,595,147, compared to amortization charges of $4,321,042 during 2008. Excluding amortization charges and the gain on sale of approximately $21 Million, the Trust generated income from discontinued operations of $507,064 during 2009, compared to income of $1,510,578 during 2008.

## Revenue

**Market Conditions**

*Fort McMurray (13 properties)*

Accounting for approximately 67% of the total available rental units, the Fort McMurray property portfolio represents the most significant revenue component in LREIT's overall operations.

As a result of the downturn in the global economy in October 2008, there was a reduction in the level of activity in the oil sands construction industry resulting in a weakening of rental market conditions in Fort McMurray. The decline in rental market conditions resulted in a reduction in occupancy levels of LREIT's property portfolio in Fort McMurray and affected the leasing of vacant suites and the retention of existing tenants.

As disclosed in the "Analysis of Vacancy Loss for Income Properties", the vacancy loss for the Fort McMurray portfolio increased from 4% during 2008, to 22% during 2009, while the average monthly rental rate decreased by $107 or 3.7%. On a quarterly basis, the vacancy loss for the Fort McMurray portfolio, for the third and fourth quarter of 2009, was significantly higher in comparison to the first two quarters of 2009. The increase in the vacancy loss in the second half of 2009 is partially attributable to a higher level of lease terminations in regard to 12-month tenancies which originated in the third quarter of 2008, prior to the onset of the economic downturn in Fort McMurray.

Although development activity in the oil sands industry is improving, the expectation is that the economic recovery in Fort McMurray may occur gradually.

*Yellowknife (3 properties)*

Rental market conditions in Yellowknife have become more competitive during 2009, however, the vacancy loss for three rental properties in Yellowknife decreased from 3% in 2008 to 1% in 2009, while the average rental rate increased by $87 or 4.9% in 2009.

*Other Locations (5 properties)*

In the other communities where LREIT properties are located, the combined vacancy loss increased from 2% during 2008, to 4% during 2009, and the average monthly rental rate increased by $52 or 6%.

## Total Revenue

**Analysis of Total Revenue**

| | Total Revenues | | | |
|---|---|---|---|---|
| | Year Ended December 31 | | Increase (decrease) | |
| | 2009 | 2008 | Amount | % of Total |
| Income Properties: | | | | |
| Rental revenue | $ 41,415,408 | $ 42,235,692 | $ (820,284) | 69 % |
| Interest and other income | 369,734 | 319,238 | 50,496 | (4)% |
| Sub-total | 41,785,142 | 42,554,930 | (769,788) | 65 % |
| Trust: interest and other income | 26,863 | 449,769 | (422,906) | 35 % |
| Total | $ 41,812,005 | $ 43,004,699 | $ (1,192,694) | 100 % |

The revenue of LREIT consists of "rental revenue" and "interest and other income". All of the revenue is generated from the portfolio of income properties, with the exception of a minor component of revenue which is derived from general trust operations.

As disclosed in the chart above, the total revenue of LREIT decreased by $1,192,694, during 2009 compared to 2008, comprised of a $769,788 decrease in revenue from income properties and $422,906 decrease in revenue from Trust operations. The decrease in revenue from income properties is comprised of a $820,284 decrease in rental revenue and a $50,496 increase in interest and other income.

***Trust Operations***

Revenue from Trust operations is comprised almost exclusively of interest income on mortgage loans receivable and cash. The revenue is classified as "interest and other income" and represents a minor component of the overall revenues of the Trust.

As noted above, revenue from Trust operations decreased by $422,906 during 2009, almost entirely due to a reduction in interest income on mortgage loans receivable. During 2008, the weighted average balance of investments in mortgage loans receivable was $6.2 Million bearing interest at 8.0%, whereas during 2009, the weighted average balance was $0.7 Million bearing interest at a weighted average of 3.19%.

### *Rental Revenue*

**Analysis of Total Revenue from Income Properties**

| | Year Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | | | Increase (decrease) | | Percentage of Total | |
| | 2009 | 2008 | Amount | % | 2009 | 2008 |
| Fort McMurray | $ 32,753,694 | $ 33,861,758 | $ (1,108,064) | (3)% | 78 % | 80 % |
| Yellowknife | 6,270,852 | 6,039,137 | 231,715 | 4 % | 15 % | 14 % |
| Other | 2,760,596 | 2,654,035 | 106,561 | 4 % | 7 % | 6 % |
| Total | $ 41,785,142 | $ 42,554,930 | $ (769,788) | (2)% | 100 % | 100 % |

**Analysis of Average Monthly Rents and Vacancy Loss for Income Properties**

| | Vacancy Loss | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | | | | | 2008 |
| | Q1 | Q2 | Q3 | Q4 | 12 Month Average | 12 Month Average |
| Fort McMurray | 10 % | 18 % | 30 % | 31 % | 22 % | 4 % |
| Yellowknife | - % | 1 % | 1 % | 1 % | 1 % | 3 % |
| Other | 2 % | 5 % | 5 % | 6 % | 4 % | 2 % |
| Total | 9 % | 15 % | 25 % | 25 % | 18 % | 3 % |

| | Average Monthly Rents | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | | | | | 2008 |
| | Q1 | Q2 | Q3 | Q4 | 12 Month Average | 12 Month Average |
| Fort McMurray | $2,993 | $2,904 | $2,733 | $2,595 | $2,806 | $2,913 |
| Yellowknife | $1,810 | $1,828 | $1,960 | $1,854 | $1,863 | $1,776 |
| Other | $728 | $739 | $740 | $743 | $738 | $686 |
| Total | $2,423 | $2,368 | $2,274 | $2,166 | $2,308 | $2,357 |

As disclosed on the first chart above, the total revenue decrease in 2009 of $769,788, reflects a decrease in revenue from the income properties in Fort McMurray of $1,108,064, partially offset by modest revenue increases in the Yellowknife and Other portfolios. The decrease in rental revenue from the Fort McMurray portfolio reflects a decrease in revenue from the Fort McMurray properties which have been in the LREIT portfolio since January 1, 2008 (i.e., "same property" revenue), partially offset by incremental revenue from the three Fort McMurray properties which were added to the income-producing portfolio during 2008. As disclosed in the same property analysis, same property revenue decreased by 13.2% during 2009, compared to 2008, comprised of a 19% revenue decrease from the Fort McMurray portfolio and a revenue increase from the Yellowknife and other portfolio of 3.8% and 4%, respectively.

Although the 2009 revenue results for Fort McMurray reflect incremental revenue from the three properties which were added to the income-producing portfolio during 2008, the revenue contribution, on a percentage basis, remained relatively constant due to the offsetting impact of increased vacancy rates and reduced rental rates. Specifically, the revenue contribution by the Fort McMurray portfolio, on a percentage basis, was 80% during 2008 compared to 78% in 2009.

## Operating Costs

**Analysis of Operating Costs**

| | Year Ended December 31 | | Increase (decrease) | |
|---|---|---|---|---|
| | 2009 | 2008 | Amount | % |
| Fort McMurray | $ 9,817,401 | $ 8,766,336 | $ 1,051,065 | 12 % |
| Yellowknife | 2,478,322 | 2,459,794 | 18,528 | 1 % |
| Other | 1,087,041 | 1,117,525 | (30,484) | (3)% |
| Total | $ 13,382,764 | $ 12,343,655 | $ 1,039,109 | 8 % |

During 2009, property operating costs for the portfolio increased by $1,039,109 or 8%, compared to 2008, with the Fort McMurray portfolio accounting for the majority of the increase due to the three Fort McMurray properties which were added to the income-producing portfolio during 2008.

## Net Operating Income and Operating Margin

**Analysis of Net Operating Income - Income Properties**

| | Net Operating Income | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Year Ended December 31 | | Increase (decrease) | | Percent of Total | | Operating Margin | |
| | 2009 | 2008 | Amount | % | 2009 | 2008 | 2009 | 2008 |
| Fort McMurray | $ 22,936,293 | $ 25,095,421 | $ (2,159,128) | (9)% | 81 % | 83 % | 70 % | 74 % |
| Yellowknife | 3,792,530 | 3,579,343 | 213,187 | 6 % | 13 % | 12 % | 60 % | 59 % |
| Other | 1,673,555 | 1,536,511 | 137,044 | 9 % | 6 % | 5 % | 61 % | 58 % |
| Total | $ 28,402,378 | $ 30,211,275 | $ (1,808,897) | (6)% | 100 % | 100 % | 68 % | 71 % |

After considering the revenue and operating cost increases as analyzed in the preceding sections of this report, the NOI for the portfolio of income properties decreased by $1,808,897 or 6% during 2009.

As with the decrease in revenue from income properties, the decrease in NOI reflects a decrease in the NOI of the Fort McMurray portfolio of $2,159,128, partially offset by a NOI increase of $350,231 from Yellowknife and other income-producing properties. The decrease in NOI from the Fort McMurray portfolio is comprised of a NOI decrease from the "same property" portfolio in Fort McMurray, partially offset by the incremental NOI from the three Fort McMurray properties which were added to the income-producing portfolio in 2008. As disclosed in the same property analysis, same property NOI decreased by 17.5% during 2009, comprised of a 24.2% NOI decrease from the Fort McMurray portfolio and a NOI increase from the Yellowknife and Other portfolios of 6.0% and 8.9%, respectively.

As disclosed on the chart above the operating margin for the property portfolio decreased from 71% during 2008, to 68%  2009.

The decline in the operating margin is primarily due to a decline in the profitability of the Fort McMurray property portfolio.

## Same Property Analysis

The same property analysis for 2009 encompasses the 18 income-producing properties which were in the LREIT portfolio, as of January 1, 2008.  The properties which are classified as held for sale, are excluded from the same property analysis.

As disclosed in the following analysis, the revenue of the same properties decreased by 13.2% during 2009, compared to 2008, and net operating income decreased by 17.5%.  The decrease in revenue was fully attributable to the property portfolio in Fort McMurray.

| | Year Ended December 31 | | Increase (decrease) | |
|---|---|---|---|---|
| | 2009 | 2008 | Amount | % |
| Revenue | | | | |
| Fort McMurray | $ 20,768,581 | $ 25,645,054 | $ (4,876,473) | (19.0)% |
| Yellowknife | 6,270,852 | 6,039,137 | 231,715 | 3.8 % |
| Other | 2,760,596 | 2,654,035 | 106,561 | 4.0 % |
| Total revenue | $ 29,800,029 | $ 34,338,226 | $ (4,538,197) | (13.2)% |
| Net operating income | | | | |
| Fort McMurray | $ 14,198,840 | $ 18,725,559 | $ (4,526,719) | (24.2)% |
| Yellowknife | 3,792,530 | 3,579,343 | 213,187 | 6.0 % |
| Other | 1,673,555 | 1,536,514 | 137,041 | 8.9 % |
| Total net operating income | $ 19,664,925 | $ 23,841,416 | $ (4,176,491) | (17.5)% |

A same property analysis, comparing third and fourth quarter results for 2009, is also provided in the section of this report entitled "Comparison to Preceding Quarter".  The same property analysis in this section includes the three Fort McMurray properties which are added to the income-producing portfolio in 2008 (Laird's Landing, Parsons Landing and Siena Apartments).

## Financing Expense

Financing expense increased by $2,091,944 or 8% during 2009, compared to 2008, comprised of a $1,631,757 increase in interest expense on acquisition payable, a $421,401 increase in convertible debenture financing expense and a $38,786 increase in mortgage loan financing expense. The decrease in mortgage loan financing expense includes a decrease in financing charges of $1,718,608 related to the change in value of interest rate swap agreements.

Financing expense encompasses mortgage loan interest, convertible debenture interest, interest expense on acquisition payable, as well as a number of "non-cash" expenses, including amortization charges for transaction costs, accretion and the change in fair value of interest rate swaps. During 2009, "non-cash" expenses represented 21% of the total financing expenses, compared to 27% during 2008. The decrease in the "non-cash" component of financing expense is mainly related to the change in value of the interest rate swap agreements.

**Analysis of Financing Expense**

| | Year Ended December 31 | | Increase (decrease) | |
|---|---|---|---|---|
| | 2009 | 2008 | Amount | % |
| **Mortgage Loans** | | | | |
| Mortgage loan interest | $ 15,249,504 | $ 13,601,331 | $ 1,648,173 | 12 % |
| Amortization of transaction costs | 539,862 | 430,641 | 109,221 | 25 % |
| Change in value - interest rate swaps | 2,293,795 | 4,012,403 | (1,718,608) | (43)% |
| Total - mortgage loans | 18,083,161 | 18,044,375 | 38,786 | - % |
| **Acquisition Payable** | | | | |
| Interest on acquisition payable | 4,076,771 | 2,445,014 | 1,631,757 | 67 % |
| Total - acquisition payable | 4,076,771 | 2,445,014 | 1,631,757 | 67 % |
| **Debentures** | | | | |
| Interest on convertible debentures | 3,911,900 | 3,943,760 | (31,860) | (1)% |
| Accretion of debt component | 2,853,290 | 2,469,702 | 383,588 | 16 % |
| Amortization of transaction costs | 659,587 | 589,914 | 69,673 | 12 % |
| Total - debentures | 7,424,777 | 7,003,376 | 421,401 | 6 % |
| **Total - financing expense** | $ 29,584,709 | $ 27,492,765 | $ 2,091,944 | 8 % |

### *Interest Expense - Mortgage Loans*

Mortgage loan interest increased by $1,648,173 or 12% during 2009, compared to 2008. The increase mainly reflects the increase in first mortgage loan debt associated with Laird's Landing and Siena Apartments which were added to the income-producing portfolio in 2008.

Interest expense associated with Parsons Landing is reflected in "interest on acquisition payable", as noted below.

### *Interest on Acquisition Payable*

During 2009, interest on acquisition payable increased by $1,631,757, representing 50.2% of the total increase in interest expense.

During 2009, interest on acquisition payable of $4,076,771 consists entirely of interest pertaining to the amount payable for Parsons Landing. During 2008, interest on acquisition payable includes interest of $699,335 on the amount payable for Millennium Village and $1,745,679 of interest on the amount payable for Parsons Landing.

The increase in interest expense on the amount payable for Parsons Landing is attributable to two main factors, as follows:

(i) during 2008, interest on the amount payable for Parsons Landing was charged to financing expense for a period of four months, following the "possession" of the property by LREIT on September 1, 2008, whereas in 2009, interest was charged for the entire year; and

(ii) from March 1, 2009 to December 31, 2009, a higher rate of interest was charged on the amount payable as a result of extending the payment deadline for Parsons Landing beyond February 28, 2009.

***Interest Expense - Debentures***

During 2009, interest on convertible debentures decreased by $31,860 or 1%, compared to 2008. The decrease mainly reflects the retirement of $1.6 Million of Series D Convertible Debentures in March 2008.

***Total Interest Expense***

During 2009, total interest expense increased by $3,248,070 or 16%, compared to 2008.

***Interest Expense Ratio***

As a percentage of operating income from continuing operations, total interest in regard to mortgage loans and acquisition payable increased from 52% during 2008 to 68% during 2009.

The increase in the ratio of mortgage loan and acquisition payable interest, relative to operating income from continuing operations, reflects the extent to which the increase in interest expense has exceeded the increase in net operating income during 2009. The proportionately higher increase in interest expense mainly reflects the high interest charges associated with the extended payment deadline for Parsons Landing and an increase in the amount of second mortgage loan interest.

After including interest on convertible debentures, the ratio of interest expense, relative to operating income is 82% in 2009 compared to 65% in 2008.

***Change in Value of Interest Rate Swaps***

As disclosed in the preceding chart, the increase in financing expense includes a decrease in the amount related to the change in value of the "interest rate swaps" of $1,718,608.

During 2008, LREIT entered into interest rate swap arrangements whereby the interest rate on two floating rate mortgages were fixed for the five and ten year terms of the mortgages. The main purpose of the interest rate swap arrangement is to reduce the risk associated with floating interest rates. In accordance with GAAP, the interest rate swap agreements are derivative financial instruments and are recorded at "fair value" on the balance sheet of the Trust. Changes in fair value are recognized as earnings/losses through charges to financing expense. Increases in fair value serve to decrease financing expense, while decreases in fair value serve to increase financing expense.

In very general terms, the fair value of the interest rate swaps is based on the difference between the net present value of projected payments under the fixed rate mortgages, compared to the net present value of projected payments under the floating rate mortgages. During 2008, the fair value of the interest rate swap arrangements decreased by $4,012,403, as declining market interest rates in the fourth quarter of 2008 served to reduce payments for mortgages with floating interest rates. During 2009, the fair value of the interest rate swap arrangements decreased by an additional $2,293,795, as a result of a further decline in market interest rates.

Although the change in the fair value of the interest rate swaps has served to increase financing expense in 2008 and 2009, the change in value is a non-cash transaction which is excluded from the determination of the operating cash flow of the Trust. As a result of fluctuations in market interest rates, the fair value of the interest rate swaps may change significantly in the future, however, the change in value has no impact on cash outflows throughout the entire term of the swap agreements. The change in value provides an indication of the relative benefit of a fixed rate mortgage, compared to a floating rate mortgage, during a specified period of time.

## Trust Expense

Trust expense increased by $137,563 during 2009, compared to 2008. The increase mainly reflects an increase of $300,655 in the service fee of Shelter Canadian, partially offset by a decrease in unit-based compensation expense of $109,069.

The service fee of Shelter Canadian is in regard to administrative and asset management services and the fee is equal to 0.3% of the gross book value of the assets of LREIT, excluding cash, as of the date of the most recently issued financial statements. The increase in the fee reflects a net book asset value which, on a monthly average basis, was higher in 2009 than in 2008.

Please refer to "Related Party Transactions" for additional information in regard to the administrative, asset management and property management services which are provided to LREIT by Shelter Canadian Properties Limited and the associated remuneration.

The decrease in unit-based compensation expense is mainly due to the fact that unit-based compensation expense was comparatively high during the first quarter of 2008 due to the extent of vesting of the options which were granted under the Unit Option Plan on January 7, 2008. The decrease in unit-based compensation expense pertaining to the Unit Option Plan was partially offset by an increase in unit based compensation expense pertaining to the Deferred Unit Plan.

Additional information regarding the Unit Option Plan and the Deferred Unit Plan is provided on Schedule II of this report.

## Amortization Expense

During 2009, amortization expense increased by $1,776,415 or 25%, compared to 2008. The increase is mainly due to amortization charges related to new income-producing properties. Amortization charges for transaction costs are recorded as financing expenses on the Consolidated Statement of Loss.

## Future Income Taxes

LREIT qualifies as a "mutual fund trust" for income tax purposes. If circumstances permit and subject to the application of the SIFT Rules (discussed below under "Changes to Tax Treatment of Trusts"), it is the intent of the Trust to distribute an amount which is not less than all of its taxable income to its Unitholders and to deduct these distributions for income tax purposes. The deductibility of distributions has to date served to reduce the taxable income of the Trust to nil.

LREIT is subject to the SIFT Rules and, subject to earlier application (discussed below), commencing in 2011, certain distributions will no longer be deductible in computing LREIT's taxable income, and LREIT will be subject to a tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Please refer to the Annual Information Form for a more detailed discussion of the SIFT Rules. In accordance with generally accepted accounting principles, LREIT has recorded a future income tax asset based on the temporary difference between the accounting and tax basis of assets held by the Trust, net of a valuation allowance to recognize the uncertainty of the future income tax asset. During 2009, the valuation allowance served to reduce the tax asset as at December 31, 2008, as well as the change in the tax asset for the year ended December 31, 2009, to nil.

The estimate of the future income tax assets and liabilities, is subject to periodic change. To the extent that the net future income tax position increases or decreases, there is a corresponding increase or decrease in the future income tax expense or recovery of the Trust, with the increase or decrease having a direct impact on bottom-line results.

As of December 31, 2009, the future income tax of LREIT was nil compared to a net asset and position for future income taxes of $2,698,804 as of December 31, 2008. The change in the estimated net future income tax position on the balance sheet resulted in a future income tax expense of $2,698,804. The future income tax expense reflects the initial recognition of the valuation allowance for the future income tax asset relating to the assets of the Trust of $6,924,249.

Future income tax expense of $2,698,804 is a non-cash item which does not affect the cash flow of the Trust.

Assets and liabilities of properties held for sale reflect future income tax assets and liabilities using the considerations outlined in the preceding paragraph.

## Comparison to Preceding Quarter

**Analysis of Loss - Fourth Quarter 2009 vs. Third Quarter 2009**

| | Three Months Ended | | Increase (decrease) | |
|---|---|---|---|---|
| | December 31, 2009 | September 30, 2009 | Amount | % |
| Rental revenue | $ 8,852,092 | $ 9,347,201 | $ (495,109) | (5.3)% |
| Interest and other income | 54,245 | 57,399 | (3,154) | (5.5)% |
| Property operating costs | 3,173,645 | 3,233,706 | (60,061) | (1.9)% |
| Net Operating Income (NOI) | 5,732,692 | 6,170,894 | (438,202) | (7.1)% |
| Trust expense | 643,461 | 710,801 | (67,340) | (9.5)% |
| Income before financing expense, amortization, and taxes (EBITDA) | 5,089,231 | 5,460,093 | (370,862) | (6.8)% |
| Financing expense | 4,276,964 | 6,634,722 | (2,357,758) | (35.5)% |
| Income (loss) before amortization, and taxes | 812,267 | (1,174,629) | 1,986,896 | (169.2)% |
| Amortization | 2,225,574 | 2,223,052 | 2,522 | 0.1 % |
| Loss from continuing operations for the period | (1,413,307) | (3,397,681) | 1,984,374 | (58.4)% |
| Income from discontinued operations for the period | 20,544,425 | 251,082 | 20,293,343 | 8,082 % |
| Income (loss) and comprehensive income (loss) for the period | $ 19,131,118 | $ (3,146,599) | $ 22,277,717 | (708.0)% |

### Overview

During the fourth quarter of 2009, LREIT incurred a loss from continuing operations, before taxes, of $1,413,307, compared to a loss from continuing operations, before taxes, of $3,397,681 during the third quarter of 2009. The decrease in the loss from continuing operations mainly reflects a decrease in financing expense, partially offset by a decrease in net operating income.

The decrease in financing expense mainly reflects a decrease in interest charges on the balance owing in regard to Parsons Landing as the majority of the interest which was forgiven on the amount payable was recorded during the fourth quarter of 2009.

The decrease in net operating income mainly reflects a decrease in the net operating income of the Fort McMurray and Yellowknife property portfolios. As disclosed in the same property analysis which follows this commentary, the net operating income of the Fort McMurray and Yellowknife property portfolios decreased by $268,034 and $149,933, respectively during the fourth quarter of 2009, compared to the third quarter of 2009.

The decrease in the NOI for the Fort McMurray portfolio is mainly due to a decrease in revenues as a result of a reduction in the monthly average rental rate. The decrease in the NOI for the Yellowknife portfolio is mainly due to increased energy and utility costs in addition to a decrease in revenue as a result of a reduction in monthly average rental rates.

After providing for income from discontinued operations, LREIT completed the fourth quarter of 2009 with income of $19,131,118, compared to a loss of $3,146,599 during the third quarter of 2009. The bottom-line results for the fourth quarter of 2009 reflect income from discontinued operations of $20,544,425, compared to $251,082 during the third quarter of 2009. Income from discontinued operations for the fourth quarter of 2009 includes $21,063,885 relating to gains on sale, compared to nil in the third quarter of 2009.

**Same Property Analysis**

The following analysis of same property results provides comparative results for the fourth quarter of 2009, compared to the third quarter of 2009.

During the third and fourth quarter of 2009, there were no changes to LREIT's portfolio of income-producing properties, aside from the reclassification of properties to discontinued operations. Accordingly, the following analysis of same property results encompasses all of the properties in LREIT's income property portfolio which are classified under continuing operations as of December 31, 2009. The NOI results for the properties that are classified as "held for sale" are reflected in the loss from discontinued operations.

| | Three Months Ended | | Increase (decrease) | |
|---|---|---|---|---|
| | December 31, 2009 | September 30, 2009 | Amount | % |
| Revenue | | | | |
| Fort McMurray | $ 6,656,762 | $ 7,079,223 | $ (422,461) | (6.0)% |
| Yellowknife | 1,555,965 | 1,640,022 | (84,057) | (5.1)% |
| Other | 685,782 | 685,190 | 592 | 0.1% |
| Total revenue | $ 8,898,509 | $ 9,404,435 | $ (505,926) | (5.4)% |
| Net operating income | | | | |
| Fort McMurray | $ 4,418,725 | $ 4,686,759 | $ (268,034) | (5.7)% |
| Yellowknife | 900,909 | 1,050,842 | (149,933) | (14.3)% |
| Other | 405,230 | 433,128 | (27,898) | (6.4)% |
| Total net operating income | $ 5,724,864 | $ 6,170,729 | $ (445,865) | (7.2)% |

## Summary of Quarterly Results

**Quarterly Analysis**

| | 2009 | | | |
|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 |
| Total revenue | $ 8,906,337 | $ 9,404,600 | $ 11,023,747 | $ 12,477,321 |
| Net operating income | $ 5,732,692 | $ 6,170,894 | $ 7,860,182 | $ 8,665,473 |
| Loss from continuing operations for the period, before future income tax | $ (1,413,307) | $ (3,397,681) | $ (3,439,091) | $ (4,529,846) |
| Income (loss) and comprehensive income (loss) for the period | $ 19,131,118 | $ (3,146,599) | $ (3,956,727) | $ (8,530,719) |
| **PER UNIT** | | | | |
| Net operating income | | | | |
| - basic | $ 0.321 | $ 0.350 | $ 0.450 | $ 0.496 |
| - diluted | $ 0.228 | $ 0.242 | $ 0.311 | $ 0.344 |
| Income (loss) from continuing operations for the period, before future income tax | | | | |
| - basic | $ (0.079) | $ (0.193) | $ (0.197) | $ (0.259) |
| - diluted | $ (0.079) | $ (0.193) | $ (0.197) | $ (0.259) |
| Income (loss) and comprehensive income (loss) for the period | | | | |
| - basic | $ 1.072 | $ (0.179) | $ (0.227) | $ (0.488) |
| - diluted | $ 0.831 | $ (0.179) | $ (0.227) | $ (0.488) |

**Quarterly Analysis**

| | 2008 | | | |
|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 |
| Total revenue | $ 13,316,263 | $ 12,168,436 | $ 9,257,322 | $ 8,262,678 |
| Net operating income | $ 9,746,256 | $ 8,982,171 | $ 6,472,324 | $ 5,460,293 |
| Loss from continuing operations for the period, before future income tax | $ (5,430,702) | $ 905,148 | $ (513,168) | $ (1,503,478) |
| Income (loss) and comprehensive income (loss) for the period | $ (2,185,348) | $ (2,433,198) | $ (4,988,811) | $ 301 |
| **PER UNIT** | | | | |
| Net operating income | | | | |
| - basic | $ 0.559 | $ 0.513 | $ 0.369 | $ 0.313 |
| - diluted | $ 0.382 | $ 0.352 | $ 0.253 | $ 0.214 |
| Income (loss) from continuing operations for the period, before future income tax | | | | |
| - basic | $ (0.312) | $ 0.052 | $ (0.029) | $ (0.086) |
| - diluted | $ (0.312) | $ 0.050 | $ (0.029) | $ (0.086) |
| Income (loss) and comprehensive income (loss) for the period | | | | |
| - basic | $ (0.125) | $ (0.139) | $ (0.284) | $ - |
| - diluted | $ (0.125) | $ (0.139) | $ (0.284) | $ - |

## Income (Loss) Per Unit

**Analysis of Income (Loss) per Unit**

| | Year Ended December 31 | | | |
|---|---|---|---|---|
| | 2009 | 2008 | Change | |
| Income (loss) and comprehensive income (loss) | | | | |
| - basic | $ 0.199 | $ (0.549) | $ 0.748 | 136 % |
| - diluted | $ 0.199 | $ (0.549) | $ 0.748 | 136 % |
| Income (loss) from continuing operations, before future income tax | | | | |
| - basic | $ (0.729) | $ (0.374) | $ (0.355) | (95)% |
| - diluted | $ (0.729) | $ (0.374) | $ (0.355) | (95)% |

Excluding future income tax, LREIT incurred a loss of $0.729 per unit during 2009, compared to a loss of $0.374 per unit during 2008. As the weighted average number of units has only decreased by 0.2% since December 31, 2008, the increase in the loss per unit mainly reflects the increase in the overall loss of the Trust before future income tax.

# ANALYSIS OF CASH FLOWS

## Operating Activities

**Cash from Operating Activities**

| | Year Ended December 31 | | Increase |
|---|---|---|---|
| ***Continuing Operations*** | 2009 | 2008 | (decrease) |
| Rental revenue | $ 41,415,408 | $ 42,235,692 | $ (820,284) |
| Interest and other income | 396,597 | 769,007 | (372,410) |
| Property operating costs | 13,382,764 | 12,343,655 | 1,039,109 |
| Net operating income (NOI) | 28,429,241 | 30,661,044 | (2,231,803) |
| Less: | | | |
| Financing expense | 29,584,709 | 27,492,765 | 2,091,944 |
| Non-cash component of financing expense | 6,346,534 | 7,502,660 | (1,156,126) |
| | 23,238,175 | 19,990,105 | 3,248,070 |
| Trust expense | 2,760,536 | 2,622,973 | 137,563 |
| Non-cash component of trust expense | 282,449 | 391,517 | (109,068) |
| | 2,478,087 | 2,231,456 | 246,631 |
| Cash provided by operating activities, before changes in non-cash operating activities | 2,712,979 | 8,439,483 | (5,726,504) |
| Changes in non-cash operating items | 725,306 | 342,599 | 382,707 |
| Cash provided by operating activities - continuing operations | $ 3,438,285 | $ 8,782,082 | $ (5,343,797) |
| ***Discontinued Operations*** | | | |
| Cash provided by operating activities, excluding leasing activity and changes in non-cash operating items - discontinued operations | $ 2,608,904 | $ 3,137,317 | $ (528,413) |
| Cash used in leasing activities | (683,746) | (592,552) | (91,194) |
| Cash provided by operating activities, before changes in non-cash operating items - discontinued operations | 1,925,158 | 2,544,765 | (619,607) |
| Changes in non-cash operating items - discontinued operations | (2,762,142) | 1,088,667 | (3,850,809) |
| Cash provided by (used in) operating activities - discontinued operations | $ (836,984) | $ 3,633,432 | $ (4,470,416) |

***Summary***

| | | | |
|---|---|---|---|
| Cash provided by operating activities, before changes in non-cash operating items | | | |
| -continuing operations | $ 2,712,979 | $ 8,439,483 | $ (5,726,504) |
| -discontinued operations | 1,925,158 | 2,544,765 | (619,607) |
| Total - continuing and discontinued operations | $ 4,638,137 | $ 10,984,248 | $ (6,346,111) |
| Cash provided by (used in) operating activities | | | |
| -continuing operations | $ 3,438,285 | $ 8,782,082 | $ (5,343,797) |
| -discontinued operations | (836,984) | 3,633,432 | (4,470,416) |
| Total - continuing and discontinued operations | $ 2,601,301 | $ 12,415,514 | $ (9,814,213) |

***Continuing Operations***

During 2009, LREIT generated cash from operating activities of $3,438,285. After excluding changes in non-cash operating items, cash from operating activities decreased by $5,726,504 during 2009, compared to 2008. The decrease in cash flow mainly reflects an increase in financing expense, on a cash basis, and the decrease in net operating income, on a cash basis.

The cash component of financing expense reflects mortgage loan and convertible debenture interest, as well as interest on the amount payable for Parsons Landing, and is calculated by excluding amortization charges for transaction costs, the change in value of interest rate swaps and the accretive portion of the debt component of convertible debentures.

An analysis of the cash component of financing expense (i.e., "total interest expense") is provided in the preceding analysis of "Financing Expense".

***Discontinued Operations***

During 2009, "operating" cash flow from discontinued operations, before changes in non-cash operating items, decreased by $619,607, compared to 2008. The decrease is mainly attributable to an increase in mortgage loan interest for "held for sale" properties, partially offset by an increase in the cash component of operating income for "held for sale" properties.

**Funds from Operations ("FFO") & Adjusted Funds from Operations ("AFFO")**

LREIT considers "Funds from Operations" ("FFO") and "Adjusted Funds from Operations" ("AFFO") to be meaningful additional measures of operating performance. FFO measures the cash generating abilities of LREIT, while AFFO is indicative of available cash flow after capital reinvestment transactions.

During 2009, FFO decreased by $5,360,833, compared to 2008, while AFFO decreased by $5,932,460. On a basic per unit basis, FFO decreased by $0.306 per unit, while AFFO decreased by $0.340 per unit.

The operating cash flow from discontinued operations before changes in non-cash operating items is included in the calculation of FFO and AFFO.

**Funds from Operations/Adjusted Funds from Operations ***

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| Income (loss) | $ 3,497,073 | $ (9,607,056) |
| Add (deduct): | | |
| Amortization expense - continuing operations | 8,863,921 | 7,087,506 |
| Amortization expense - discontinued operations | 2,595,147 | 4,321,042 |
| Future income tax - continuing operations | 2,698,804 | 254,392 |
| Future income tax - discontinued operations | 603,772 | 1,011,650 |
| Non-controlling interest - discontinued operations | 599,729 | 87,860 |
| Gain on sale - discontinued operations | (21,063,885) | - |
| **Funds from operations** * | (2,205,439) | 3,155,394 |
| Add (deduct): | | |
| Straight-line rent adjustment - discontinued operations | (9,684) | (13,554) |
| Net amortization of above/below market in-place leases - discontinued operations | 2,788 | 1,774 |
| Accretion of debt component of convertible debentures | 2,853,290 | 2,469,702 |
| Unit-based compensation | 282,449 | 391,517 |
| Change in fair value of interest rate swaps | 2,293,795 | 4,012,403 |
| Tenant inducement and leasing expenses - discontinued operations | (683,746) | (592,552) |
| Ongoing improvements to income properties - continuing operations | (225,553) | (813,666) |
| Ongoing improvements to income properties - discontinued operations | (189,955) | (560,613) |
| **Adjusted funds from operations** * | $ 2,117,945 | $ 8,050,405 |
| FFO per unit * | | |
| - basic | $ (0.126) | $ 0.180 |
| - diluted | $ (0.126) | $ 0.172 |
| AFFO per unit * | | |
| - basic | $ 0.121 | $ 0.461 |
| - diluted | $ 0.121 | $ 0.437 |

* FFO and AFFO are non-GAAP financial measures of operating performance widely used by the real estate industry. Accordingly, FFO and AFFO should not be construed as an alternative to net income or cash flow from operating activities determined in accordance with GAAP.

FFO and AFFO have been calculated in accordance with the recommendations of RealPac, however, the method that is used by LREIT for calculating FFO and AFFO may differ from other issuers' methods and accordingly, may not be comparable with measures used by other issuers. The FFO and AFFO per unit amounts have been calculated on a basis consistent with that prescribed by GAAP for calculating earnings per unit.

### Distributable Income

Distributable income is a financial measurement which is commonly used to assess the cash distribution capabilities and cash flows of investment trusts and, as such, management believes that the disclosure of distributable income provides useful information to investors. Distributable income does not have any standardized meaning prescribed by GAAP and, therefore, the method that is used by LREIT for calculating distributable income may not be comparable to similar measures presented by other issuers. The most directly comparable GAAP measurement of the cash flows of LREIT is "cash from operating activities", as disclosed in the Consolidated Statement of Cash Flows in the financial statements. Accordingly, a reconciliation between cash from operating activities and distributable income is provided in the chart below.

**Reconciliation Between Cash from Operating Activities and Distributable Income**

| | Year Ended December 31 | |
|---|---|---|
| | 2009 | 2008 |
| Cash provided by continuing operating activities | $ 3,438,285 | $ 8,782,082 |
| Changes in non-cash operating items | (725,306) | (342,599) |
| | 2,712,979 | 8,439,483 |
| Add (deduct): | | |
| Cash flow from discontinued operations - net of changes in non-cash operating items | 1,925,158 | 2,544,765 |
| Difference between contract/market rates | 52,978 | 190,262 |
| Tenant inducement and leasing expenses | 683,746 | 592,552 |
| Amortization of tenant inducement and leasing expenses | (127,493) | (305,692) |
| Distributable income | $ 5,247,368 | $ 11,461,370 |
| Per unit | | |
| - Basic | $ 0.299 | $ 0.656 |
| - Diluted | $ 0.299 | $ 0.592 |

Changes in non-cash operating items are excluded from LREIT's calculation of distributable income as non-cash operating items are subject to significant temporary fluctuations which are typically reversed over time, mainly due to timing differences in accounts receivable and accounts payable.

The operating cash flow from discontinued operations net of changes in non-cash items is included in the calculation of distributable income. For discontinued operations, lease acquisition costs are also excluded from the calculation of Distributable Income, as such costs are subject to significant fluctuation based on leasing activity, while amortization charges for lease acquisition costs are deducted as amortization charges are more representative of the average annual cost of leasing acquisition activities.

**Total Distributions**

In 2008, LREIT paid quarterly distributions of $0.14 per unit, representing a total distribution of $0.56 per unit.

For the months of January and February 2009, LREIT declared a distribution of $0.04667 per unit, representing a total distribution of $0.9334 per unit. Subsequent to the payment of the distribution for February 2009, LREIT suspended distributions due to the decline in rental market conditions in Fort McMurray and the impact on operating cash flow.

Distributions will continue to be suspended for the foreseeable future, given the other funding priorities of LREIT.

After considering the value of units issued under the distribution reinvestment plan ("DRIP") and distributions paid on limited partnership units, the total distributions of LREIT for 2009 (i.e., the distributions for January and February 2009) amounted to $21,172,570. In comparison, the distributions for 2008 were $10,029,556.

An analysis of total distributions and distribution variances is provided in the following chart.

| | Year Ended December 31 | |
|---|---|---|
| | 2009 | 2008 |
| **Total distributions** | | |
| Distributions paid on units | $ 1,530,736 | $ 8,104,253 |
| Value of trust units issued under DRIP | 104,343 | 1,725,598 |
| Distributions paid in units | 19,504,206 | - |
| Distributions per Statement of Equity | 21,139,285 | 9,829,851 |
| Distribution paid on LP units | 33,285 | 199,705 |
| Total distributions | 21,172,570 | 10,029,556 |
| Less: | | |
| Value of trust units issued under DRIP | (104,343) | (1,725,598) |
| Units Distributed | (19,504,206) | - |
| Total distributions paid in cash | $ 1,564,021 | $ 8,303,958 |
| **Distribution variances** | | |
| Distributable income | $ 5,247,368 | $ 11,461,370 |
| Excess of distributable income over distributions paid in cash | $ 3,683,347 | $ 3,157,412 |
| Cash provided by operating activities- continuing operations | $ 3,438,285 | $ 8,782,082 |
| Cash provided by operating activities- discontinued operations | (836,984) | 3,633,432 |
| Cash provided by operating activities | $ 2,601,301 | $ 12,415,514 |
| Excess of cash provided by operating activities over distributions paid in cash | $ 1,037,280 | $ 4,111,556 |

## Distribution Variances

As LREIT suspended distributions subsequent to February 2009, a comparative analysis of distribution variances and payout percentages has limited relevance.

*Comparison to Distributable Income*

As disclosed in the preceding chart, distributable income exceeded distributions paid in cash by $3,683,347 during 2009, compared to $3,157,412 during 2008.

On a percentage basis, total distributions paid in cash were equal to 30% of distributable income during 2009, compared to 72% during 2008.

The change in the distributable income variances and payout percentages is mainly due to the suspension of distributions by LREIT subsequent to February 2009 and, to a much lesser extent, the decrease in distributable income in 2009.

*Comparison to Cash From Operating Activities*

As disclosed in the preceding chart, cash from operating activities exceeded distributions paid in cash by $1,037,280 or 66.3% during 2009 and by $4,111,556 or 49.5% during 2008.

The change in the variance between distributions paid in cash and cash from operating activities in 2009 and 2008 mainly reflects the suspension of distributions in 2009, as well as a $3,468,102 decrease in the extent to which "changes in non-cash operating items" served to increase operating cash flows in 2009. The increase in "changes in non-cash operating items" is comprised of an increase of approximately $0.4 Million in regard to continuing operations and an decrease of approximately $3.9 Million in regard to discontinued operations. The increase pertaining to continuing operations is mainly due to the change in accrued interest payable relating to the Parsons Landing acquisition payable.

# CAPITAL RESOURCES AND LIQUIDITY

## Source and Use of Funds - General

LREIT requires an ongoing source of cash to fund regular mortgage loan principal payments and improvements to income properties. Although there may be quarterly periods in which there is a cash deficiency from operating activities, on an annual basis, cash from operating activities effectively represents the initial source of funding for regular mortgage loan principal payments and improvements to income properties. As distributions were suspended subsequent to February 2009, the current funding requirements of LREIT do not encompass the funding of distributions.

Other non-recurring investment and financing activities, may result in a cash inflow or cash outflow, depending on specific events which occur each quarter.

LREIT also requires additional capital on a periodic basis to fund the equity component of new property acquisitions and lump-sum convertible debenture repayments.

The net cash inflow from the divestiture program and the "operation" of held for sale properties, as reflected under discontinued operations, is primarily designated for lump-sum debt repayments, including the retirement of convertible debenture debt. In addition, the net cash inflow from discontinued operations may serve as a supplemental funding source for continuing operations to the extent that there is a cash deficiency in continuing operations.

## Source and Use of Funds - 2009 Summary

### Continuing Operations

An analysis of the cash flows of LREIT for 2009, separated into "continuing operations" and "discontinued operations" is provided in the chart which follows this section of the MD&A. The analysis discloses the following:

(i) regular monthly principal payments, improvements to income properties and distributions exceeded cash from operating activities by $4,250,562.

(ii) after including other financing and investing activities, there was a net cash outflow of $7,075,567 from continuing operations. The net cash outflow is more than offset by the net cash inflow from discontinued operations, as noted below.

**Discontinued Operations**

As disclosed in the cash flow analysis, the net cash inflow from discontinued operations was $7,813,539, comprised of the following components:

(i) a net cash outflow of $836,984 from the "operations" of discontinued properties;

(ii) a net cash inflow from property sales of $29,631,650. The net cash inflow from property sales is net of selling expenses and any mortgage loan debt which was discharged on sale or assumed by or provided to the Purchaser;

(iii) a net cash outflow of $17,094,997 in regard to interim loans retired; and

(iv) a net cash outflow of $3,886,130 from other financing and investing activities.

The majority of the cash inflow from discontinued operations essentially represented the primary funding source for the revolving loan and line of credit repayments which occurred in the fourth quarter of 2009.

**Ending Cash Position**

The net cash inflow from continuing and discontinued operations amounted to $737,972 during 2009. After accounting for the opening bank balance of $3,549,892, LREIT completed 2009 with a cash balance of $4,287,864.

**Cash Flow Analysis (Note 1) - Year Ended December 31, 2009**

| | | |
|---|---|---|
| **CONTINUING OPERATIONS** | | |
| **Cash provided by operating activities** | | $ 3,438,285 |
| **Cash provided by (used in) on-going financing and investment activities** | | |
| Regular repayment of principal on mortgage loans | (5,316,733) | |
| Improvements to income properties (Note 2) | (841,378) | |
| Distributions | (1,530,736) | (7,688,847)* |
| Shortfall in cash provided by operating activities | | (4,250,562)* |
| **Cash provided by (used in) other financing and investment activities** | | |
| Total cash used in financing activities | (7,791,332) | |
| Total cash used in investing activities | (2,722,520) | |
| Add back: Financing/investing cash outflows deducted above | 7,688,847 * | (2,825,005)* |
| **Net cash outflow from continuing operations** | | (7,075,567) |
| **DISCONTINUED OPERATIONS** | | |
| **Cash provided by (used in) operations of properties sold and held for sale** | | (836,984) |
| **Net cash proceeds from property sales** | | 29,631,650 |
| **Interim loans retired** | | (17,094,997) |
| **Cash provided by (used in) other activities in discontinued operations** | | (3,886,130) |
| **Net cash inflow from discontinued operations** | | 7,813,539 |
| **Cash increase** | | 737,972 |
| **Cash, beginning of year** | | 3,549,892 |
| **Cash, end of year** | | $ 4,287,864 |

**Note 1 - GAAP Measurements**

The preceding cash flow analysis represents the re-formatting of amounts from the Consolidated Statement of Cash Flows in the financial statements in order to separately identify the variance between the cash inflow from operating activities and the cash outflow from "ongoing" financing and investing activities and to highlight the cash inflows/outflows associated with property sales and lump-sum repayments of interim mortgage loan debt. The specific line item amounts which are disclosed in the analysis, agree to the Consolidated Statement of Cash Flows with the exception of the asterisked sub-totals and the line amount titled "cash provided by (used in) other activities in discontinued operations" which is the cumulative total of the individual amounts which are not separately disclosed in the analysis.. The order of presentation of the line items differs from the Consolidated Statement of Cash Flows, as follows:

- the cash outflows for two financing activities (regular repayments of principal on mortgage loans and distributions) and one investing activity (improvements to income properties) are disclosed separately under the category of "Ongoing Financing and Investing Activities".
- the net cash outflow for the remaining financing and investment activities are disclosed under the category of "Other Financing and Investing" activities.

**Note 2 - Improvements to Income Properties**

Improvements to income properties consist of capital expenditures which were incurred during the normal course of operations, such as improvements to the income properties and grounds, as well as, common area upgrades and in-suite replacements, including appliances, carpeting and draperies.

## Sources and Use of Funds - 2010

### Sources

**Working Capital/Existing Cash**

As of December 31, 2009, the working capital deficit of LREIT, after including the face value of the Series E debentures and excluding accrued liabilities for property acquisitions, was approximately $10.5 Million. Including accrued liabilities for property acquisitions of $47,720,000, the working capital deficit of LREIT was $58.2 Million as of December 31, 2009.

As of December 31, the cash balance of LREIT was $4,287,864,

**Revolving Loan Commitment from 2668921 Manitoba Ltd.**

In February 2010, LREIT withdrew $5 Million on the revolving loan commitment with 2668921 Manitoba Ltd. representing the maximum amount available under the loan. The $5 Million withdrawal represented a portion of the funding for the retirement of the Series E debentures.

In March 2010, the revolving loan commitment was repaid in full from the net proceeds from the sale of properties and proceeds from the public offering of second mortgage bonds and warrants.

**Line of Credit**

In February 2010, LREIT utilized approximately $4.8 Million on the line of credit with the Royal Bank of Canada, thereby increasing the loan to the maximum available limit of $5 Million. The $4.8 Million utilization represented a portion of the funding for the retirement of the Series E debentures. In March 2010, LREIT repaid $4.1 Million on the operating line of credit from net proceeds of sale of properties held for sale and proceeds from public offering of second mortgage bonds and warrants.

**Cash from Operating Activities**

The cash provided by operating activities in 2010 is dependent on a number of factors, including:

(i) the extent to which rental market conditions improve in Fort McMurray during 2010;

(ii) the ability of LREIT to secure the necessary mortgage loan financing for Parsons Landing and thereby achieve a reduction in financing costs for the property;

(iii) the ability of LREIT to renew the maturing mortgage loan debt of income properties at an overall interest rate which is not significantly higher than the existing interest rates; and

(iv) the extent to which LREIT generates additional cash from property sales for the pay down of debt associated with continuing operations.

**Discontinued Operations**

As of December 31, 2009, 10 properties were classified as held for sale by LREIT. The estimated gross selling price and net cash proceeds of the 10 "held for sale" properties is $155.9 Million and $61.9 Million, respectively. On March 1, 2010, two of the properties were sold at a total gross selling price of $19,170,000. After accounting for expenses, the repayment or assumption of mortgage debt by the purchaser and the provision of $3 Million of 5.5% second mortgage loan financing by LREIT, the sales resulted in net cash proceeds of approximately $6.4 Million

### Mortgage Loan Financing

As opportunities arise, first mortgage loans may be upward refinanced at maturity in order to raise additional capital to supplement the cash generated from operating activities.

### Debt and/or Equity Offerings

On February 25, 2010, LREIT completed a public offering of 6,780 investment units comprised of second mortgage bonds and warrants, generating gross proceeds of $6.8 Million.

LREIT has the capability of pursuing additional offerings of debt and/or equity in the future as a source of investment capital. LREIT may also issue trust units to vendors as consideration for real property acquisitions.

## Uses

### Parsons Landing

As previously disclosed in this report, the deadline for payment of the balance owing for Parsons Landing of approximately $48 Million is May 31, 2010. After providing for $1.4 Million of furniture credits and $12 Million of second mortgage loan financing from the vendor and the anticipated first mortgage loan financing of $30.0 Million, the amount to be paid in cash is approximately $4.2 Million.

## Mortgage Loan Principal Payments

### Continuing Operations

A summary of the mortgage loan obligations of LREIT relating to continuing operations for 2010 and for the next five years, is provided in the following chart:

**Summary of Contractual Obligations - Long-term Debt**

| Payments Due by Period | Total | 2010 | 2011/2012 | 2013/2014 | 2015 and beyond |
|---|---|---|---|---|---|
| Regular mortgage loans | $ 205,785,513 | $ 73,658,705 | $ 42,831,921 | $ 72,518,383 | $ 16,776,504 |
| Floating rate demand loans | 72,766,738 | 72,766,738 | - | - | - |
| Vendor take-back mortgage loan | 4,000,000 | 4,000,000 | - | - | - |
| Total | $ 282,552,251 | $ 150,425,443 | $ 42,831,921 | $ 72,518,383 | $ 16,776,504 |

The total amount due during 2010 of $150,425,443 is comprised of the following amounts:

(i) regular repayments of principal in the amount of $4,029,357;

(ii) principal of $23,335,561 on first or second mortgage loans which mature during 2010;

(iii) principal of $46,293,787 in regard to two first mortgage loans which mature subsequent to 2010 that are in breach of debt service coverage requirements;

(iv) principal of $72,766,738 on demand loans that are in breach of debt service coverage requirements;

(v) principal of $4,000,000 in regard to a vendor take-back loan which matures in 2010.

In total $119,060,525 of mortgage loan debt for continuing operations was in breach of debt service coverage requirements as of December 31, 2009, including $17,766,738 of mortgage loan debt with a maturity date in 2010. For $72.8 Million of the debt which was in breach of the debt service coverage requirement as of December 31, 2009, a forbearance letter has been received from the lender with an expiry date of April 20, 2010.

Management is working toward a resolution of the default situation for all of the mortgage loans which are in breach of the debt service coverage requirements. It is anticipated that the default will be satisfactorily resolved, although a partial pay-down of the principal balances of some of the mortgage loans may be required.

All of the mortgage loan debt which matures during 2010, including $17,766,738 of mortgage loan debt which is in breach of the debt service coverage requirement, is expected to be renewed or refinanced under similar conditions, subject to any partial paydowns which may be required for the mortgage loan debt which is in breach of the debt service coverage requirements, except for the $4,000,000 take-back loan which is expected to be repaid at maturity and $5,101,221 of first mortgage loan debt which is expected to be discharged on the sale of the mortgaged property. The mortgaged property "Woodlily Courts" will be reclassified as "held for sale" in the first quarter of 2010.

**Discontinued Operations**

The mortgage loan debt for the ten properties which are classified as "held for sale" as of December 31, 2009, amounts to $84.8 Million, of which $17.4 Million matures during 2010.

On March 3, 2010, $9.4 Million of the mortgage loan debt for "held for sale" properties was discharged on the sale of two properties. All of the discharged debt had a maturity date beyond 2010.

All of the mortgage loan debt for "held for sale" properties which matures during 2010 is expected to be discharged on sale or renewed under similar terms and conditions.

**Improvements to Existing Properties**

Property improvement costs for 2010 are not expected to exceed $1.8 Million.

**Convertible Debenture/Principal Payments**

A summary of the net amount outstanding as of December 31, 2009 in regard to the three remaining series of convertible debentures is provided in the following chart. As previously disclosed, the Series E convertible debenture debt of $11.95 Million matured on February 17, 2010. The debt was retired using $5 Million from the line of credit with 2668921 Manitoba Ltd. and $4.8 Million from the line of credit with the Royal Bank of Canada, with the balance paid in cash.

| Issue Date/Maturity Date | Series | Amount Issued | Net Amount Outstanding December 31, 2009 |
|---|---|---|---|
| Feb. 17/05/Feb. 17/10 | E | $ 12,000,000 | $ 11,950,000 |
| Mar. 10/06/Mar. 11/11 | F | 13,680,000 | 13,680,000 |
| Dec. 8/06/Dec. 31/11 | G | 25,732,000 | 25,732,000 |
| Face Value | | $ 51,412,000 | $ 51,362,000 |

The Series F debentures provide for the outstanding amount of the debentures to become payable on demand upon default and acceleration, under certain terms and conditions, of a mortgage loan or a convertible debenture. As previously disclosed in this report, the Trust is not in compliance with four first mortgage loans and one second mortgage loan totaling $124,161,746, as a result of a violation of the debt service coverage requirement. If any of the mortgage lenders demand the repayment of the loans, the Series F debentures may become payable on demand.

## RELATED PARTY TRANSACTIONS

**Shelter Canadian Properties Limited ("Shelter Canadian")**

*Asset and Property Management*

Shelter Canadian provides administrative and asset management services to LREIT, pursuant to the terms of a Services Agreement. The Services Agreement provides for the remuneration of Shelter Canadian to be established at a level which is commensurate with customary comparable market asset management fees, subject to the discretion of the Governance, Compensation and Nominating Committee of the Board of Trustees.

Shelter Canadian currently receives a service fee equal to 0.3% of the gross book value of the total assets of the Trust. The gross book value of the total assets of the Trust is defined as the total assets, as disclosed on the most recently issued financial statements, excluding cash. Payment of the fee occurs on a monthly basis, on the last day of each month. The current term of the Services Agreement expires on December 31, 2010. During 2009, LREIT incurred service fees payable to Shelter Canadian of $1,961,963. Service fees are included in trust expense.

Shelter Canadian is also the Property Manager for LREIT, pursuant to the Property Management Agreement. Shelter Canadian has a direct involvement in the management of all of the income properties in the portfolio of LREIT and acts as the Property Manager for all of the properties, except for Siena Apartments and the seniors' housing complexes, which are managed by third party managers who specialize in seniors' housing. In accordance with the terms of the Property Management Agreement, Shelter Canadian receives a property management fee equal to 4% of gross receipts from the income properties which it manages. In regard to commercial properties, Shelter Canadian Properties Limited is also entitled to leasing commissions on new leases of 3% to 5% of base rental payments and leasing commissions on renewal of 1 1/2% to 2 1/2% of base rental payments. Shelter Canadian Properties Limited is also entitled to tenant improvement and renovation fees equal to 5% of the total cost of such work. The current term of the Management Agreement expires on August 30, 2012.

During 2009, LREIT incurred property management fees payable to Shelter Canadian of $2,356,549, as well as leasing commissions of $113,453 and tenant improvements and renovation fees of nil. Property management fees are included in property operating costs and during the period of major in-suite renovations or development are capitalized to the cost of buildings and properties under development. Leasing commissions and tenant improvement and renovation fees are capitalized to income properties.

*Loans*

In June 2009, LREIT obtained a $500,000 second mortgage loan and a $2.7 Million revolving "operating" loan commitment from 2668921 Manitoba Ltd., the parent company of Shelter Canadian. In September 2009, the revolving loan commitment was increased to $5 Million. The loans bear interest at 7.5% and are due on June 1, 2010 and June 30, 2010, respectively. There was a $15,000 processing fee payable to 2668921 Manitoba Ltd. in regard to the second mortgage loan.

During 2009 all withdrawals on the revolving loan commitment were repaid and, as of December 31, 2009, the amount available under the revolving loan commitment was $5,000,000.

The loans were approved by the independent Trustees of LREIT. Mr. Arni Thorsteinson, the Chief Executive Officer of LREIT and a Trustee, is also President of Shelter Canadian Properties Limited and President of 2668921 Manitoba Ltd. and abstained from voting in regard to the approval of the loans.

## REVENUE/INCOME AND OTHER COMMITMENTS

### Lakewood Manor

The acquisition of Lakewood Manor was completed by LREIT, effective July 1, 2007. All of the units at the property are leased by a major oil sands company, pursuant to a three year lease agreement, under which the lessee is also responsible for all property operating costs. The net operating income of the property is approximately $4.8 Million per annum, representing the amount of gross rental revenue.

### Siena Apartments

The acquisition of Siena Apartments was completed by LREIT, effective July 2, 2008. All of the units at the property are leased by a major oil sands company, pursuant to a lease agreement expiring May 1, 2012, under which the lessee is also responsible for all property operating costs. The net operating income of the property is approximately $2.2 Million per annum, representing the amount of gross rental revenue.

The agreement also provides the oil sands company with an option to extend the lease for an additional five years at current market rates at that time.

LREIT also has a right of first refusal to acquire Cortona Apartments (formerly known as Phase II of Siena Apartments). Cortona Apartments consists of 57 suites and is also 100% leased to the same major oil sands operating company on a net rent basis for a five-year term until 2013.

### Elgin Lodge

In conjunction with the acquisition of Elgin Lodge in June 2006, LREIT retained Kingsway Arms Management Services Inc. ("Kingsway") to manage the property for a ten year term, expiring on May 31, 2016. Kingsway is an Ontario-based company, which acquires, manages and develops retirement homes, catering principally to the independent and assisted living segments. Kingsway currently manages a portfolio of nine properties, totaling 850 suites located across Ontario.

A 60-suite expansion was completed at Elgin Lodge during 2007. During the five year period from June 1, 2006, Kingsway is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the expanded property exceeds the total of the cost of the property to LREIT, including the cost of the expansion and the unpaid portion of a 12% annual return on the LREIT equity investment. Consideration recorded at December 31, 2009, of $434,982, which increases the cost of the building, is included in accounts payable and accrued liabilities.

### The Clarington Seniors Residence

LREIT has also retained Kingsway to manage The Clarington Seniors Residence for a ten-year term, expiring on February 12, 2017. During the five year period after the "lease-up" date, Kingsway is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the property exceeds the total of the original acquisition cost to LREIT and the unpaid portion of a 8% annual return on the LREIT equity investment. Consideration recorded at December 31, 2009, of $477,901, which increases the cost of the building, is included in accounts payable and accrued liabilities.

## CHANGES IN ACCOUNTING POLICIES

**New Accounting Standards - Adopted January 1, 2009**

**Goodwill and intangible assets**

The CICA issued a new Handbook Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Handbook Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard.

On January 20, 2009, the CICA issued Emerging Issues Committee ("EIC") abstract EIC-173-Credit Risks and the Fair Value of Financial Assets and Financial Liabilities. This abstract provides guidance on CICA Handbook Section 3855 Financial Instruments - Recognition and Measurement and requires an entity to consider its own credit risks as well as the credit risk of the counter party when determining the fair value of financial assets and liabilities , including derivative instruments.

**Financial Instruments - Disclosure**

CICA Handbook Section 3862 - Financial Instruments - Disclosures has been amended to include additional disclosure requirements about fair value measures and to enhance liquidity risk disclosure requirements for publicly accountable enterprises. The amendments apply to annual financial statements relating to fiscal years ending after September 30, 2009.

The adoption of these standards did not have an impact on the consolidated financial statements.

**Future Changes to Significant Accounting Policies**

**International Financial Reporting Standards ("IFRS")**

The CICA Accounting Standards Board has adopted a strategic plan for the direction of accounting standards in Canada. As part of the plan, accounting standards for public companies will be required to converge with International Financial Reporting Standards for fiscal years beginning on or after January 1, 2011 with comparative figures presented on the same basis. The International Financial Reporting Standards will replace Canada's current GAAP for public companies.

Although the conceptual framework for IFRS is similar to Canadian GAAP; there are differences in certain matters of recognition, measurement and disclosure. The Trust has performed an initial assessment of the impact of IFRS and has identified differences between IFRS and Canadian GAAP in investment property; classification of Trust units; and lease incentives.

A summary of the identified differences in accounting principles are as follows:

Investment Properties

Income properties as reflected in the December 31, 2009 interim financial statements will be considered to be "Investment Properties" and the accounting principles enumerated under IAS 40 "Investment Property" (IAS 40) will apply. As with Canadian GAAP, IAS 40 provides that investment properties will initially be measured at cost. Subsequent to initial recognition, however, IAS 40 provides an entity with two choices, as follows:

- continue with a cost valuation model with note disclosure of fair values:
- recognize the fair value of investment properties on the balance sheet with valuation adjustments reflected in income.

In either option, the Trust will be required to disclose fair values as at January 1, 2010 in the opening balance sheet to be prepared under IAS 1 "Presentation of Financial Statements" (IAS 1) on the adoption of IFRS for the Trust's fiscal year beginning January 1, 2011.

The provision of fair value information under either option will require that the Trust create a valuation process with reasonable and supportable assumptions concerning cash flows from current leases and future leases and cash outflows in respect of the leases and investment properties.

Classification of Trust Units

The Declaration of Trust requires that all taxable income be distributed to its Unitholders each year. As IFRS is currently drafted and generally interpreted by the Canadian accounting profession, the units may be regarded under IFRS as a "liability" rather than "equity" with the associated distributions classified as interest expense. In order to continue to present units as equity, the Declaration of Trust was amended on December 9, 2009, to remove the requirement of the Trust to distribute its taxable income and to provide that the Trustees may distribute all of the taxable income to the Unitholders

Lease Incentives

Canadian GAAP provides that lease incentives be amortized over the life of the lease with the amortization charge reflected as an amortization expense without affecting net operating income.

Under IFRS, lease incentives are governed by Standing Interpretations Committee Interpretation 15, "Operating Leases - Incentives" (SIC 15). SIC 15 requires that lease incentives be reflected as a reduction to rental income and operating income over the lease term on a straight-line basis.

First-time Adoption of International Financial Reporting Standards

The Trust's adoption of IFRS will require the application of IFRS 1, "First-Time Adoption of International Financial Reporting Standards " (IFRS 1), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively. IFRS 1 also contains certain exceptions and limited optional exemptions in specified areas of certain standards.

The Trust is in the process of reviewing the impact of the adoption of IFRS, including the above changes, on the financial statements and evaluating the accounting policy alternatives for the purpose of determining the necessary changes to accounting policies, internal control procedures, disclosure control and business processes. This will be an ongoing process as new standards and recommendations are issued by the IASB and the CICA Accounting Standards Board. The Trust's financial position and results of its operations may be significantly different when presented in accordance with IFRS.

**Business Combinations**

CICA Handbook Section 1582 - Business Combinations will apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. CICA Handbook Sections 1601 - Consolidations and 1602 - Non-Controlling Interests will be effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. These sections replace the former CICA Handbook Sections 1581 - Business Combinations and 1600 - Consolidated Financial Statements. CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements. CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination.

## OPERATING RISKS AND UNCERTAINTIES

An investment in units of LREIT encompasses the risks which are inherent in the ownership and operation of a portfolio of residential and commercial properties, as well as the normal risks which are associated with an investment in a real estate investment trust. **For a summary of certain additional key risks relating to LREIT, see the Annual Information Form, which is available at www.sedar.com.**

The key risks include the following:

**Continuing Operations**

As previously disclosed in this report, there are a number of variables and risk factors that have been identified in regard to assessing whether LREIT has the ability to continue to operate, including: (i) the net losses sustained by LREIT in 2008 and 2009, (ii) the breach of debt service coverage requirements on five mortgage loans in the aggregate principal amount of $124,161,746 which, in addition to potential repayment of such mortgages on demand, could potentially result in $13.68 Million of convertible debenture debt becoming payable on demand (which, in turn, could potentially result in $6.78 Million of bonds becoming payable on demand), (iii) the impact of increased vacancy rates and reduced rental rates in Fort McMurray on the ability of LREIT to continue to secure financing on the Fort McMurray properties, and (iv) the working capital deficit of the Trust, as of December 31, 2009 in the amount of $10,468,086.

Management believes that LREIT has the ability to continue operations as a result of the steps which have been taken to address the risk factors, and after considering events which have occurred subsequent to December 31, 2009, including the repayment of the Series E debentures in February 2010; the issue of mortgage bonds; the renewal or refinancing of all mortgage loans which have matured to the date of this report in 2010; the completion of additional property sales in 2010 and the resulting pay-down of additional debt.

**Real Property Ownership**

The properties of LREIT are subject to the normal risks common to real property ownership and operation, including the risk of a reduced demand due to changes in general economic conditions, local real estate markets, competition from other available premises and various other factors.

The properties of LREIT generate income through rent payments made by the tenants of the properties. Upon the expiry of any lease, there can be no assurance that the lease will be renewed or the tenant replaced. The terms of any subsequent lease may be less favourable than the existing lease. Leasing results are affected by a number of factors, including location of the property and, in particular, the level of supply and demand in the local rental market.

**Public Market Risk**

It is not possible to predict the price at which units will trade in the future and there can be no assurance that an active trading market for the units will be sustained. The units will not necessarily trade at values determined solely by reference to the value of the properties of LREIT. Accordingly, the units may trade at a premium or a discount to the value implied by the value of the properties of LREIT. The market price for the units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of LREIT.

**Completion of Divestiture Program**

LREIT is pursuing a divestiture program targeting the sale of assets, with a value in excess of $250 Million, by December 31, 2010. The objective of the divestiture program is to reduce total debt, including convertible debenture debt, and in particular higher cost interim mortgage loan financing.

During 2009, LREIT sold 13 properties under the divestiture program at a combined gross selling price of $90.4 Million. As a result of the sales, the Trust repaid $17.1 Million of interim mortgage loan financing during 2009. On March 1, 2010, LREIT sold two additional properties at a combined gross selling price of $19,170,000.

There can be no assurance that LREIT will complete the divestiture program under the time frame or to the extent and on the terms which are contemplated by Management.

**Completion of Parsons Landing Acquisition**

There is a risk that financing arrangements for Parsons Landing will not be completed within a satisfactory time frame and the property may be listed for sale in 2010. In the event of sale, LREIT could incur a full or partial loss of the cumulative payments to the vendor. See "Status of Parsons Landing Financing".

**Current Economic Conditions**

Canadian real estate investment trusts are subject to risks generally incidental to the Canadian real estate, credit, capital and financial markets. The global recessionary economic conditions and the global financial liquidity crisis that existed in 2008, 2009 and is continuing into 2010, have resulted in persistent interruptions in the credit and capital markets, devaluations of assets directly or indirectly linked to the Canadian real estate finance markets and the concurrent reduction of long and short-term liquidity from the capital markets.

Sensitivity to the global economic conditions, and their impact in Canada, may negatively affect the income received from LREIT's properties. Inherent illiquidity may limit LREIT's ability to vary its portfolio in response to changes in the global, national and/or local economic conditions and may ultimately prevent LREIT from implementing its strategies. Increased vacancy rates and difficulties re-leasing properties, commonly associated with recessionary economic conditions, may occur and may adversely affect the income received from LREIT's real property assets.

**Concentration of LREIT's Portfolio in One Market**

The property portfolio of LREIT has significant exposure to the Fort McMurray, Alberta market. Excluding the 10 properties which are classified as "held for sale", there were 21 properties in the real estate portfolio of LREIT as of December 31, 2009, including one commercial property and 20 residential properties, comprising 1,742 rental units. The residential property portfolio includes 13 properties that are located in Fort McMurray, comprising a total of 1,167 suites, or 67% of the total residential suites in the income-producing property portfolio. The 13 properties have an aggregate acquisition price of $336.8 Million, which represents approximately 86% of the total aggregate purchase price of the portfolio of income-producing properties.

The 13 properties in Fort McMurray accounted for 78% of the total revenue of LREIT during 2009 and 81% of the net operating income.

None of the properties which are classified as "held for sale" as of December 31, 2009 are located in Fort McMurray.

**Oil Sands Industry**

As disclosed above, LREIT has a high concentration of properties in the Fort McMurray, Alberta market and employees from the oil sands industry represent the primary tenant base of the Fort McMurray portfolio. LREIT also has two properties in Fort McMurray which are 100% leased to major oil sands companies, under a single lease agreement, as follows:

- Lakewood Manor - all units 100% leased under a three year lease agreement, expiring on June 30, 2010; and
- Siena Apartments - all units 100% leased under a lease agreement, expiring on May 1, 2012, with the option of an extension for five years at current market rates at that time.

As a result of current reduced construction activity in the oil sands industry, there is an increased risk of lease renewal for suites which are leased to oil sands companies or to the employees of oil sands companies.

Certain significant expenditures, including property taxes, utility payments, maintenance costs, mortgage payments, insurance costs and related charges must be made throughout the period of ownership of real property regardless of whether the property is producing any income. If LREIT were unable to meet mortgage payments on any property, losses could be sustained as a result of the mortgagee's exercise of its rights of foreclosure or sale.

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relation to demand or the perceived desirability of such investments. Such illiquidity may tend to limit LREIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If LREIT were to be required to liquidate its real property investments, the proceeds to LREIT might be significantly less than the aggregate carrying value of its properties.

**Financing**

*General*

The ability of LREIT to raise additional capital for operating or investing activities is subject to uncertainty. Factors which could impair the ability of LREIT to raise additional capital include a continued downturn in general economic conditions, a more restrictive capital market, a change in legislation and numerous other factors beyond the control of LREIT.

*Mortgage Financing*

The adoption of more restrictive and conservative lending policies by mortgage lenders following the economic downturn in October 2008, combined with the utilization of interim sources of mortgage financing by LREIT and the decline in operating income of the Fort McMurray property portfolio, has increased the level of risk for LREIT in regard to debt financing.

In the event that LREIT is unable to renew its mortgage loan debt at maturity, or obtain replacement financing, LREIT would not be in a position to repay the debt and would be in default of its debt obligations. In such event, the lenders could potentially take action against LREIT and the indebted properties.

As previously disclosed in this report, LREIT is in breach of a debt service coverage covenant in regard to four first mortgage loans and a second mortgage loan totaling $123,974,033. There is a risk that the mortgage loans will become payable on demand and, as a result of cross default clauses, a risk that secured convertible debentures, with a face value of $13,680,000, may become payable on demand. Management is taking steps to reduce the risk by requesting a revision in the debt service coverage covenant.

**Sources of Capital**

Prior to 2009 LREIT utilized second mortgage and interim financing as a source of funds in order to supplement the funding of distributions as well as the funding of income property improvements and unit repurchases under the normal course issuer bid. As of December 31, 2009, the second mortgage loans and interim mortgage loans of LREIT amounted to $33.6 Million. Although it is anticipated that LREIT will be able to renew its existing interim mortgage loan financing at maturity, it is unlikely that LREIT will undertake additional interim financing.

LREIT is undertaking a divestiture program in order to create an additional source of capital in order to supplement the cash provided from operating activities.

**Payment of Cash Distributions**

A return on an investment in units is not comparable to the return on an investment in a fixed-income security. The recovery of the initial investment in units is at risk and the return on an investment in units is based on many performance assumptions. The ability of LREIT to pay distributions is dependent upon a number of factors, including the level of operating cash flows, the amount of cash reserves, the debt covenants and obligations of the Trust, the working capital requirements of the Trust and the future capital requirements of the Trust. Cash distributions may be reduced or suspended at any time. In addition, the market value of the units may decline if LREIT is unable to provide a satisfactory return to Unitholders.

In accordance with the terms of the Declaration of Trust, as amended pursuant to the Special Resolution which was approved at the special meeting of the Unitholders in December 2009, the cash distributions of LREIT are established at the discretion of the Trustees. If circumstances permit and subject to the application of the SIFT Rules discussed below, it is the intent of the Trust to distribute an amount which is not less than all of its taxable income to its Unitholders and to deduct these distributions for income tax purposes.

Due to the decline in operating cash flow during 2009, LREIT has suspended cash distributions.

**Changes to Tax Treatment of Trusts**

On June 22, 2007, new legislation relating to, among other things, the federal income taxation of publicly traded income trusts (the "SIFT Rules") was enacted. Under the SIFT Rules, certain distributions from a "specified investment flow-through" trust (a "SIFT") will no longer be deductible in computing a SIFT's taxable income, and a SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions of income of a SIFT received by a Unitholder that are not deductible to the SIFT will be characterized as dividends payable to the Unitholders. Generally, distributions paid by a SIFT as a return of capital will generally not be subject to the tax.

The SIFT Rules provide that a SIFT which was publicly listed prior to November 1, 2006 (an "Existing Trust") will become subject to the tax on distributions commencing in the 2011 taxation year. However, an Existing Trust may become subject to this tax prior to 2011 if its equity capital increases beyond certain limits measured against the market capitalization of the Existing Trust at the close of trading on October 31, 2006. Based on its October 31, 2006 market capitalization, LREIT may increase its equity capital by $50 Million for the period November 1, 2006 to December 31, 2007, and each of the years ending December 31, 2008, December 31, 2009 and December 31, 2010 (the "Safe Harbour Limit"). To date, LREIT's equity capital has not increased beyond the Safe Harbour Limit.

The SIFT Rules do not apply to a "real estate investment trust" (a "Qualifying REIT") that meets prescribed conditions relating to the nature of its revenue and property (the "REIT Conditions"). LREIT does not currently satisfy the REIT Conditions. Accordingly, LREIT is subject to the SIFT Rules and, subject to earlier application if it increases its equity capital beyond its Safe Harbour Limit, LREIT will be subject to the tax on distributions commencing in 2011. Prior to 2011, LREIT will consider its alternatives, including restructuring its affairs to qualify as a Qualifying REIT, however, no assurances can be given that any reorganization can or will be implemented before 2011, or that any such reorganization, if implemented, would not result in material costs or other adverse consequences to LREIT and its Unitholders. In addition, no assurance can be given that LREIT's equity capital will not increase beyond the Safe Harbour Limit prior to 2011.

Please refer to the Annual Information Form for a more detailed discussion of the SIFT Rules.

**Legal Claims**

In the normal course of operations, the Trust will become subject to a variety of legal and other claims. Management and legal counsel evaluate all claims on their apparent merits, and accrue management's best estimate of the estimated costs to satisfy such claims. Although the outcome of legal and other claims are not reasonably determinable, management believes that any such outcome will not be material.

**Relationship with Shelter Canadian Properties Limited**

The financial performance of LREIT will depend in part on the performance of Shelter Canadian in providing administrative and asset management services to the Trust, pursuant to the Services Agreement.

**Reliance on Key Personnel**

The success of LREIT is highly dependent on the services of certain management personnel, including Arni Thorsteinson. The loss of the services of such personnel could have an adverse effect on LREIT.

**Other**

Other risks and uncertainties are more fully explained in the other regulatory filings of LREIT, including the Annual Information Form.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements of LREIT, in accordance with Canadian generally accepted accounting principles (GAAP), requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The estimates are based on historical experience and on other assumptions that are believed to be reasonable under the circumstances. Under different assumptions or conditions, the actual results may differ, potentially materially, from the estimated amounts. Many of the conditions impacting the assumptions and estimates are beyond the control of management. The estimates and assumptions are evaluated on a periodic basis.

Financial statement items which encompass estimates include the following:

- allocation of the cost of property acquisition: a portion of the acquisition cost of an income property is allocated to tenant origination costs associated with in-place leases and the cost of tenant relationships, lease origination costs above market leases and below market leases. The amount allocated to the above is based on the estimated fair market value of each variable. The allocated amounts are of significance, as the costs are amortized over a relatively short time frame (I.e., the term of the respective tenant leases) in comparison to the amount allocated to buildings and equipment;

- amortization of the building component of Income Properties: a portion of the purchase price of an income property is allocated to "building" based on the estimated value of the building on an "as if vacant" basis. Amortization expense is based on the estimated useful life of the building. The estimated useful life of the building may vary and could result in a different amount of amortization charged to income;

- amortization of property improvements: expenditures relating to improvements to income properties are capitalized to the cost of income properties and amortized for a period of five to 25 years, based on the estimated useful life of the improvements. The estimated useful life of improvements may vary and could result in a different amount of amortization charged to income;

- the classification of properties held for sale;

- unit-based compensation expense: unit-based compensation expense is based on the estimated fair value of the applicable options using the Black-Scholes option pricing method;

- the determination of the amount of temporary differences, the timing of reversal and the tax rate to be used in calculating future income tax assets and liabilities; and

- the allocation of convertible debentures between debt and equity based on the estimated fair value of the debt using an estimated cost of borrowing.

The estimates which were used for financial statement reporting purposes, for the above noted items, are not expected to change from period to period.

# TAXATION

## Taxation of LREIT

LREIT qualifies as a mutual fund trust for income tax purposes. Subject to the SIFT Rules, LREIT is generally subject to tax in Canada under the Income Tax Act (the "Tax Act") in respect to its taxable income each year, except to the extent that such taxable income is paid or deemed to be payable to Unitholders and deducted by LREIT for tax purposes. The distributions of LREIT are established at the discretion of the Trustees. If circumstances permit and subject to the application of the SIFT Rules, it is the intent of the Trust to distribute or designate all taxable income directly earned by LREIT to the Unitholders in order that LREIT will not be subject to income tax under Part I of the Tax Act.

Under the SIFT Rules, if LREIT does not meet the REIT Conditions to become a Qualifying REIT resulting in the tax on distributions commencing to apply to LREIT in 2011 (or earlier if LREIT increases its equity capital beyond its Safe Harbour Limit), certain distributions from LREIT will no longer be deductible in computing its taxable income, and it will be subject to tax on such distributions at a rate that is substantively equivalent to the general tax rate applicable to a Canadian corporation. However, distributions paid as a return of capital will generally not be subject to the tax.

## Taxation of Unitholders

The Declaration of Trust generally requires LREIT to claim the maximum amount of capital cost allowance for purposes of computing its income for tax purposes. Subject to the SIFT Rules, a Unitholder is required to include, in computing income for tax purposes each year, the portion of the amount of net income and net taxable capital gains of LREIT paid or payable to the Unitholder in the year. Distributions in excess of the taxable income of LREIT for the year which are allocated to a Unitholder are not included in computing the taxable income of the Unitholder. However, the adjusted cost base of the units which are held by a Unitholder will generally be reduced by the amount of distributions not included in income.

The cash distributions which have been paid to the Unitholders since the inception of LREIT as a real estate investment trust in September 2002, have exceeded the income of LREIT, as calculated for income tax purposes. All of the distributions, which have been paid by LREIT from September 2002 to December 31, 2009, have represented a reduction in the cost base of the units.

Under the SIFT Rules, should they become applicable to LREIT as set out above, certain distributions from LREIT which would otherwise have been ordinary income will be characterized as dividends in addition to being subject to tax in LREIT at rates similar to the combined federal and provincial corporate tax rates. Distributions to Canadian resident individuals will be deemed to be "eligible dividends", qualifying for the enhanced dividend tax credit.

Upon the disposition or deemed disposition by a Unitholder of a unit, a capital gain (or a capital loss) will generally be realized to the extent that the net proceeds of disposition of the unit exceed (or are exceeded by) the adjusted cost base of the unit. Currently, only 50% of a capital gain ("taxable capital gain") must be included in computing a Unitholders' income and 50% of a capital loss (an "allowable capital loss") may be deducted against taxable capital gains.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

For the financial year ended December 31, 2009, the Chief Executive Officer and the Chief Financial Officer (the "Certifying Officers"), together with other members of management, have evaluated the design and operational effectiveness of LREIT's disclosure controls and procedures, as defined in Multilateral Instruments 52-109. The Certifying Officers have concluded that the disclosure controls and procedures are designed to ensure that information is accumulated and communicated to management, to allow timely decisions regarding required disclosures.

The internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian Generally Accepted Accounting Principles. The Certifying Officers, together with other members of management, have evaluated and concluded that the design and operation of LREIT's internal controls over financial reporting are effective for the financial year ended December 31, 2009.

No changes were made to the design of the internal controls over financial reporting during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the effectiveness of the internal control system.

Readers are cautioned, however, that a control system can only provide reasonable, not absolute, assurance that the objectives of the control system are achieved. Due to the inherent limitations in all control systems, an evaluation of controls cannot provide absolute assurance that all control issues, including instances of fraud, if any, have been detected. Inherent limitations include the possibility that the assumptions and judgments of management could ultimately prove to be incorrect under varying conditions and circumstances; or that isolated errors could prove to have a significant impact on the reliability of information.

Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and it is not possible to provide complete assurance that a control system will succeed in achieving its stated goals under all potential future conditions.

## ADDITIONAL INFORMATION

Additional information relating to LREIT, including the Annual Information Form, is available on the SEDAR website at www.sedar.com. SEDAR acts as a facilitator for the electronic filing of securities information, as required by the securities regulatory agencies in Canada.

## APPROVAL BY TRUSTEES

The content of the 2009 Annual Report of Lanesborough Real Estate Investment Trust, including Schedule I and Schedule II, and the delivery of the report to the Unitholders has been approved by the Trustees.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
March 23, 2010

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST
# MANAGEMENT'S DISCUSSION AND ANALYSIS - 2009

## SCHEDULE I

## Real Estate Portfolio as of December 31, 2009

**Property Portfolio - December 31, 2009**

| Property | Location | Purchase Price | Acquisition Date | Suites/ Leasable Area - Sq. Ft. | Occupancy December 31 2009 |
|---|---|---|---|---|---|
| ***INCOME PRODUCING PROPERTIES*** | | | | | |
| **RESIDENTIAL** | | | | | |
| **Manitoba** | | | | | |
| Highland Tower (1) | Thompson | $ 5,700,000 | January 2005 | 77 | 97 % |
| **Saskatchewan** | | | | | |
| Woodlily Courts | Moose Jaw | 3,700,000 | June 2006 | 102 | 100 % |
| **Alberta** | | | | | |
| Norglen Terrace | Peace River | 2,500,000 | October 2004 | 72 | 99 % |
| Nelson Ridge Estates | Fort McMurray | 40,575,000 | April 2005 | 225 | 65 % |
| Gannet Place | Fort McMurray | 6,873,700 | June 2006 | 37 | 80 % |
| Lunar Apartments | Fort McMurray | 4,457,100 | June 2006 | 24 | 57 % |
| Parkland Apartments | Fort McMurray | 2,230,200 | June 2006 | 12 | 45 % |
| Skyview Apartments | Fort McMurray | 5,385,800 | June 2006 | 29 | 39 % |
| Snowbird Manor | Fort McMurray | 6,314,500 | June 2006 | 34 | 38 % |
| Whimbrel Terrace | Fort McMurray | 6,873,700 | June 2006 | 37 | 76 % |
| Laird's Landing | Fort McMurray | 51,350,000 | August 2006 | 189 | 57 % |
| Woodland Park | Fort McMurray | 37,865,000 | March 2007 | 107 | 63 % |
| Lakewood Manor | Fort McMurray | 59,900,000 | July 2007 | 175 | 100 % |
| Millennium Village | Fort McMurray | 24,220,000 | November 2007 | 72 | 37 % |
| Parsons Landing (3) | Fort McMurray | 60,733,000 | September 2008 | 160 | 77 % |
| Siena Apartments | Fort McMurray | 30,000,000 | July 2008 | 66 | 100 % |
| Westhaven Manor | Edson | 4,050,000 | May 2007 | 48 | 75 % |
| **Northwest Territories** | | | | | |
| Beck Court | Yellowknife | 14,300,000 | April 2004 | 120 | 100 % |
| Three Lakes Village | Yellowknife | 10,900,000 | May 2005 | 50 | 94 % |
| Nova Court (4) | Yellowknife | 15,000,000 | March 2007 | 106 | 100 % |
| **Total - Residential** | | **$ 392,928,000** | Total suites | **1,742** | |
| **COMMERCIAL** | | | | | |
| Purolator | Burlington | 1,200,000 | September 2003 | 16,117 | 100 % |
| **Total income producing properties** | | **$ 394,128,000** | | | |

**Property Portfolio - December 31, 2009**

| Property | Location | Purchase Price | Acquisition Date | Suites/ Leasable Area - Sq. Ft. | Occupancy December 31 2009 |
|---|---|---|---|---|---|
| ***PROPERTIES HELD FOR SALE*** | | | | | |
| **RESIDENTIAL** | | | | | |
| **Manitoba** | | | | | |
| Chancellor Gate | Winnipeg | $ 6,750,000 | August 2005 | 48 | 100 % |
| Colony Square | Winnipeg | 29,907,700 | October 2008 | 428 | 92 % |
| Willowdale Gardens | Brandon | 4,326,000 | January 2006 | 88 | 96 % |
| **Saskatchewan** | | | | | |
| Chateau St. Michael's (2) | Moose Jaw | 7,600,000 | June 2006 | 93 | 99 % |
| Riverside Terrace (2) | Saskatoon | 24,000,000 | July 2005 | 181 | 95 % |
| **Alberta** | | | | | |
| Nova Manor | Edmonton | 2,615,000 | May 2004 | 32 | 90 % |
| **Ontario** | | | | | |
| Elgin Lodge (2) | Port Elgin | 18,122,000 | June 2006 | 124 | 66 % |
| Clarington Seniors Residence (2) | Bowmanville | 22,400,000 | February 2007 | 118 | 57 % |
| **Total - Residential** | | **$ 115,720,700** | Total suites | **1,112** | |
| **COMMERCIAL** | | | | | |
| **Retail and Office** | | | | | |
| McIvor Mall | Winnipeg | $ 6,700,000 | February 2004 | 65,283 | 100 % |
| Colony Square | Winnipeg | 7,931,600 | October 2008 | 83,190 | 99 % |
| | | 14,631,600 | | 148,473 | |
| **Light Industrial** | | | | | |
| 156 / 204 East Lake Blvd. | Airdrie | 1,600,000 | June 2003 | 39,936 | - % |
| **Total - Commercial** | | **$ 16,231,600** | Total leasable area | **188,409** | |
| **Total discontinued operations** | | **$ 131,952,300** | | | |
| **Total real estate portfolio** | | **$ 526,080,300** | | | |

Notes to the Property Portfolio:

(1) Includes the cost of major renovations and asset additions.
(2) Seniors housing complex.
(3) LREIT took possession of Parsons Landing on September 1, 2008. LREIT is obligated to pay the balance of the purchase price by May 31, 2010. See "Property Acquisitions - Parsons Landing" above.
(4) Property includes 8,400 square feet of commercial space.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST
# MANAGEMENT'S DISCUSSION AND ANALYSIS - 2009

## SCHEDULE II

## Details of DRIP, NCIB, Unit Option Plan, Deferred Unit Plan and Limited Partnership Units

**Distribution Reinvestment Plan ("DRIP")**

The "Distribution Reinvestment Plan" provides that Unitholders may choose to have monthly cash distributions automatically reinvested in additional units, while receiving a "bonus" distribution of units equal to 4% of the reinvested amount. Participants in the DRIP may also purchase additional units on a distribution payment date. The purchase price of the units will generally be equal to the weighted average closing price of the units for the five trading days immediately preceding the relevant distribution payment date.

During the first quarter of 2009, 48,576 units were issued under the Distribution Reinvestment Plan at an average purchase price of $2.23 per unit, representing a total value of $108,517. There have not been any additional units issued under the Distribution Reinvestment Plan subsequent to the first quarter of 2009 as a result of the suspension of distributions by LREIT.

The value of the DRIP units is included in the determination of the total amount of distributions declared by LREIT.

**Normal Course Issuer Bid**

In January 2008, LREIT initiated a normal course issuer bid ("NCIB") for its trust units, under which it is entitled to purchase a limited number of the issued and outstanding units of the Trust, as specified by the TSX. The initial 12 month term of the NCIB was renewed in January 2009 for an additional 12 month term that expires on January 22, 2010.

During the period from January 1, 2009 to January 30, 2009, the Trust purchased and cancelled an additional 99,507 units at a weighted average price of $2.77, pursuant to the normal course issue bid.

Since January 2009, there have not been any additional purchases and given the cash constraints of the Trust, it is anticipated that there will not be any additional purchases under the normal course issuer bid during the fourth quarter of 2009. The Trust is not required to purchase any units under the normal course issuer bid.

**Unit Options**

Pursuant to the Unit Option Plan, the Trust may grant unit purchase options to the Trustees, Directors and Senior Officers of LREIT and to other individuals who are employed or retained by the Trust to perform specific duties.

On January 7, 2008, LREIT granted options to acquire a total of 370,000 units to 26 individuals, including 245,000 units which were granted to the four independent trustees, the Chief Executive Officer and the Chief Financial Officer of LREIT, and 125,000 units which were granted to 20 management and other senior employees of Shelter Canadian Properties who are engaged in LREIT related functions. The options which were issued to the four independent trustees vested immediately, while the remaining options vest equally on each of the grant date and the four subsequent anniversaries of the grant date. All of the options are exercisable at a price of $5.10.

As of December 31, 2009, LREIT had 1,452,000 options outstanding of which 1,156,800 or 79.7% had vested, including 196,400 options which vested during the year ended December 31, 2009. LREIT has not granted any options under the Unit Option Plan since January 2008.

In accordance with Canadian generally accepted accounting principles, the estimated fair value of the options is expensed over the vesting period of the options and the expense is recorded as "unit-based compensation". Unit-based compensation expense is included in trust expense in the Consolidated Statements of Loss and Comprehensive Loss. During the year ended December 31, 2009, unit-based compensation expense related to unit options which were not fully vested as of December 31, 2008 amounted to $104,355.

As unit-based compensation is a "non-cash" expense, it does not impact the operating cash flows of the Trust.

**Deferred Unit Plan**

On June 18, 2008, the Trust adopted a deferred unit plan, under which, any trustee, officer, employee, or consultant employee of the Trust may elect to have their annual bonus, annual board retainer or board meeting fees paid in the form of deferred units. Deferred units granted to Trustees shall vest immediately. Deferred units granted to participants other than Trustees shall vest 33% on the first anniversary of grant, 33% on the second anniversary of grant, and 34% on the third anniversary of grant. In the event of any change of control (as defined in the deferred unit plan), any unvested deferred units shall vest upon the earlier of the next applicable vesting date that is immediately prior to the date on which the change of control occurs Whenever cash distributions are paid, additional deferred units are credited to the participant based on the number of deferred units held. The deferred units credited to a participant vest immediately and are redeemable by the participant on retirement or on "termination" other than for cause. If a participant is terminated for cause, only the deferred units which have vested shall be redeemable and any unvested deferred units shall be cancelled. Additional details of the Deferred Unit Plan are disclosed in Note 15 to the 2009 annual financial statements of LREIT.

Effective July 1, 2008, the Trustees also approved a compensation package, whereby specific fees were established for the independent Trustees for serving on the Board, acting as a Committee Chair and attending meetings. During the year ended December 31, 2009, the total fees payable to independent Trustees under the compensation package amounted to $178,094.

All of the independent Trustees elected to have their compensation for the year ended December 31, 2009 paid in the form of deferred units. The number of deferred units received is determined by dividing the amount of the compensation by the market value of the trust units, as of the date on which the compensation is payable. Based on an average market value of $0.80, there were 222,182 deferred units granted to the independent Trustees during the year ended December 31, 2009.

The value of the deferred units is a unit-based compensation expense, including in "Trust expense" in the financial statements of LREIT. Unit-based compensation expense is a "non-cash" expense, which does not affect the cash flow of the Trust.

**Limited Partnership Units**

In June 2006, LREIT acquired the Village West Townhouses in Saskatoon, Saskatchewan. The acquisition of the property encompassed the issuance of 456,617 Class B Limited Partnership Units ("LPU's") of a wholly owned Limited Partnership which was established by the Trust (LREIT Village West Limited Partnership). The LPU's were issued at a value of $6 per LPU, representing total consideration of $2,739,704. The limited partnership agreement provided for the holder of the LPU's to receive cash distributions equal to the cash distributions which are paid on the trust units of LREIT.

On November 1, 2006, 100,000 of the LPU's were exchanged for LREIT trust units.

During 2009, distributions in regard to the LPU's amounted to $33,285.

As a result of the sale of the Village West Townhouses in November 2009, the Village West Limited Partnership was dissolved on December 1, 2009 and all of the outstanding LPU's (356,617 in total) were exchanged, on a one for one basis, for units of the Trust.

## MANAGEMENT'S RESPONSIBILITY

The consolidated financial statements and management's discussion and analysis contained in the annual report are the responsibility of the management of Lanesborough Real Estate Investment Trust. To fulfill this responsibility, management maintains systems of internal control which are designed to give reasonable assurance that transactions are authorized and properly recorded, assets are safeguarded and financial records are properly maintained to provide reliable financial information for the preparation of the consolidated financial and other financial reports. The consolidated financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, reflect estimates based on management's best judgment in the circumstances.

The financial statements have been reviewed and approved by the Board of Trustees and by the Audit Committee, which is comprised of independent Trustees. The Audit Committee meets regularly with management and the auditors. The auditors have full and direct access to the Audit Committee.

Meyers Norris Penny LLP, the independent chartered accountants, were appointed by the Unitholders and are engaged to audit the consolidated financial statements in accordance with generally accepted auditing standards and provide an independent auditor's opinion.

"Arni C. Thorsteinson"

Arni C. Thorsteinson
Chief Executive Officer

"Kenneth J. Dando"

Kenneth J. Dando
Chief Financial Officer

March 23, 2010

## Auditors' Report

To the Unitholders of Lanesborough Real Estate Investment Trust:

We have audited the consolidated balance sheets of Lanesborough Real Estate Investment Trust as at December 31, 2009 and 2008 and the consolidated statements of equity, income (loss) and comprehensive income (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Meyers Norris Penny LLP

Winnipeg, Manitoba

March 23, 2010

Chartered Accountants

## LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONSOLIDATED BALANCE SHEETS

| | December 31 2009 | December 31 2008 |
|---|---|---|
| **Assets** | | |
| Income properties (Note 4) | **$383,889,710** | $391,284,957 |
| Mortgage loans receivable (Note 5) | **7,050,000** | - |
| Cash | **4,287,864** | 3,549,892 |
| Other assets (Note 6) | **7,074,109** | 7,689,530 |
| Assets of properties held for sale (Note 7) | **134,842,883** | 202,983,952 |
| | **$537,144,566** | $605,508,331 |
| **Liabilities and Equity** | | |
| Mortgage loans payable (Note 8) | **$281,374,398** | $283,503,730 |
| Convertible debentures (Note 9) | **45,940,843** | 42,427,966 |
| Accounts payable and accrued liabilities (Note 10) | **60,783,383** | 58,943,715 |
| Bank indebtedness (Note 11) | **-** | 3,320,000 |
| Liabilities of properties held for sale (Note 7) | **107,506,055** | 179,883,436 |
| | **495,604,679** | 568,078,847 |
| Equity | **41,539,887** | 37,429,484 |
| | **$537,144,566** | $605,508,331 |

Approved by the Board of Trustees

*"Charles Loewen"*

*"Cheryl Barker"*

The accompanying notes are an integral part of these financial statements.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONSOLIDATED STATEMENTS OF EQUITY

### Year Ended December 31, 2009:

| | Units | Cumulative Loss | Cumulative Distributions | Equity Component of Debentures | Total |
|---|---|---|---|---|---|
| Equity, December 31, 2008 | $ 79,750,666 | $ (17,929,355) | $ (37,496,464) | $ 13,104,637 | $ 37,429,484 |
| Issue of units on exchange of LP units of Village West LP | 2,139,702 | - | - | - | 2,139,702 |
| Units purchased under normal course issuer bid | (275,757) | - | - | - | (275,757) |
| Issue costs | (6,502) | - | - | - | (6,502) |
| Unit-based compensation | 282,449 | - | - | - | 282,449 |
| Units issued on distribution reinvestment plan | 108,517 | - | - | - | 108,517 |
| Income (loss) and comprehensive income (loss) | - | 3,497,073 | - | - | 3,497,073 |
| Distributions declared | - | - | (21,139,285) | - | (21,139,285) |
| Units issued on payment of distributions | 19,504,206 | - | - | - | 19,504,206 |
| Equity, December 31, 2009 | $ 101,503,281 | $ (14,432,282) | $ (58,635,749) | $ 13,104,637 | $ 41,539,887 |

### Year Ended December 31, 2008:

| | Units | Cumulative Income (loss) | Cumulative Distributions | Equity Component of Debentures | Total |
|---|---|---|---|---|---|
| Equity, December 31, 2007 | $ 79,124,607 | $ (8,322,299) | $ (27,666,613) | $ 13,427,295 | $ 56,562,990 |
| Maturity of Series D debentures | 322,658 | - | - | (322,658) | - |
| Units purchased under normal course issuer bid | (1,778,440) | - | - | - | (1,778,440) |
| Issue costs | (111,802) | - | - | - | (111,802) |
| Unit-based compensation | 391,517 | - | - | - | 391,517 |
| Units issued on distribution reinvestment plan | 1,802,126 | - | - | - | 1,802,126 |
| Income (loss) and comprehensive income (loss) | - | (9,607,056) | - | - | (9,607,056) |
| Distributions declared | - | - | (9,829,851) | - | (9,829,851) |
| Equity, December 31, 2008 | $ 79,750,666 | $ (17,929,355) | $ (37,496,464) | $ 13,104,637 | $ 37,429,484 |

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **Revenue** | | |
| Rentals from income properties (Note 16) | **$ 41,415,408** | $ 42,235,692 |
| Interest and other income | **396,597** | 769,007 |
| | **41,812,005** | 43,004,699 |
| **Expenses** | | |
| Property operating costs | **13,382,764** | 12,343,655 |
| Income before the undernoted | **28,429,241** | 30,661,044 |
| Financing expense (Note 17) | **29,584,709** | 27,492,765 |
| Trust expense | **2,760,536** | 2,622,973 |
| Amortization (Note 18) | **8,863,921** | 7,087,506 |
| | **41,209,166** | 37,203,244 |
| Loss from continuing operations before income taxes | **(12,779,925)** | (6,542,200) |
| Future income tax expense (Note 19) | **2,698,804** | 254,392 |
| Loss from continuing operations | **(15,478,729)** | (6,796,592) |
| Income (loss) from discontinued operations (Note 7) | **18,975,802** | (2,810,464) |
| Income (loss) and comprehensive income (loss) | **$ 3,497,073** | $ (9,607,056) |
| Income (loss) per unit (Note 20) | | |
| Basic and diluted | | |
| Continuing operations | **$ (0.883)** | $ (0.388) |
| Discontinued operations | **1.082** | (0.161) |
| Total | **$ 0.199** | $ (0.549) |

The accompanying notes are an integral part of these financial statements.

## LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **Cash provided by (used in) operating activities** | | |
| Loss from continuing operations | **$ (15,478,729)** | $ (6,796,592) |
| Items not affecting cash | | |
| Accretion on debt component of convertible debentures (Note 17) | **2,853,290** | 2,469,702 |
| Unit-based compensation | **282,449** | 391,517 |
| Amortization (Note 18) | **10,063,370** | 8,108,061 |
| Change in fair value of interest rate swaps (Note 17) | **2,293,795** | 4,012,403 |
| Future income taxes (Note 19) | **2,698,804** | 254,392 |
| | **2,712,979** | 8,439,483 |
| Changes in non-cash operating items | **725,306** | 342,599 |
| | **3,438,285** | 8,782,082 |
| **Cash provided by (used in) financing activities** | | |
| Proceeds of mortgage loan financing | **5,000,000** | 87,168,619 |
| Repayment of mortgage loans on refinancing | **(2,100,000)** | (38,066,146) |
| Repayment of Series D debentures | **-** | (1,593,000) |
| Repayment of principal on mortgage loans | **(5,316,733)** | (4,485,274) |
| Expenditures on transaction costs | **(248,106)** | (1,279,019) |
| Proceeds (repayment) of line of credit | **(3,320,000)** | 280,000 |
| Proceeds of revolving loan commitment | **4,905,000** | - |
| Repayment of revolving loan commitment | **(4,905,000)** | - |
| Units purchased and cancelled under normal course issuer bid | **(275,757)** | (1,778,440) |
| Distributions paid on units (Note 21) | **(1,530,736)** | (8,104,253) |
| | **(7,791,332)** | 32,142,487 |
| **Cash provided by (used in) investing activities** | | |
| Acquisition of income properties | **-** | (30,500,000) |
| Payment of acquisition cost payable | **-** | (19,615,893) |
| Construction of income properties | **-** | (4,972,385) |
| Improvements to income properties | **(841,378)** | (2,785,820) |
| Increase in properties under development | **-** | (7,080,690) |
| Refund of deposits (deposits on potential acquisitions) | **200,000** | (1,010,000) |
| Decrease (increase) in restricted cash (Note 6) | **(2,081,142)** | (971,525) |
| | **(2,722,520)** | (66,936,313) |
| **Sub-total** | **(7,075,567)** | (26,011,744) |

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

# CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **Balance forward** | **(7,075,567)** | (26,011,744) |
| **Cash provided by (used in) discontinued operations** | | |
| Income (loss) from discontinued operations (Note 7) | **18,975,802** | (2,810,464) |
| Gain on sale | **(21,063,885)** | - |
| Items not affecting cash | | |
| Straight-line rent adjustment | **(9,684)** | (13,554) |
| Amortization | **3,503,170** | 4,861,825 |
| Future income taxes | **603,772** | 1,011,650 |
| Non-controlling interest | **599,729** | 87,860 |
| | **2,608,904** | 3,137,317 |
| Changes in non-cash operating items | **(2,762,142)** | 1,088,667 |
| Tenant inducements and leasing expenditures incurred through leasing activity | **(683,746)** | (592,552) |
| | **(836,984)** | 3,633,432 |
| Proceeds of mortgage loan financing | **4,400,000** | 45,716,669 |
| Repayment of mortgage loans on refinancing | **(4,492,566)** | - |
| Repayment of interim mortgage loans | **(17,094,997)** | - |
| Repayment of principal on mortgage loans | **(2,535,641)** | (2,286,612) |
| Expenditures on transaction costs | **(857,829)** | (61,571) |
| Distributions paid on LP units of Village West LP | **(33,285)** | (199,705) |
| Acquisition of income properties | **-** | (16,365,000) |
| Improvements to income properties | **(652,769)** | (780,166) |
| Proceeds of sale | **29,631,650** | - |
| Increase in properties under development | **(98,658)** | (1,168,068) |
| Decrease (increase) in restricted cash | **384,618** | (343,692) |
| | **7,813,539** | 28,145,287 |
| **Cash increase** | **737,972** | 2,133,543 |
| **Cash, beginning of year** | **3,549,892** | 1,416,349 |
| **Cash, end of year** | **$ 4,287,864** | $ 3,549,892 |

**Supplementary cash flow information** (Note 21)

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**DECEMBER 31, 2009 AND 2008**

### *1 Organization*

Lanesborough Real Estate Investment Trust ("the Trust") is a closed-end real estate investment trust which was created under a Declaration of Trust dated April 23, 2002 and amended on June 12, 2006, June 18, 2008 and December 9, 2009.

### *2 Basis of presentation and continuing operations*

The accompanying financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). These financial statements reflect the operations of the Trust and wholly owned operating subsidiaries and LREIT Village West Limited Partnership ("Village West LP"), an entity controlled by the Trust to December 1, 2009, when the Village West LP was dissolved. All inter-entity transactions have been eliminated.

The consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and the settlement of liabilities for the next fiscal year.

The consolidated financial statements do not give effect to adjustments that would be necessary should the Trust be required to realize its assets in other than the normal course of business. The use of GAAP applicable to a going concern may be inappropriate as a result of the potential inability of the Trust to continue as a going concern. The Trust sustained losses from continuing operations of $15,478,729 and $6,796,592 for the years ended December 31, 2009 and 2008, respectively; has a working capital deficit of $10,468,086 and $2,141,026 for the years ended December 31, 2009 and 2008, respectively; has been in breach of debt service coverage requirements during 2009 and was in breach of debt service covenants as of December 31, 2009.

The Trust is in breach of the 1.4 times debt service coverage requirement of 2 first mortgage loans totaling $46,293,787 on properties located in Fort McMurray, Alberta.

The breaches of the debt service covenant requirements are a result of the negative impact of the slow down of development activities in the oil sands industry and the associated decline in the rental market conditions in Fort McMurray. Given that the rental market conditions may not improve substantially in the near future, the breach in the debt service covenant requirements may continue for the next 12 months.

The Trust has received notice from the lender that the breach must be cured. The Trust has continued to attempt a modification and waiver of the debt service covenants.

The Trust is in breach of the 1.2 times debt service coverage requirement of a first and second mortgage loan totaling $72,766,738 on three properties located in Fort McMurray, Alberta.

The breaches of the debt service covenant requirements are also a result of the negative impact of the slow down of development activities in the oil sands industry and the associated decline in the rental market conditions in Fort McMurray. Given that the rental market conditions may not improve substantially in the near future, the breach in the debt service covenant requirements may continue for the next 12 months.

The Trust has received a letter of forbearance from the lender in regards to the breach to April 20, 2010.

***2 Basis of presentation and continuing operations (continued)***

The Trust is in breach of the 1.3 times debt service coverage requirement of a $5,101,221 first mortgage loan on a property located in Moose Jaw, Saskatchewan. The Moose Jaw property has been classified as discontinued operations.

It is the intention of the Trust to sell this property within the next twelve months, and use the proceeds from sale to repay the outstanding first mortgage loan balance. In addition, the Trust will be requesting a forbearance letter from the lender.

There are no cross-default covenants between the five mortgages noted above and the other mortgage loans of the Trust.

The breaches of the debt service covenant requirements have not resulted in an acceleration of the repayment of the mortgage loans. There is no assurance, however, that the lenders will not accelerate repayment of the mortgage loans.

The cross-default clauses of the Series E and F secured convertible debentures provide that the convertible debentures may become payable, on demand, if, at a future date, the repayment of a mortgage loan is accelerated by a lender. Subsequent to December 31, 2009, the Series E debentures in the amount of $11,950,000 were paid in full. The Series F convertible debentures, with a face value of $13,680,000, may become payable on demand. If the convertible debentures become payable on demand, in accordance with GAAP, the carrying value of the liability component of the convertible debentures would be increased to the face value of the convertible debentures of $13,680,000. The amount of the increase in the face value of the convertible debentures would be recorded as financing expense in the period that the debentures become payable on demand.

Management believes the going concern assumption to be appropriate for the financial statements as the Trust has been able to refinance its lending facilities at appropriate rates and has implemented a divestiture strategy. The increased vacancy rates and reduced rental rates experienced in a portion of the Fort McMurray property portfolio in 2009, however, have created uncertainty as to the Trust's ability to secure the necessary financing required to maintain the existing mortgage debt on these properties.

If the going concern assumption is inappropriate, adjustments would be necessary to the carrying values of assets and liabilities and reported revenues and expenses used in these consolidated financial statements.

## *3 Significant accounting policies*

**Change in accounting policy**
In February 2008, the CICA issued a new Handbook Section 3064, "Goodwill and Intangible Assets". This new section replaces Section 3062, "Goodwill and Intangible Assets", and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Handbook Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard.

On January 20, 2009, the CICA issued Emerging Issues Committee ("EIC") abstract EIC-173-Credit Risks and the Fair Value of Financial Assets and Financial Liabilities. This abstract provides guidance on CICA Handbook Section 3855 Financial Instruments - Recognition and Measurement and requires an entity to consider its own credit risk as well as the credit risk of the counter party when determining the fair value of financial assets and liabilities, including derivative instruments.

CICA Handbook Section 3862 - Financial Instruments - Disclosures has been amended to include additional disclosure requirements about fair value measures and to enhance liquidity risk disclosure requirements for publicly accountable enterprises.

The Trust adopted these standards effective January 1, 2009. The adoption of these standards did not have an impact on the Consolidated Financial Statements.

**Use of estimates**
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates and as adjustments become necessary, the adjustments are reported in earnings in the year in which the adjustments become known.

Significant items subject to estimates include the allocation of the total cost to income properties on acquisition, the transfer of amounts from properties under development to income properties, the remaining useful life of the income properties, undiscounted cash flows to be generated from income properties, the classification of properties held for sale, the calculation of future income tax assets and liabilities and the completion of the Parsons Landing acquisition.

**Income properties**
Income properties include land, buildings and related costs and improvements, furniture, equipment and appliances, tenant inducements and leasing expenses and intangible assets.

Income properties are carried at cost. Tenant inducements and leasing expenses that are incurred to obtain a lease are capitalized to the cost of buildings and improvements.

A portion of the total cost of acquisition of an income property is allocated to reflect the tenant origination costs (tenant inducements and leasing expenses) associated with in-place leases. A portion of the total cost of acquisition of an income property is also allocated to intangible assets to reflect the cost of lease origination costs, tenant relationships and above market leases.

## 3 *Significant accounting policies (continued)*

***Income properties (continued)***

If events or circumstances indicate that the carrying value of the income properties may be impaired, a recoverability analysis is performed based upon estimated undiscounted cash flows to be generated from the income properties. If the analysis indicated that the carrying value is not recoverable from future cash flows, the income properties are written down to estimated fair value and an impairment loss is recognized.

Amortization on buildings is recorded on a straight-line basis over their useful lives ranging from 25 to 50 years. Amortization of improvements is recorded on a straight-line basis over their remaining useful lives ranging from 5 to 25 years. Amortization of tenant inducements and leasing expenses is recorded on a straight-line basis over the term of the respective leases. Amortization of furniture, equipment and appliances is recorded on a straight-line basis over their remaining useful lives ranging from 5 to 15 years. Amortization of intangible assets is recorded on a straight-line basis over the term of respective leases.

**Properties under development**

Properties under development are carried at cost. Cost is comprised of acquisition costs, external and internal development and initial leasing costs, property operating costs and financing expenses less rental revenue incurred during the period of development prior to achieving a satisfactory level of occupancy within a predetermined time period.

**Discontinued operations**

Assets and liabilities held for sale include the assets and liabilities of a property when the property is available for immediate sale; management has committed to a plan to sell the property and is actively locating a buyer at a sales price that is reasonable in relation to current fair value; and the sale is probable and expected to be completed within a one-year period. Properties held for sale are carried at the lower of cost and net realizable value, less selling costs. Amortization is not recorded on these properties once classified as held for sale. The results of operations associated with properties disposed of, or classified as held for sale, are reported separately as income from discontinued operations. The operations and cash flows of the property can be clearly distinguished, operationally and for financial purposes, and have been reported in discontinued operations.

**Convertible debentures**

Convertible debentures are separated into debt and equity components based on the respective fair values at the date of issue. The value of the equity component is calculated at the estimated fair value of the holders' options to convert the debentures into units. The value assigned to the debt component of convertible debentures represents the value of future interest and principal payments due under the terms of the debentures.

**Unit options**

The Trust has a unit option plan available for trustees, officers and employees of the Trust, as well as management company employees of the Trust, including Shelter Canadian Properties Limited and consultants retained by the Trust including investor relations consultants. Consideration paid by option holders on exercise of unit options is credited to Equity. The fair value based method of accounting is applied to all unit-based compensation. The fair value of the unit options granted is estimated on the date of grant using the Black-Scholes option pricing model. Compensation expense in regard to options granted to officers, employees and trustees is recognized over the vesting period of the options.

## *3 Significant accounting policies (continued)*

**Revenue recognition**
Rents are recognized as revenue over the terms of the related lease agreements. Rental revenue from leases with contractual rent increases is recognized on a straight-line basis over the term of the respective leases. The difference between the rental revenue recognized and the amount contractually due under the lease agreements is recorded to straight-line rent receivable and accrued rental revenue. Recoveries from tenants for property operating costs and property taxes are recognized as revenue during the year in which the applicable costs are incurred. Meal and other revenue is recognized as earned.

**Income taxes**
In accordance with the terms of the Declaration of the Trust, the Trust intends to distribute its income for income tax purposes each year to such an extent that it will not be liable for income taxes under Part 1 of the Income Tax Act.

In June 2007, new legislation relating to, among other things, the federal income taxation of publicly traded income trusts was enacted. Under the new rules, certain distributions from a "specified investment flow-through" trust (a "SIFT") will no longer be deductible in computing a SIFT's taxable income, and a SIFT will be subject to tax on such distributions at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. Distributions paid as returns of capital will not be subjected to this tax.

The new rules do not apply to a "real estate investment trust" that meets prescribed conditions relating to the nature of its income and investments (a "Qualifying REIT"). In the opinion of management, the Trust does not currently satisfy the prescribed conditions. The new legislation does not apply to the Trust until 2011 as it provides for a transition period for publicly traded entities that existed prior to November 1, 2006. Prior to 2011, the Trust will consider its alternatives, including restructuring its affairs in order to meet the prescribed conditions and become a Qualifying REIT.

As the Trust does not currently meet the criteria for a Qualifying REIT, GAAP requires that the future income tax asset and liability calculation and estimates reflect its current income tax status, notwithstanding the intent of the Trust to become a Qualifying REIT prior to 2011 to the extent possible.

In accordance with GAAP, the Trust is required to: (i) determine its temporary differences between asset balances for income tax purposes and the balances recorded in accordance with GAAP; (ii) determine the periods over which those temporary differences are expected to reverse; and (iii) apply the tax rates enacted at the balance sheet date that will apply in the periods those temporary differences are expected to reverse. The Trust is required to use reasonable estimates in completing the calculation and the result of the calculation is recorded as a future income tax asset, if the asset is more likely than not to be realized, or liability.

Wholly-owned operating subsidiaries of the Trust are operating businesses and provide for income tax expense using the asset and liability method of accounting for income taxes at enacted or substantively enacted rates. Current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between tax and accounting bases of assets and liabilities, as well as the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized.

### *3 Significant accounting policies (continued)*

**Comprehensive income**
The Trust does not have any other comprehensive income or accumulated other comprehensive income.

**Per unit calculations**
Basic per unit amounts are calculated using the weighted average number of units outstanding during the year, including vested deferred units. Diluted per unit amounts are calculated after considering the potential exercise of convertible debentures, unvested deferred units, and outstanding unit options. The dilutive effect on per unit amounts resulting from outstanding unit options is calculated using the treasury stock method. Under this method, the diluted weighted average number of units is calculated assuming the proceeds that arise from the exercise of the outstanding options are used to purchase units of the Trust at their average market price for the period.

**Financial instruments**
All financial instruments are measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other liabilities.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with gains and losses recognized in net earnings. Financial assets classified as held-to-maturity, loans and receivables and other financial liabilities (other than those held-for-trading) are measured at amortized cost using the effective interest rate method of amortization. Available-for-sale financial assets are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Net gains and losses arising from changes in fair value of loans and receivables, held-to-maturity investments, and other liabilities are recognized in net income upon derecognition or impairment.

Derivative instruments are recorded on the balance sheet at fair value including those derivatives that are embedded in a financial instrument or other contract but are not closely related to the host financial instrument or contract, respectively. Changes in the fair values of derivative instruments are recognized in net earnings, except for derivatives that are designated as cash flow hedges, in which case the fair value change for the effective portion of such hedging relationships are recognized in other comprehensive income.

The Trust has designated its financial instruments, as follows:

| Financial Statement Item | Classification | Measurement |
|---|---|---|
| Cash | Held for trading | Fair value |
| Mortgage loans receivable | Loans and receivables | Amortized cost |
| Other assets | | |
| Amounts receivable | Loans and receivables | Amortized cost |
| Restricted cash | Held for trading | Fair value |
| Mortgage loans payable | Other financial liabilities | Amortized cost |
| Accounts payable and accrued liabilities | | |
| Interest rate swaps | Held for trading | Fair value |
| Other accounts payable and accrued liabilities | Other financial liabilities | Amortized cost |
| Convertible debentures - debt component | Other financial liabilities | Amortized cost |
| Bank indebtedness | Held for trading | Fair value |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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## *3 Significant accounting policies (continued)*

**Financial instruments (continued)**
Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. Transaction costs include fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs. Transaction costs are expensed as incurred for financial instruments classified or designated as held for trading. For other financial instruments, transaction costs are capitalized in the cost of the related asset or liability on initial recognition and are measured at amortized cost using the effective interest rate method.

The Trust assesses impairment of all financial assets, except those classified as held for trading. Management considers whether there has been a breach in contract, such as default of interest or principal payments in determining whether objective evidence of impairment exists. Impairment is measured as the difference between the asset's carrying value and its fair value. Impairment is included in current earnings.

**Future change to significant accounting policies**

CICA Handbook Section 1582 - Business Combinations will apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. CICA Handbook Sections 1601 - Consolidations and 1602 - Non-Controlling Interests will be effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption of these sections is permitted as of the beginning of a fiscal year. All three sections must be adopted concurrently. These sections replace the former CICA Handbook Sections 1581 - Business Combinations and 1600 - Consolidated Financial Statements. CICA Handbook Section 1601 establishes standards for the preparation of consolidated financial statements. CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination.

## *4 Income properties*

| December 31, 2009 | Cost | Accumulated Amortization | Net Book Value |
|---|---|---|---|
| Land | $ 65,674,473 | $ - | $ 65,674,473 |
| Buildings and improvements | 331,062,222 | (19,962,650) | 311,099,572 |
| Furniture, equipment and appliances | 10,132,060 | (3,062,682) | 7,069,378 |
| Intangible assets | 207,222 | (160,935) | 46,287 |
| | $407,075,977 | $ (23,186,267) | $383,889,710 |

| December 31, 2008 | Cost | Accumulated Amortization | Net Book Value |
|---|---|---|---|
| Land | $ 65,674,473 | $ - | $ 65,674,473 |
| Buildings and improvements | 329,658,846 | (12,413,860) | 317,244,986 |
| Furniture, equipment and appliances | 10,066,762 | (1,768,123) | 8,298,639 |
| Intangible assets | 207,222 | (140,363) | 66,859 |
| | $405,607,303 | $ (14,322,346) | $391,284,957 |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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### *4 Income properties (continued)*

The tenant at Lakewood Manor has the option to purchase the townhouse portion of the property for $27,667,200 until June 30, 2010. The net book value of the townhouse portion of Lakewood Manor at December 31, 2009 is $24,851,105.

At December 31, 2009 and 2008, the carrying value of the income properties was not impaired.

### *5 Mortgage loans receivable*

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Second mortgage loan receivable from Gill Apartments Ltd., due October 1, 2014. The loan bears interest at 5% and provides for monthly payments of interest only. | $ 500,000 | $ - |
| Second mortgage loan receivable from Mainstreet Equity Corp., due June 1, 2011. The loan bears interest at 3% until June 1, 2010 and 6% thereafter and provides for monthly payments of interest only. | 6,550,000 | - |
| | $ 7,050,000 | $ - |

### *6 Other assets*

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Restricted cash | | |
| Tenant security deposits | $ 1,800,264 | $ 2,480,611 |
| Reserves required by mortgage loan agreements | 1,386,848 | 623,889 |
| Sale proceeds in escrow | 2,041,795 | - |
| Normal course issue payments in escrow | - | 43,265 |
| | 5,228,907 | 3,147,765 |
| Amounts receivable | 552,717 | 566,927 |
| Prepaid expenses, deposits and other | 1,282,485 | 1,066,034 |
| Deposits on potential acquisitions | 10,000 | 210,000 |
| Future income taxes (Note 18) | - | 2,698,804 |
| | $ 7,074,109 | $ 7,689,530 |

Amounts receivable includes rent receivable of $408,122 (2008 - $477,203) net of an allowance for doubtful accounts of $92,205 (2008 - $70,118).

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

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### *7 Discontinued operations*

The Trust is pursuing a divestiture program. In this regard, the Trust has designated 10 properties as held for sale and, for the year ended December 31, 2009, has sold 13 properties.

Assets and liabilities held for sale reflect the assets and liabilities of the 10 income properties held for sale at December 31, 2009. Assets and liabilities held for sale at December 31, 2008 reflect the assets and liabilities of the 10 income properties held for sale plus the assets and liabilities of the 13 properties which were sold. Discontinued operations reflect the revenue and expense and cash flow of the 10 properties held for sale and the 13 income properties sold during the year ended December 31, 2009, including the gain on sale for the 13 properties which were sold.

In addition, the Trust is contractually obligated to use proceeds of sale from the 23 income properties held as discontinued operations to retire $15.9 Million of interim loans payable (2008 - $35.4 Million). In accordance with Canadian generally accepted accounting principles, such debt and the interest expense associated with such debt is reflected in discontinued operations.

During the year ended December 31, 2009, the Trust sold 13 properties for gross proceeds of $90,392,000 resulting in a gain on sale of $21,063,885 and net cash proceeds of $29,631,650 after sales expenses, mortgage debt retirement and, in some circumstances, the provision of financing to the purchaser. Net cash proceeds were used to retire $17,094,997 of interim debt and to improve the working capital of the Trust. The properties sold include commercial and residential properties and for segmented reporting purposes were located in the "other" geographic category.

The following table discloses the balance sheets and statements of income (loss) for discontinued operations.

| | December 31 2009 | December 31 2008 |
|---|---|---|
| **Balance sheets** | | |
| **Assets** | | |
| Income properties (a) | $ 132,569,624 | $ 162,805,329 |
| Properties under development | - | 35,957,774 |
| All other assets | 2,273,259 | 4,220,849 |
| | 134,842,883 | 202,983,952 |
| **Liabilities** | | |
| Mortgage loans payable (b) | 84,707,141 | 135,517,277 |
| Interim loans payable | 15,763,338 | 34,906,154 |
| Accounts payable and accrued liabilities | 3,863,028 | 4,368,550 |
| Future income taxes (f) | 3,172,548 | 3,518,197 |
| Non-controlling interest (c) | - | 1,573,258 |
| | 107,506,055 | 179,883,436 |
| | $ 27,336,828 | $ 23,100,516 |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**DECEMBER 31, 2009 AND 2008**

***7 Discontinued operations (continued)***

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **Statements of income (loss)** | | |
| **Revenue** | | |
| Rentals from income properties | $ 28,984,786 | $ 23,611,579 |
| Interest and other income | 132,861 | 186,016 |
| | 29,117,647 | 23,797,595 |
| **Expenses** | | |
| Property operating costs | 16,192,045 | 12,388,494 |
| Financing expense (d) | 11,215,037 | 8,799,013 |
| Amortization (e) | 2,595,147 | 4,321,042 |
| Income tax expense - current and future (f) | 603,772 | 1,011,650 |
| | (1,488,354) | (2,722,604) |
| Non-controlling interest | (599,729) | (87,860) |
| | (2,088,083) | (2,810,464) |
| **Gain on sale** | 21,063,885 | - |
| **Income (loss) from discontinued operations** | $ 18,975,802 | $ (2,810,464) |

(a) At December 31, 2009 and 2008, the carrying value of discontinued properties is not impaired.

(b) Mortgage loans payable

| | December 31 2009 | 2008 |
|---|---|---|
| Mortgage loan balances | $ 84,789,406 | $135,823,146 |
| Unamortized transaction costs | (140,085) | (416,667) |
| Difference between contract and market interest rates on mortgage loans assumed (e) | 57,820 | 110,798 |
| | $ 84,707,141 | $135,517,277 |

In accordance with GAAP, a mortgage is to be recorded at fair market value on the acquisition of a property and the difference between contractual and market interest rates is capitalized and amortized over the term of the respective mortgage.

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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***7 Discontinued operations (continued)***

(c) Non-controlling interest represents the interest of the holder of the Class B units (LP Units) of Village West LP, an entity controlled by the Trust, which is consolidated in the financial statements. The Limited Partnership Agreement of Village West LP provides that Village West LP will be dissolved upon sale of its property. As a result, the Class B limited partnership units of Village West LP were exchanged, on a one for one basis for units of the Trust, resulting in the issue of 356,617 units of the Trust, and Village West LP was dissolved, in December 2009.

The change in non-controlling interest is summarized as follows:

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Balance, beginning of year | $ 1,573,258 | $ 1,685,103 |
| Share of income of Village West Townhouses | 599,729 | 87,860 |
| Distributions on LP Units of Village West LP | (33,285) | (199,705) |
| Exchange of LP Units of Village West LP for Trust Units | (2,139,702) | - |
| Balance, end of year | $ - | $ 1,573,258 |

(d) **Financing expense**

| | Year Ended December 31 2009 | Year Ended December 31 2008 |
|---|---|---|
| Mortgage loan interest | $ 10,256,824 | $ 8,069,742 |
| Amortization of transaction costs | 958,213 | 729,271 |
| | $ 11,215,037 | $ 8,799,013 |

(e) **Amortization**

| | Year Ended December 31 2009 | Year Ended December 31 2008 |
|---|---|---|
| Building | $ 2,082,090 | $ 3,357,925 |
| Furniture, equipment and appliances | 157,968 | 288,324 |
| Intangible assets, except for in-place leases | 355,089 | 674,793 |
| | 2,595,147 | 4,321,042 |
| Transaction costs (d) | 958,213 | 729,271 |
| Above market in-place leases | 3,129 | 10,171 |
| Below market in-place leases | (341) | (8,397) |
| Difference between contract and market interest rates on mortgage loans assumed (b) | (52,978) | (190,262) |
| | $ 3,503,170 | $ 4,861,825 |

***7 Discontinued operations (continued)***

(f) **Future income taxes**

Future income taxes consists of the following components:

| | December 31 2009 | December 31 2008 |
|---|---|---|
| **Future income tax asset relating to the assets of Trust:** | | |
| Future income tax asset relating to the temporary difference between the accounting and tax basis held in the Trust expected to reverse after 2010 for: | | |
| Income properties | $ 730,674 | $ 760,152 |
| Transaction costs | 105,924 | (29,525) |
| | 836,598 | 730,627 |
| Valuation allowance | (836,598) | - |
| | $ - | $ 730,627 |
| **Future income tax liability relating to the wholly owned subsidiaries:** | | |
| Future income tax asset (liability) relating to the temporary differences between the accounting and tax basis of income properties held in wholly owned subsidiaries | $ (2,773,834) | $ (3,518,197) |
| Future income tax asset relating to operating losses of wholly owned subsidiaries | 2,273,348 | 1,569,604 |
| | (500,486) | (1,948,593) |
| Valuation allowance | (2,672,062) | (1,569,604) |
| | $ (3,172,548) | $ (3,518,197) |

In recognition of the uncertainty with respect to the realization of the income tax assets, a full valuation allowance was recorded to reduce the future income tax assets to nil at December 31, 2009.

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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***7 Discontinued operations (continued)***

***(f) Future income taxes (continued)***

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| **Future income tax expense (recovery):** | | |
| Trust | | |
| Decrease (increase) in future income tax asset resulting from a change in temporary differences relating to: | | |
| Income properties | $ 29,478 | $ 50,632 |
| Transaction costs | (135,449) | (13,547) |
| Valuation allowance | 836,598 | - |
| | 730,627 | 37,085 |
| Decrease (increase) in future income tax asset resulting from a change in tax rate for: | | |
| Income properties | - | 44,601 |
| Transaction costs | - | (1,748) |
| | - | 42,853 |
| | 730,627 | 79,938 |
| Wholly owned subsidiaries | | |
| Increase (decrease) in future income tax liability resulting from a change in temporary differences relating to income properties | (676,981) | 73,769 |
| Increase (decrease) in future income tax liability resulting from changes in tax rates | (18,202) | (37,965) |
| Increase in future income tax asset resulting from operating losses | (752,924) | (705,116) |
| Valuation | 1,102,488 | 1,569,604 |
| | (345,619) | 900,292 |
| Current income taxes at statutory tax rates | 218,764 | 31,420 |
| | (126,855) | 931,712 |
| | $ 603,772 | $ 1,011,650 |

The wholly owned subsidiaries have the following operating losses available to reduce income for tax purposes in future years. The potential benefit of these losses has not been reflected in the consolidated financial statements.

Operating losses carried forward expiring in:

| | |
|---|---|
| 2026 | $ 113,256 |
| 2027 | 2,354,010 |
| 2028 | 2,437,741 |
| 2029 | 2,431,870 |
| | $ 7,336,877 |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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### *8 Mortgage loans payable*

| | Interest Rates at December 31, 2009 | | | |
|---|---|---|---|---|
| | Range | Weighted Average Interest Rate | Weighted Average Term to Maturity | December 31 2009 |
| Income properties | | | | |
| Fixed rate mortgages | 4.8% - 12.0% | 5.8% | 4.1 years | $209,785,513 |
| Floating rate mortgages | 5.8% - 6.0% | 5.9% | Demand | 72,766,738 |
| | | | | 282,552,251 |
| Unamortized transaction costs | | | | (1,177,853) |
| | | | | $281,374,398 |

The Trust has entered into interest rate swap arrangements whereby the interest rate on the floating rate mortgages in the amounts of $20,171,559 and $22,147,455, have fixed rates of 5.74% and 5.82% and mature in 2013 and 2018, respectively.

| | Interest Rates at December 31, 2008 | | | |
|---|---|---|---|---|
| | Range | Weighted Average Interest Rate | Weighted Average Term to Maturity | December 31 2008 |
| Income properties | | | | |
| Fixed rate mortgages | 4.5% - 7.3% | 5.8% | 5.2 years | $210,368,987 |
| Floating rate mortgages | 4.5% - 6.3% | 4.6% | Demand | 74,600,000 |
| | | | | 284,968,987 |
| Unamortized transaction costs | | | | (1,465,257) |
| | | | | $283,503,730 |

### 8 *Mortgage loans payable (continued)*

Approximate principal repayments are as follows:

| | |
|---|---|
| Year ending December 31 | |
| 2010 | $150,425,443 |
| 2011 | 8,490,771 |
| 2012 | 34,341,150 |
| 2013 | 39,654,242 |
| 2014 | 32,864,141 |
| Thereafter | 16,776,504 |
| | $282,552,251 |

Certain of the mortgage loans payable are subject to covenants, including minimum debt service coverage requirements. The Trust is not in compliance with four first mortgage loans and one second mortgage loan totaling $124,161,746, as a result of a breach of the debt service coverage requirements in respect of such mortgage loans. In accordance with GAAP, the balance of the mortgage loans, which are in breach of debt service coverage requirements, is included in principal repayments in 2010.

Mortgage loans are secured by mortgage charges registered against specific income properties and are secured by assignment of book debts, by assignments of rents and repayment guarantees.

All mortgages which have matured subsequent to December 31, 2009 have been renewed.

### 9 *Convertible debentures*

The face value of the outstanding convertible debentures is as follows:

| | December 31 | |
|---|---|---|
| | 2009 | 2008 |
| Series E | $ 11,950,000 | $ 11,950,000 |
| Series F | 13,680,000 | 13,680,000 |
| Series G | 25,732,000 | 25,732,000 |
| | $ 51,362,000 | $ 51,362,000 |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**DECEMBER 31, 2009 AND 2008**

### *9 Convertible debentures (continued)*

During the years ended December 31, 2009 and 2008, there have not been any conversions of convertible debentures.

The allocation of the convertible debentures to debt and equity components is based on the net present value of future interest and principal payments with an estimated cost of borrowing without conversion option of 15% for Series E, Series F and Series G debentures.

| December 31, 2009 | Debt | Equity | Total |
|---|---|---|---|
| Convertible debentures | | | |
| Series E - 8%, due February 17, 2010 | $ 11,814,795 | $ 2,835,690 | $ 14,650,485 |
| Series F - 7.5%, due March 11, 2011 | 12,587,225 | 3,564,376 | 16,151,601 |
| Series G - 7.5%, due December 31, 2011 | 22,541,667 | 6,704,571 | 29,246,238 |
| | 46,943,687 | 13,104,637 | 60,048,324 |
| Unamortized transaction costs | (1,002,844) | - | (1,002,844) |
| | $ 45,940,843 | $ 13,104,637 | $ 59,045,480 |

| December 31, 2008 | Debt | Equity | Total |
|---|---|---|---|
| Convertible debentures | | | |
| Series E - 8%, due February 17, 2010 | $ 11,081,742 | $ 2,835,690 | $ 13,917,432 |
| Series F - 7.5%, due March 11, 2011 | 11,791,848 | 3,564,376 | 15,356,224 |
| Series G - 7.5%, due December 31, 2011 | 21,216,807 | 6,704,571 | 27,921,378 |
| | 44,090,397 | 13,104,637 | 57,195,034 |
| Unamortized transaction costs | (1,662,431) | - | (1,662,431) |
| | $ 42,427,966 | $ 13,104,637 | $ 55,532,603 |

The Accretion of the debt component for the year ended December 31, 2009 of $2,853,290 (2008 - $2,469,702), which increases the debt component from the initial carrying amount, is included in financing expense.

The Series E and F debentures provide that for the outstanding amount of the debentures may become payable on demand upon default and acceleration, under certain terms and conditions, of a mortgage loan or a convertible debenture. Subsequent to December 31, 2009, the Series E debentures in the amount of $11,950,000 were paid in full. The Trust is not in compliance with four first mortgage loans and one second mortgage loan totaling $124,161,746, as a result of a breach of the debt service coverage requirements in respect of such mortgage loans. If, at a future date, the lenders demand the repayment of any of the loans, the Series F convertible debentures, with a face value of $13,680,000, may become payable on demand.

The Series E and F convertible debentures of the Trust are secured by a security interest on all the property and assets of the Trust. The security interest ranks senior to the trust units and subordinate to mortgage loans payable and related collateral security.

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### *10 Accounts payable and accrued liabilities*

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Accounts payable and accrued liabilities | $ 1,727,737 | $ 2,108,857 |
| Payable on acquisition of Parsons Landing | 47,720,000 | 48,220,000 |
| Construction costs payable | 1,134,621 | 254,432 |
| Mortgage and debenture interest payable | 1,788,794 | 1,850,590 |
| Mortgage guarantee fees payable | 290,667 | - |
| Tenant security deposits | 1,815,366 | 2,497,433 |
| Interest rate swaps | 6,306,198 | 4,012,403 |
| | $ 60,783,383 | $ 58,943,715 |

The amount payable on the acquisition of Parsons Landing includes the acquisition cost payable in the amount of $45,233,000 which is expected to be paid May 31, 2010.

**Interest rate swaps**
The Trust entered into interest rate swap arrangements whereby the interest rate on the floating rate mortgages have been fixed for the five and ten year terms of the mortgages. The interest rate swaps are derivative financial instruments classified as held-for-trading and are recorded on the balance sheet at fair value. The change in the fair value for the year ended December 31, 2009 was $2,293,795 (2008 - $4,012,403) and is included in financing expense.

### *11 Bank indebtedness*

Bank indebtedness consists of a revolving line of credit that the Trust obtained from a Canadian chartered bank in 2007 in the maximum amount of $5,000,000, bearing interest at Prime plus 3.5% (2008 - prime) and repayable on demand. The line of credit is secured by a second mortgage on an income property. The amount available on the line of credit is reduced by $125,000 relating to the issue of a letter of credit. As at December 31, 2009, $4,875,000 was available to the Trust (2008 - $1,555,000).

### *12 Related party transactions*

Related party transactions have occurred in the normal course of operations and are measured at the exchange amount which is the amount established and agreed by the related parties. Shelter Canadian Properties Limited is a related party by virtue of the property management agreement and services agreement with the Trust and, in addition, 2668921 Manitoba Ltd., the parent company to Shelter Canadian Properties Limited is a related party as 2668921 Manitoba Ltd. is owned by the family trust of an officer and Trustee of the Trust.

### *12 Related party transactions (continued)*

**Management agreement**
The property management agreement with Shelter Canadian Properties has a five year term expiring on August 30, 2012. Under the property management agreement, Shelter Canadian Properties Limited administers the day-to-day operations of the Trust's portfolio of income properties, except for the seniors housing complexes. The Trust pays property management fees equal to 4% of gross receipts from the income properties owned by the Trust. In regard to commercial properties, Shelter Canadian Properties Limited is also entitled to leasing commissions on new leases of 3% to 5% of base rental payments and leasing commissions on renewal of 1 1/2% to 2 1/2% of base rental payments. Shelter Canadian Properties Limited is also entitled to tenant improvement and renovation fees equal to 5% of the total cost of such work. Property management fees are included in property operating costs; leasing fees are capitalized to income properties; and during the period of major in-suite renovations or development are capitalized to the cost of buildings and properties under development.

The Trust incurred property management fees payable to Shelter Canadian Properties Limited of $1,626,160 for the year ended December 31, 2009 (2008 - $1,809,305). Property Management fees are included in property operating costs.

The Trust incurred property management fees on discontinued operations payable to Shelter Canadian Properties Limited of $730,389 for the year ended December 31, 2009 (2008 - $646,953). Property Management fees are included in property operating costs of discontinued operations and during the period of major in-suite renovations or development are capitalized to the cost of assets of properties held for sale.

The Trust incurred leasing commissions on commercial income properties included in discontinued operations to Shelter Canadian Properties Limited of $113,453 for the year ended December 31, 2009 (2008 - $40,938). The amounts are capitalized to cost of assets held for sale and, for properties which have been sold, are reflected in the gain on sale.

Included in accounts payable and accrued liabilities at December 31, 2009 is a balance of $17,713 (2008 - $31,839), payable to Shelter Canadian Properties Limited in regard to outstanding property management fees.

Included in accounts payable and accrued liabilities of discontinued operations at December 31, 2009 is a recoverable balance of $16,157 (2008 - payable balance of $20,038), to Shelter Canadian Properties Limited in regard to property management fees.

**Services agreement**
The Trust has renewed the services agreement with Shelter Canadian Properties Limited, with the same terms and conditions, for a term expiring December 31, 2010. Under the services agreement, Shelter Canadian Properties Limited provides the Trust management and support services for the administration of the day-to-day activities of the Trust. The Trust pays service fees equal to 0.3% of the gross book value of the assets of the Trust, excluding cash.

The Trust incurred service fees of $1,961,963 for the year ended December 31, 2009 (2008 - $1,661,308). Service fees are included in trust expense.

## *12 Related party transactions (continued)*

**Financing**

On June 30, 2009, the Trust obtained a second mortgage loan in the amount of $500,000 from 2668921 Manitoba Ltd. The loan bears interest at 7.5%, is due on June 1, 2010 and is secured by a second mortgage charge on an income property. The loan is included in mortgage loans payable at December 31, 2009. A processing fee of $15,000 was paid to 2668921 Manitoba Ltd. in regard to the loan and is included in transaction costs. Interest of the second mortgage loan for the year ended December 31, 2009 of $24,657 (2008 - nil) is included in financing expense.

On June 30, 2009, the Trust obtained a $2.7 Million revolving loan commitment from 2668921 Manitoba Ltd. for general operating purposes. The loan commitment was increased to $5 Million on September 2, 2009. The loan bears interest at 7.5%, is due on June 30, 2010 and is unsecured.

During the year, advances and repayments under the revolving loan commitment totaled $4,905,000 and $4,905,000 respectively, (2008 - nil and nil respectively). Interest on the loan commitment for the year ended December 31, 2009 of $93,406 (2008 - nil) is included in financing expense.

The second mortgage loan and the revolving loan were approved by the independent Trustees of the Trust.

**Guarantees**

Certain of the mortgage loans payable have been guaranteed by Shelter Canadian Properties Limited. There were not any fees charged to the Trust in regard to the guarantees.

## *13 Units*

| | Year Ended December 31, 2009 | | Year Ended December 31, 2008 | |
|---|---|---|---|---|
| | Units | Amount | Units | Amount |
| Outstanding, beginning of year | 17,588,081 | $ 79,750,666 | 17,529,894 | $ 79,124,607 |
| Maturity of Series D debentures | - | - | - | 322,658 |
| Issued on distribution reinvestment plan | 48,576 | 108,517 | 514,387 | 1,802,126 |
| Issue costs | - | (6,502) | - | (111,802) |
| Purchased and cancelled under normal course issuer bid | (99,507) | (275,757) | (456,200) | (1,778,440) |
| Unit-based compensation | - | 282,449 | - | 391,517 |
| Exchange of Village West Class B LP units | 356,617 | 2,139,702 | - | - |
| Units issued on payment of distributions | - | 19,504,206 | - | - |
| Outstanding, end of year | 17,893,767 | $101,503,281 | 17,588,081 | $ 79,750,666 |

## *13 Units (continued)*

**Distribution Reinvestment Plan**
Pursuant to the distribution reinvestment plan ("DRIP"), holders of units may elect to have all or a portion of their distributions automatically reinvested in additional units. Participants in the DRIP receive a bonus distribution of units equal to 4% of the amount of the cash distribution which is reinvested. The purchase price of the units is equal to the weighted average closing price of the Units for the five trading days immediately preceding the distribution payment date. During the year ended December 31, 2009, 48,576 (2008 - 514,387) units have been issued pursuant to the DRIP.

**Units purchased and cancelled under normal course issuer bid**
On January 16, 2008, the Trust announced its intention to make a normal course issuer bid to acquire up to 876,494 units, representing 5% of the issued and outstanding units of the Trust, over the twelve month period ended January 20, 2009.

On January 21, 2009, the Trust announced its intention to make a normal course issuer bid to acquire up to 877,404 units, representing 5% of the issued and outstanding units of the Trust, over the twelve month period ending January 22, 2010.

Units purchased by the Trust under its normal course issuer bid are cancelled. During the year ended December 31, 2009 the Trust has purchased and cancelled 99,507 (2008 - 456,200) units under its normal course issuer bid at a weighted average price of $2.77 (2008 - 3.50) per unit.

## *14 Unit option plan*

The Trust may grant options to the Trustees, senior officers and consultants of the Trust. The maximum number of units reserved for issuance under the unit option plan is limited to 5% of the total number of issued and outstanding units. The Trustees shall set the exercise price at the time that an option is granted under the plan, which exercise price shall not be less than the discounted market price of the units as determined under the policies of the Exchange on the date of grant. The options will have a maximum term of five years from the date of grant.

The fair value of each unit option granted is estimated on the date of grant using the Black-Scholes option pricing model.

Unit-based compensation expense for the year ended December 31, 2009 of $104,355 (2008 - $312,730), relating to options issued was recorded to expense the fair value unit-based compensation. Unit-based compensation is included in trust expense.

### *14 Unit option plan (continued)*

A summary of the status of the unit options and changes during the period is as follows:

| | Year Ended December 31, 2009 | | Year Ended December 31, 2008 | |
|---|---|---|---|---|
| | Units | Weighted Average Exercise Price | Units | Weighted Average Exercise Price |
| Outstanding, beginning of year | 1,452,000 | $ 5.56 | 1,110,000 | $ 5.72 |
| Granted, January 7, 2008 | - | - | 370,000 | 5.10 |
| Expired, August 11, 2008 | - | - | (28,000) | 5.73 |
| Outstanding, end of year | 1,452,000 | $ 5.56 | 1,452,000 | $ 5.56 |
| Vested, end of year | 1,156,800 | | 960,400 | |

At December 31, 2009 the following unit options were outstanding:

| Exercise price | Options outstanding | Options vested | Expiry date |
|---|---|---|---|
| $ 5.42 | 30,000 | 30,000 | January 17, 2011 |
| 5.80 | 935,000 | 788,000 | July 26, 2011 |
| 5.30 | 120,000 | 120,000 | June 8, 2012 |
| 5.10 | 367,000 | 218,800 | January 7, 2013 |
| | 1,452,000 | 1,156,800 | |

### *15 Deferred unit plan*

The Trust has adopted a deferred unit plan, under which, any trustee, officer, employee, or consultant employee of the Trust may elect to have their annual bonus, annual board retainer or board meeting fees payable to that person by the Trust paid in the form of deferred units. The number of deferred units received by a participant is determined by dividing the amount of the annual bonus, annual board retainer or board meeting fees as applicable to be paid in the form of deferred units on that date by the fair market value of the Trust's units.

Deferred units granted to Trustees shall vest immediately. Deferred units granted to participants other than Trustees shall vest 33% on the first anniversary of grant, 33% on the second anniversary of grant, and 34% on the third anniversary of grant. In the event of any change of control, any unvested deferred units shall vest upon the earlier of the next applicable vesting date and the date that is immediately prior to the date upon which the change of control is completed. The board shall have the discretion to vary the manner in which deferred units vest for any participant.

The deferred units credited to a participant (including deferred units that have not yet vested) shall vest immediately and be redeemable by the participant following the termination other than for cause, retirement, or death, of the participant. In the event that a participant is terminated for cause, only the deferred units that have vested shall be redeemable and any unvested deferred units shall be cancelled.

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### *15 Deferred unit plan (continued)*

Whenever cash distributions are paid on the units of the Trust, additional deferred units will be credited to the participant based on the number of deferred units held, the amount of the distribution and the market value of a unit of the Trust on the date of the distribution. Additional deferred units shall vest at the same time and on the same basis as the deferred units in respect of which they are credited.

Deferred units granted to Trustees, and fully vested, for the year ended December 31, 2009, totaled 222,182 (2008 - 23,528), and 245,710 aggregate deferred units were outstanding at December 31, 2009 (2008 - 23,528).

Unit-based compensation expense for the year ended December 31, 2009, relating to deferred units granted was $178,094 (2008 - $78,787) and was recorded to expense the fair value unit-based compensation.

### *16 Rentals from income properties*

Rental revenue contractually due from tenants includes the recovery of property operating costs and property taxes from tenants of $1,408,924 for the year ended December 31, 2009 (2008 - $1,437,354).

### *17 Financing expense*

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| Interest on acquisition payable (Note 26) | $ 9,918,409 | $ 2,445,014 |
| Forgiveness of interest on acquisition payable | (5,841,638) | - |
| | 4,076,771 | 2,445,014 |
| Mortgage loan interest | 15,249,504 | 13,601,331 |
| Convertible debenture interest | 3,911,900 | 3,943,760 |
| Accretion of the debt component of convertible debentures | 2,853,290 | 2,469,702 |
| Amortization of transaction costs | 1,199,449 | 1,020,555 |
| Change in fair value of interest rate swaps | 2,293,795 | 4,012,403 |
| | $ 29,584,709 | $ 27,492,765 |

### *18 Amortization*

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| Building | $ 7,548,790 | $ 6,090,479 |
| Furniture, equipment and appliances | 1,294,559 | 941,668 |
| Intangible assets, except for in-place leases | 20,572 | 55,359 |
| | 8,863,921 | 7,087,506 |
| Transaction costs | 1,199,449 | 1,020,555 |
| | $ 10,063,370 | $ 8,108,061 |

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## *19 Future income taxes*

Future income taxes consists of the following components:

| | December 31 2009 | December 31 2008 |
|---|---|---|
| **Future income tax asset relating to the assets of Trust:** | | |
| Future income tax asset relating to the temporary difference between the accounting and tax basis held in the Trust expected to reverse after 2010 for: | | |
| Income properties | $ 7,063,859 | $ 2,758,833 |
| Transaction costs | (139,610) | (60,029) |
| | 6,924,249 | 2,698,804 |
| Valuation allowance | (6,924,249) | - |
| | $ - | $ 2,698,804 |

| | Year Ended December 31 2009 | Year Ended December 31 2008 |
|---|---|---|
| **Future income tax expenses (recoveries):** | | |
| Trust | | |
| Decrease (increase) in future income tax asset resulting from a change in temporary differences relating to: | | |
| Income properties | $ (4,305,026) | $ 161,130 |
| Transaction costs | 79,581 | (43,111) |
| Valuation allowance | 6,924,249 | - |
| | 2,698,804 | 118,019 |
| Decrease (increase) in future income tax asset resulting from a change in tax rate for: | | |
| Income properties | - | 141,936 |
| Transaction costs | - | (5,563) |
| | - | 136,373 |
| | $ 2,698,804 | $ 254,392 |

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## *20 Per unit calculations*

Basic per unit information is calculated based on the weighted average number of units outstanding for the year, including vested deferred units. Diluted per unit information is calculated based on the weighted average diluted number of units for the year, considering the dilutive effect of unvested deferred units, the potential exercise of outstanding unit options to the extent that the unit options are dilutive and the potential conversion of outstanding convertible debentures to the extent that the debentures are dilutive.

Income (loss) per unit calculations are based on the following:

***Continuing Operations***

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| Loss | $ (15,478,729) | $ (6,796,592) |
| Diluted loss | $ (15,478,729) | $ (6,796,592) |
| Units | 17,465,519 | 17,483,454 |
| Vested deferred units | 72,851 | 2,149 |
| Weighted average basic number of units | 17,538,370 | 17,485,603 |
| Weighted average diluted number of units | 17,538,370 | 17,485,603 |

***Discontinued Operations***

| | Year Ended December 31 2009 | 2008 |
|---|---|---|
| Income (loss) | $ 18,975,802 | $ (2,810,464) |
| Diluted income (loss) | $ 18,975,802 | $ (2,810,464) |
| Units | 17,465,519 | 17,483,454 |
| Vested deferred units | 72,851 | 2,149 |
| Weighted average basic number of units | 17,538,370 | 17,485,603 |
| Weighted average diluted number of units | 17,538,370 | 17,485,603 |

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### *21 Supplementary cash flow information*

| | Year Ended December 31 | |
|---|---|---|
| | 2009 | 2008 |
| **Interest paid and received** | | |
| Interest paid on mortgage loans | $ 15,642,725 | $ 13,117,509 |
| Interest paid on acquisition payable | $ 4,076,771 | $ 2,445,014 |
| Interest paid on convertible debentures | $ 3,911,900 | $ 3,982,686 |
| Interest received on mortgage loans receivable | $ - | $ 313,865 |
| Other interest received | $ 396,597 | $ 483,567 |
| **Cash distributions** | | |
| Distributions declared | $ 21,139,285 | $ 9,829,851 |
| Distributions paid in units | (19,504,206) | - |
| Distributions to participants in the DRIP | (104,343) | (1,725,598) |
| Distributions paid in cash | $ 1,530,736 | $ 8,104,253 |

### *22 Distribution of taxable income*

In accordance with the Declaration of Trust, the Trust intends, but is not obligated, to make distributions in an amount equal to the aggregate of taxable income from operations and realized capital gains, net of any realized allowable capital losses.

The following table reflects a comparison of realized capital gains to distributions declared.

| | Year Ended December 31 | |
|---|---|---|
| | 2009 | 2008 |
| Realized capital gains | $ 19,153,410 | $ - |
| Distributions declared | $ 21,139,285 | $ 9,829,851 |

### *23 Financial instruments and risk management*

**Risk management**
In the normal course of business, the Trust is exposed to financial risk that arises from its indebtedness, including fluctuations in interest rates and in the credit quality of its tenants. Management's involvement in operations helps identify risks and variations from expectations. As a part of the overall operation of the Trust, management takes steps to avoid undue concentrations of risk. The Trust manages the risks, as follows:

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***23 Financial instruments and risk management (continued)***

**Liquidity risk**
The Trust is in breach of the debt service coverage requirements on mortgage loans totaling $124,161,746 on properties in Fort McMurray, Alberta and one property in Moose Jaw, Saskatchewan. The Trust is continuing to communicate with the lenders and management believes that all of the covenant breaches will be resolved in some manner. As rental market conditions in Fort McMurray may not improve substantially in the near future, all of the affected properties may not attain income levels in 2010 which satisfy the existing debt service coverage requirements. The Trust intends to pursue a sale of the property in Moose Jaw in 2010. There is no assurance that the lenders will not accelerate payment of the mortgage loans. There are no cross-default covenants with respect to the other mortgage loans of the Trust.

The cross-default clauses of the Series E and F secured convertible debentures provide that the convertible debentures may become payable, on demand, if the repayment of a mortgage loan is accelerated by a lender. Subsequent to December 31, 2009, the Series E debentures in the amount of $11,950,000 were paid in full. If, at a future date, one of the lenders demands the repayment of the loans, the Series F convertible debentures, with a face value of $13,680,000, may become payable on demand.

In addition to the liquidity risk relating to the mortgage financing for Parsons Landing, liquidity risk arises from the possibility of the Trust not having sufficient debt and equity capital available to refinance its debt as it matures.

The risk associated with the refinancing of maturing debt is mitigated as the maturity dates of the mortgage portfolio are staggered over a number of years and by limiting the use of floating interest rate debt.

As at December 31, 2009, the weighted average term to maturity of the fixed rate mortgages on income properties is 4.1 years (2008 - 5.2 years).

The repayment obligations in regard to mortgage loans payable and convertible debentures are as follows:

| Year ending December 31 | Mortgage Loans Payable | Convertible Debentures | Total |
|---|---|---|---|
| 2010 | $150,425,443 | $ 11,950,000 | $162,375,443 |
| 2011 | 8,490,771 | 39,412,000 | 47,902,771 |
| 2012 | 34,341,150 | - | 34,341,150 |
| 2013 | 39,654,242 | - | 39,654,242 |
| 2014 | 32,864,141 | - | 32,864,141 |
| Thereafter | 16,776,504 | - | 16,776,504 |
| | $282,552,251 | $ 51,362,000 | $333,914,251 |

In accordance with GAAP, the balance of the mortgage loans that are not in compliance with minimum debt service requirements, has been included in principal repayments in 2010.

## *23 Financial instruments and risk management (continued)*

**Interest rate risk**
Interest risk arises from debt financing including the risk that the Trust will not be able to refinance the mortgages with terms as favourable as those of existing mortgages. The risk is minimized by having the majority of the mortgage loans on fixed term arrangements. In addition, the maturity dates of the mortgages are staggered over a number of years to reduce the exposure in any one year. At December 31, 2009 the percentage of fixed rate mortgage loans to total mortgage loans was 74% (2008 - 74%).

The Trust has floating rate mortgages on income properties (excluding floating rate mortgages with interest rates fixed by use of interest rate swap arrangements) totaling $72,766,738, or 26% of the total mortgage loans at December 31, 2009 (2008 - 26%).

Floating rate mortgages on properties under development comprise construction loans and loans on properties during the period of lease-up.

As at December 31, 2009, the Trust has total contractual mortgage principal maturities on income properties to December 31, 2012 of $64,943,582, representing 23% of total mortgage loans. Should the amounts be refinanced upon maturity at an interest rate differential of 1%, financing expense would change by $649,436 per year.

As at December 31, 2009, the Trust had floating rate mortgages totaling $72,766,738. Should interest rates change by 1%, financing expense would change by $727,667 per year.

With the exception of interest rate swap arrangements, the Trust does not trade in financial instruments.

**Credit risk**
Credit risk arises from the possibility that tenants may be unable to fulfil their lease commitments. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The Trust has credit policies to address credit risk which include the analysis of financial position and credit history of a prospective tenant and by obtaining security deposits whenever permitted by legislation. An allowance for doubtful accounts or other impairment provisions are established based upon factors surrounding credit risk, historical trends and other information.

Thirteen properties, representing 78% of rentals from income properties, are located in Fort McMurray, Alberta. The credit risk associated with the tenants in Fort McMurray is mitigated due to the long-term nature of the oil sands industry and the credit worthiness of the commercial tenants which comprise a significant portion of the rent receivable. The Trust has a corporate tenant that accounts for 20% of rentals from income properties for the year ended December 31, 2009.

***23 Financial instruments and risk management (continued)***

**Credit risk (continued)**

Rent is past due when a tenant has failed to make a payment when contractually due. The following is an aging of rent receivable past due but not impaired:

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Rent receivable overdue: | | |
| 0 to 30 days | $ 132,944 | $ 264,350 |
| 31 to 60 days | 33,133 | 67,191 |
| More than 60 days | 242,045 | 86,114 |
| | $ 408,122 | $ 417,655 |

A reconciliation of allowance for doubtful accounts is as follows:

| | December 31 2009 | December 31 2008 |
|---|---|---|
| Balance, beginning of year | $ 70,119 | $ 23,742 |
| Amount charged to bad debt expense relating to impairment of rent receivable | 183,558 | 131,528 |
| Amounts written off as uncollectible | (161,472) | (85,151) |
| Balance, end of year | $ 92,205 | $ 70,119 |
| Amount charged to bad debts as a percent of rentals from income properties | 0.44% | 0.31% |

**Currency risk**

Currency risk is the risk that changes in foreign exchange rates may have an effect on future cash flows associated with financial instruments. The Trust does not have any transactions denominated in foreign currency and is not exposed to foreign currency risk.

**Other price risk**

Other price risk is the risk that changes in market prices, including commodity or equity prices, will have an effect on future cash flows associated with financial instruments. The cash flows associated with financial instruments of the Trust are not exposed to other price risk.

**Fair values**

Financial instruments include cash, mortgage loans receivable, amounts receivable, interest rate swaps, restricted cash, mortgage loans payable, accounts payable and accrued liabilities, the debt component of convertible debentures and bank indebtedness. Except for mortgage loans receivable, mortgage loans payable and the debt component of convertible debentures, the carrying values of these financial instruments approximate fair value due to the short term nature of the financial instruments.

Financial instruments carried at fair value include cash, restricted cash, interest rate swaps and bank indebtedness. Fair value is determined based on quoted market price.

## *23 Financial instruments and risk management (continued)*

**Fair values (continued)**

The fair value of the mortgages receivable is impacted by the difference between the yield for such instruments in an open market and the yield negotiated as part of a sale of property and by changes in market yields. The fair value of the mortgages receivable has been estimated based on the current market rates for second mortgage loans with similar terms and conditions. The estimated fair value of mortgages receivable is $7,390,271.

The fair value of the fixed rate mortgage loans payable are impacted by changes in market yields which can result in differences between the carrying value and fair value of the instruments. The fair value of mortgage loans payable has been estimated based on the current market rates for mortgages with similar terms and conditions. The estimated fair value of fixed rate mortgage loans payable for the period ended December 31, 2009 is $291,000,000 (December 31, 2008 - $298,000,000).

The carrying value of the debt components of convertible debentures payable are impacted by changes in market yields which can result in differences between the carrying value and fair value of instruments. The fair value of the debt component of convertible debentures payable has been estimated based on the current market rates for debentures with similar terms and conditions. The estimated fair value of the debt component of convertible debentures payable for the period ended December 31, 2009 is $31,325,026 (December 31, 2008 - $33,290,680).

## *24 Management of capital*

The capital structure of the Trust is comprised of the following:

| | December 31 2009 | 2008 |
|---|---|---|
| Mortgage loans payable | $282,552,251 | $284,968,987 |
| Convertible debentures | | |
| Debt component | 46,943,687 | 44,090,397 |
| Equity component | 13,104,637 | 13,104,637 |
| | 60,048,324 | 57,195,034 |
| Trust units | 101,503,281 | 79,750,666 |
| | $444,103,856 | $421,914,687 |

### *24 Management of capital (continued)*

The Trust manages capital in order to safeguard its ability to continue as a going concern; to ensure that returns are provided to Unitholders and to ensure an appropriate balance of risk and return.

The overall capital management strategy addresses the following considerations:

- The equity component of acquired properties is primarily funded from the proceeds of trust units or convertible debentures.
- Mortgage debt financing is arranged to optimize the leveraged returns from the real estate portfolio.
- Total mortgage debt financing is maintained within the overall debt limits as established by the Declaration of Trust. The Declaration of Trust provides for mortgage indebtedness of the Trust up to 75% of the appraised value of all properties.
- Whenever possible, the Trust will utilize fixed rate debt financing.
- Mortgage due dates are structured to reflect the properties being financed and debt maturity dates will be staggered, to the extent possible, in order to reduce refinancing risk.
- The Trust is undertaking a divestiture program targeting the sale of assets in order to reduce total debt including convertible debenture debt.

The Trust monitors capital from time-to-time using a variety of measures. Monitoring procedures are performed as a part of the overall management of operations and are performed with the goal of enhancing the ability of the Trust to access capital and/or reduce the cost of capital.

In order to maintain or adjust the capital structure the Trust may issue units, debentures or mortgage debt; adjust the amount of distributions paid to unitholders; return capital to unitholders; purchase units; or reduce debt.

Market requirements for attracting capital may vary in ways that the Trust may not be able to accurately predict.

### *25 Segmented financial information*

The assets are located in Fort McMurray, Alberta (13 properties), Yellowknife, Northwest Territories (3 properties) and other locations in Canada (4 properties).

Revenue is primarily derived from the operations of residential real estate comprised of multi family rental properties.

Year ended December 31, 2009:

| | Fort McMurray | Yellowknife | Other | Trust | Total |
|---|---|---|---|---|---|
| Rentals from income properties | 32,433,428 | 6,248,101 | 2,733,879 | - | 41,415,408 |
| Interest and other income | 320,266 | 22,751 | 26,717 | 26,863 | 396,597 |
| Property operating costs | 9,817,401 | 2,478,322 | 1,087,041 | - | 13,382,764 |
| Financing expense | 18,976,939 | 1,265,093 | 826,741 | 8,515,936 | 29,584,709 |
| Amortization | 7,323,073 | 922,073 | 618,775 | - | 8,863,921 |
| Income (loss) from continuing operations | (3,363,719) | 1,605,361 | 228,045 | (13,948,416) | (15,478,729) |
| Total assets from continuing operations | 334,990,309 | 39,337,965 | 15,202,246 | 9,358,061 | 398,888,581 |

**LANESBOROUGH REAL ESTATE INVESTMENT TRUST**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**DECEMBER 31, 2009 AND 2008**

## *25 Segmented financial information (continued)*

Year ended December 31, 2008:

| | Fort McMurray | Yellowknife | Other | Trust | Total |
|---|---|---|---|---|---|
| Rentals from income properties | 33,604,718 | 6,004,036 | 2,626,938 | - | 42,235,692 |
| Interest and other income | 257,039 | 35,101 | 27,098 | 449,769 | 769,007 |
| Property operating costs | 8,766,336 | 2,459,794 | 1,117,525 | - | 12,343,655 |
| Financing expense | 17,010,937 | 1,287,642 | 776,580 | 8,417,606 | 27,492,765 |
| Amortization | 5,567,847 | 881,010 | 638,649 | - | 7,087,506 |
| Income (loss) from continuing operations | 2,516,636 | 1,410,692 | 121,282 | (10,925,140) | (6,876,530) |
| Total assets from continuing operations | 342,318,641 | 38,537,426 | 17,311,018 | 212,798 | 398,379,883 |

## *26 Commitments*

### Acquisition

**Parsons Landing Apartments**

On September 1, 2008, the Trust acquired possession of Parsons Landing, a residential property located in Fort McMurray, Alberta, for a total cost of $63,200,000, including GST.  On November 1, 2007, the Trust provided a $10,000,000 second mortgage loan, which bore interest at 8%. On possession of Phase I of the property on May 14, 2008, a purchase instalment payment of $2,500,000 was made and $5,250,000 of the second mortgage loan was applied to the purchase price.  On possession of Phase II of the property on September 1, 2008, the balance of the second mortgage loan of $4,750,000 was applied to the purchase price.  After accounting for the payment of an additional deposit of $2.5 Million on October 1, 2008, the balance owing on Parsons Landing was $48.2 Million as of December 31, 2008, including GST.

The balance owing of the payable on acquisition in the amount of $48,220,000 was originally due on February 28, 2009.

The permanent mortgage financing for Parsons Landing is uncompleted and, as a result, the vendor has agreed to extend the deadline for payment of the balance owing to May 31, 2010, with interest of $4,348,105 from January 1, 2010 to May 31, 2010.  The vendor received payment of $500,000 on May 12, 2009 to be applied to the balance owing.  The vendor received payment of interest payments of $300,000 per month from March to December 2009 and has forgiven interest in excess of $300,000 per month to December 31, 2009 in the amount of $5,841,638.  The vendor has agreed to accept interest payments of $300,000 per month for January to May 2010.  On closing, the vendor has agreed to provide a credit of $1,440,000 for furniture purchased by the Trust and also a $12,000,000 second mortgage loan, with a 15 month term, and to forgive interest in excess of $300,000 per month for the period from January 1 to May 31, 2010 of $2,848,105.  The payment extension is conditional upon the Trust obtaining a commitment for mortgage financing of $30,000,000 by April 30, 2010.  The previous reduction of the purchase price of $3,100,000, on closing, has been rescinded in exchange for a reduced interest rate on the loan payable to the vendor.

The vendor is permitted to sell the property and the Trust may list the property for sale. In the event of the sale of Parsons Landing, the Trust will be liable to the vendor for any shortfall between the net proceeds of the sale and the acquisition cost payable of $45,233,000 plus interest.

## *26 Commitments (continued)*

**Management Contracts**

The Trust has retained the following third party managers to provide on-site management services to the seniors housing complexes:

| Property | Manager | Term Expiring |
|---|---|---|
| Riverside Terrace | LutherCare Communities | July 31, 2015 |
| Chateau St. Michael's | Integrated Life Care Inc. | September 30, 2010 |
| Elgin Lodge | Kingsway Arms Management Inc. | May 31, 2016 |
| Clarington Seniors Residence | Kingsway Arms Management Inc. | February 12, 2017 |

In addition, Siena apartments condominium is managed by Pacer Management Inc. for a term expiring 2012.

## *27 Contingent consideration on acquisition*

**Elgin Lodge**
During the five year period from June 1, 2006, Kingsway Arms Management Services Inc. is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the expanded Elgin Lodge property exceeds the total of the cost to the Trust, including the expansion costs and the unpaid portion of a 12% return on equity. Consideration recorded at December 31, 2009 of $434,982 (2008 - $314,869), which increases the cost of the building, is included in assets of discontinued operations.

**Clarington Seniors Residence**
During the five year period after lease-up is achieved, Kingsway Arms Management Services Inc. is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the property exceeds the total of the acquisition cost to the Trust and the unpaid portion of an 8% return on equity. Consideration recorded at December 31, 2009 of $477,901 (2008 - $313,951), which increases the cost of the building, is included in assets of discontinued operations.

## *28 Subsequent events*

**Divestitures**
On March 1, 2010 the Trust sold McIvor Mall for gross proceeds of $11.2 Million resulting in an approximate gain on sale of $5.69 Million. The Trust provided second mortgage financing to the purchaser in the amount of $3 Million, bearing interest at 5.5% and maturing on July 1, 2014. Net cash proceeds, after expenses, closing adjustments and the assumption by the purchaser of approximately $4.8 Million in first mortgage debt and the $3.0 Million of financing provided to the purchaser, was approximately $3.1 Million and will be utilized to improve the working capital of the Trust.

On March 1, 2010 the Trust sold Chancellor Gate for gross proceeds of $7.97 Million, resulting in an approximate gain on sale of $2.0 Million. Net cash proceeds, after expenses, closing adjustments, and retiring the first mortgage loan of approximately $4.8 Million, was approximately $3.3 Million and will be utilized to improve the working capital of the Trust.

**Convertible Debentures**
The Series E debentures in the amount of $11,950,000 matured on February 17, 2010 and were repaid in full.

***28 Subsequent events (continued)***

**Normal Course Issue Bid**

On January 11, 2010, the Trust renewed its normal course issuer bid to purchase up to an aggregate of 1,368,158 trust units for a one year period expiring January 12, 2011. Purchases will be made at market prices through the facilities of the Toronto Stock Exchange. Any units purchased by the Trust will be cancelled.

On January 11, 2010, the Trust announced its intent to make a normal course issuer bid to purchase up to an aggregate principal amount of $1,368,000 of 5 Year 7.5% Subordinated Series F Convertible Debentures and up to an aggregate principal amount of $2,573,000 of 5 Year 7.5% Series G Convertible Redeemable Unsecured Subordinated Debentures over a 12 month period ending January 12, 2011. Purchases will be made at market prices through the facilities of the Toronto Stock Exchange. Any debentures purchased by the Trust will be cancelled.

**Public Offering of Second Mortgage Bonds and Warrants**

On March 9, 2010, the Trust sold 6,780 investment units at a price of $1,000 per unit for aggregate gross proceeds $6,780,000. Each Unit is comprised of one 5 year 9% second mortgage bond in the principal amount of $1,000 and 1,000 trust unit purchase warrants. Each Warrant entitles the holder thereof to purchase one trust unit of LREIT at a price of $1.00 until March 9, 2015.

**Bank indebtedness**

Subsequent to December 31, 2009, the Trust drew $4,970,000 and repaid $4,130,000 on the line of credit.

**Revolving loan**

Subsequent to December 31, 2009, the Trust drew $5,000,000 and repaid $5,000,000 on the revolving loan from 2668921 Manitoba Ltd.

***29 Comparative figures***

Certain of the prior year figures have been reclassified to be comparable to the current year.

# UNITHOLDER INFORMATION

## Trustees and Officers

The investment policies and operations of LREIT are subject to the control of the trustees, pursuant to the terms of a Declaration of Trust. The Declaration of Trust provides for a minimum of three trustees and a maximum of ten trustees and requires that the majority of trustees be independent trustees. The Declaration of Trust provides Shelter Canadian Properties Limited with the right to appoint one trustee.

The current trustees of LREIT are Mr. Charles Loewen, Mr. Earl Coleman, Mr. Harold Milavsky, FCA, Ms. Cheryl Barker, CA and Mr. Arni Thorsteinson, CFA. Mr Loewen is the Chief Executive Officer of Online Enterprises Inc. and serves as Chairman of LREIT. Mr. Coleman is the President of Big Freight Systems Inc. Mr. Milavsky and Ms. Barker were appointed at the Annual General Meeting in June 2006. Mr. Milavsky is the Chair of the Board, Quantico Capital Corporation. Ms. Barker was the President, MTS (Manitoba) prior to her retirement in February 2006. Mr. Thorsteinson is the President of Shelter Canadian Properties Limited and serves as Chief Executive Officer of LREIT. Mr. Thorsteinson is the appointee of Shelter Canadian Properties Limited.

The Chief Financial Officer and Secretary of LREIT is Mr. Kenneth Dando, CA, Senior Manager of Corporate Accounting and Financial Reporting for Shelter Canadian Properties Limited.

## Administrator of the Trust

Shelter Canadian Properties Limited has been appointed by the Trustees, pursuant to the terms of a Services Agreement, to administer the daily affairs of LREIT and to perform the accounting and reporting functions of LREIT.

## Property Management

Shelter Canadian Properties Limited has been appointed by the Trustees, pursuant to the terms of the Property Management Agreement, to act as the Property Manager for all of the income properties in the LREIT portfolio. Shelter Canadian Properties Limited manages all of the income properties except for the Siena Apartments and the seniors' housing complexes, where the Trust has retained third party property managers to provide on-site management services, due to the nature of the operations.

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Website: www.lreit.com

## Unit Listing

Toronto Stock Exchange (TSX)
Unit trading symbol: LRT.UN
Debenture trading symbol: LRT.DB.F
LRT.DB.G

## Unitholder and Investor Contact

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## Transfer Agent and Registrar

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