LANESBOROUGH

REIT

2013 ANNUAL REPORT

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Unitholder Returns

	Year Ended December 31, 2013 (Per unit)	Year Ended December 31, 2012 (Per unit)
Opening price	$0.65	$0.42
Closing price	$1.07	$0.65

Lanesborough Real Estate Investment Trust ("LREIT") units are listed on the Toronto Stock Exchange under the symbol "LRT.UN". The Series G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G". The 5 year 9% second mortgage bonds and two series of warrants are listed on the Toronto Stock Exchange under the symbols "LRT.NT.A", "LRT.WT" and "LRT.WT.A", respectively.

CHIEF EXECUTIVE OFFICER'S MESSAGE
2013 Annual Report

Highlights

During 2013, LREIT made significant progress toward improving its overall financial and liquidity position as a result of a number of key accomplishments.

- **Elimination of debt covenant breaches:** During 2013, LREIT resolved debt covenant breaches on three mortgage loans with a combined principal balance of approximately $80.8 Million. The resolution of the debt covenant breaches has eliminated a major risk factor and will enable LREIT to move forward with additional debt restructuring initiatives. As of December 31, 2013, all debt covenant breaches have been eliminated with the exception of one swap mortgage loan which is in breach of net operating income achievement requirements.

- **Property divestitures:** During 2013, LREIT sold two additional properties under its divestiture program, including the sale of Nova Court on December 31, 2013. The two sales resulted in net proceeds of $14.5 Million after accounting for selling costs and the discharge/assumption of the existing mortgage loan debt. Subsequent to December 31, 2013, the Trust redeemed $10 Million of the 9% mortgage bonds which were secured against the Nova Court property.

- **NOI gains for Fort McMurray properties:** During 2013, the net operating income of the Fort McMurray property portfolio, excluding Parsons Landing, increased by $1.5 Million or 11%, compared to 2012. The increase in operating income reflects the continued strengthening of economic conditions in Fort McMurray and the completion of income-enhancing capital expenditures for the six apartment properties which are located in the downtown area of the City.

- **Debt reduction:** After accounting for regular and lump-sum mortgage loan principal payments and debt discharged/assumed on the sale of properties, the total long-term debt of LREIT decreased by $21.0 Million during 2013. As of December 31, 2013, the weighted average interest rate of the total debt of LREIT, including the revolving loan, was 5.9%, compared to 7.4% as of December 31, 2012. As of December 31, 2013, the total debt of LREIT, including the revolving loan, was equal to 76% of the carrying value of the total property portfolio, excluding Parsons Landing.

- **Reconstruction and completion of acquisition - Parsons Landing:** On June 1, 2013, approximately 16 months after the property was destroyed by a fire, 84 of the 160 units at Parsons Landing returned to active rental operations. On October 3, 2013, the reconstruction of the remaining 76 units was completed and the entire project became fully operational. On March 6, 2014, the purchase of Parsons Landing was completed. The acquisition was funded by $39,290,000 of net proceeds from a 7.95%, $40,000,000 first mortgage loan maturing on April 30, 2015, an advance under the revolving loan and the balance in cash.

Income Results

During 2013, LREIT achieved an increase in income from investment properties of $14.1 Million, mainly due to the following factors:

– despite a reduction in the number of income-producing properties, the net operating income of LREIT, combined with income recoveries on Parsons Landing, increased by $1.1 Million or 4% during 2013, mainly due to the NOI increase for the Fort McMurray property portfolio. During 2013, the average monthly rental rate of the Fort McMurray property portfolio increased by 5% and the overall occupancy level improved from 90% in 2012 to 91% in 2013.
– interest expense decreased by $6.0 Million or 18% during 2013, due to the reduction in mortgage loan debt, the decrease in the weighted average interest rate of debt and the elimination of mortgage prepayment charges.
– as a result of the continued appreciation of property values and the return of Parsons Landing to rental operations, fair value gains/adjustments contributed $15.9 Million to income.

During 2013, income from discontinued operations decreased by $18.7 Million, compared to 2012. The decrease in income from discontinued operations is attributable to the sale of two of the seniors' housing complexes in 2012 and the associated gain of $15 Million which was recorded on the sale of the two properties.

Overall, LREIT completed 2013 with comprehensive income of $15.5 Million, compared to comprehensive income of $20.1 Million in 2012.

Cash Flow Results

During 2013, the cash inflow from operating activities, excluding working capital adjustments, amounted to $2.0 Million, compared to a cash outflow of $2.1 Million during 2012. Including working capital adjustments, LREIT completed 2013 with a cash inflow from operating activities of $1.6 Million, compared to a cash outflow of $4.5 Million during 2012.

Outlook

The primary objective of LREIT for 2014 will be to further improve its overall liquidity position through the completion of additional property sales and the refinancing of existing mortgage loan debt at lower interest rates. In addition to the continuation of the condominium sales program at Lakewood Townhomes, LREIT's sale efforts will focus on the remaining seniors' housing complexes.

The potential for LREIT to achieve additional NOI and valuation gains for the Fort McMurray property portfolio remains strong given the high level economic activity in the oil sands industry.

ARNI C. THORSTEINSON, CFA
Chief Executive Officer
March 13, 2014

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 ("Financial Statements") of LREIT for December 31, 2013 with reference to the Annual Report for 2012 and the quarterly reports for 2013.

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 breaches of covenants under financing agreements, risks associated with delayed acquisition of properties, 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, 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, reliance on Shelter Canadian Properties Limited ("Shelter Canadian") or its parent company 2668921 Manitoba Ltd. for interim funding and additional risks associated with 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.

Financial Statements

Throughout this report, the consolidated financial statements as of December 31, 2013 will be referred to as the "Financial Statements"; the consolidated statements of financial position as of December 31, 2013 will be referred to as the "Statement of Financial Position"; the consolidated statements of comprehensive income (loss) for the year ended December 31, 2013 will be referred to as the "Income Statement"; and the consolidated statements of cash flows for the year ended December 31, 2013 will be referred to as the "Statement of Cash Flows".

FINANCIAL SUMMARY

	December 31 2013	December 31 2012	December 31 2011
STATEMENT OF FINANCIAL POSITION			
Total assets	$ 468,072,319	$ 481,552,578	$ 555,220,070
Total long-term financial liabilities **(1)**	$ 301,147,731	$ 323,026,417	$ 399,176,274
Weighted average interest rate			
- Mortgage loan debt	5.4 %	7.2 %	6.9 %
- Total debt	5.9 %	7.4 %	7.2 %

	Year Ended December 31 2013	Year Ended December 31 2012	Year Ended December 31 2011
DISTRIBUTIONS			
Distributions paid in units	$ 6,900,000	$ -	$ -
Per unit	$ 0.36	$ -	$ -
KEY FINANCIAL PERFORMANCE INDICATORS (2)			
Operating Results			
Rentals from investment properties	$ 40,328,764	$ 38,410,992	$ 41,852,726
Net operating income *	$ 24,208,769	$ 22,429,229	$ 25,729,391
Income before taxes and discontinued operations *	$ 14,689,374	$ 601,545	$ 2,382,662
Income and comprehensive income	$ 15,519,586	$ 20,098,308	$ 5,035,231
Cash Flows			
Cash provided by (used in) operating activities	$ 1,625,477	$ (4,538,612)	$ (1,566,188)
Funds from Operations (FFO) *	$ (887,528)	$ (7,138,217)	$ (6,993,506)
Adjusted Funds from Operations (AFFO) *	$ (3,863,140)	$ (10,207,994)	$ (8,483,052)
Distributable loss*	$ (1,501,299)	$ (5,091,215)	$ (5,002,715)
Per Unit			
Net operating income *			
- basic	$ 1.276	$ 1.204	$ 1.394
- diluted	$ 1.045	$ 1.197	$ 1.391
Income before taxes and discontinued operations *			
- basic	$ 0.774	$ 0.032	$ 0.129
- diluted	$ 0.634	$ 0.032	$ 0.129
Income and comprehensive income			
- basic	$ 0.818	$ 1.079	$ 0.273
- diluted	$ 0.670	$ 1.073	$ 0.272
Cash provided by (used in) operating activities			
- basic	$ 0.086	$ (0.244)	$ (0.085)
- diluted	$ 0.070	$ (0.244)	$ (0.085)
Funds from Operations (FFO) *			
- basic and diluted	$ (0.047)	$ (0.383)	$ (0.379)
Adjusted Funds from Operations (AFFO) *			
- basic and diluted	$ (0.204)	$ (0.548)	$ (0.460)
Distributable loss *			
- basic and diluted	$ (0.079)	$ (0.273)	$ (0.271)

(1) Long-Term Financial Liabilities

Long-term financial liabilities consist of mortgage loans, a swap mortgage loan, debentures, a defeased liability and mortgage bonds. The swap mortgage loan and mortgage bonds are included at face value.

(2) Non-IFRS Measurements

Items marked with an asterisk represent measurements which are not calculated or presented in accordance with International Financial Reporting Standards (IFRS) or which do not have a standardized meaning as prescribed by IFRS. The non-IFRS 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 IFRS for purposes of assessing the performance of LREIT. LREIT believes, however, that the non-IFRS measurements are useful in supplementing the reader's understanding of the performance of the Trust. Details regarding the calculation of the non-IFRS measurements and a reconciliation to IFRS measurements, where applicable, are provided in the report.

EXECUTIVE 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 45 properties with an acquisition cost of approximately $597 Million, including 14 properties located in Fort McMurray, Alberta.

In 2009, 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, 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. In October 2011, the divestiture program was expanded to include a condominium sales program for the Lakewood Townhomes property in Fort McMurray, Alberta.

As of December 31, 2013, 23 properties and 16 condominium units have been sold under the divestiture program for gross proceeds of $260.8 Million. The property portfolio of LREIT, as of December 31, 2013 consists of the remaining 22 properties, comprised of 20 investment properties (including the unsold condominium units at Lakewood Townhomes) and two seniors' housing complexes. The operating results for the two seniors' housing complexes are classified under discontinued operations.

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 Investment Strategy".

Qualification for REIT Exception

LREIT qualified for the REIT Exception for income tax purposes for the 2013 tax year. As a result, LREIT paid a "special" distribution, in the form of additional trust units, in an amount that is required in order that LREIT did not have any current income tax expense in 2013. 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.

It will be necessary for LREIT to meet certain "tests" or conditions on an ongoing basis to retain its status as a Qualifying REIT. Management expects that LREIT will satisfy all tests and conditions and will continue to qualify for the REIT Exception in 2014 and in subsequent years.

Highlights of 2013 Results and Key Issues/Events

1. Background Information

The revenues and expenses for the seniors' housing complexes are disclosed under one line item titled "Income from Discontinued Operations" in the Income Statement. The following analysis of revenues and expenses does not include the revenues and expenses of the seniors' housing complexes, or the gain on the sale of the seniors' housing complexes. The portfolio of seniors' housing complexes consisted of two properties throughout 2013. In 2012, LREIT sold two seniors' housing complexes.

The revenues and expenses disclosed in the analysis reflect the revenues and expenses of investment properties. During 2013, LREIT sold two investment properties (the Purolator Building and Nova Court) and three condominium units at the Lakewood Townhomes. During 2012, LREIT sold one of the investment properties (Siena Apartments) and 13 condominium units at the Lakewood Townhomes. The revenues and expenses of the Purolator Building, Nova Court and the Siena Apartments are disclosed as "Properties Sold" in the analyses throughout this report. The net operating income of LREIT includes income from "Properties Sold" to the date of the property sale. As the Purolator Building and Nova Court were sold on October 1, 2013 and December 31, 2013, respectively, the property sales did not have a significant impact on net operating income.

The fire at Parsons Landing resulted in the temporary removal of 160 suites from rental operations at the beginning of February 2012. Parsons Landing is disclosed as a separate segment in the analyses throughout this report. On June 1, 2013, the reconstruction of 84 suites at Parsons Landing was completed and the suites were returned to rental operations. On October 3, 2013, Parsons Landing was fully reconstructed, resulting in the return of the remaining 76 suites to active rental operations.

During the period of reconstruction, (i.e., from the date of the fire to the date that suites were returned to rental operations) the income of LREIT includes insurance recoveries in regard to Parsons Landing. The insurance recoveries are disclosed separately under the line item "insurance recovery on Parsons Landing" and are not included in net operating income.

Cash flow from operating activities includes net operating income, less interest and trust expenses incurred, on a cash basis, from the investment properties and the seniors' housing complexes in discontinued operations.

2. Operations

	Year Ended December 31	
	2013	2012
Average occupancy level		
Fort McMurray	91%	90%
Other investment properties	93%	97%
Properties sold *	100%	100%
Total	92%	92%
Average rental rate		
Fort McMurray	$2,329	$2,218
Other investment properties	$929	$903
Properties sold *	$2,521	$2,438
Total	$1,773	$1,709

* The operating results of properties sold are analysed separately as the properties do not contribute to net operating income, subsequent to the closing date of sale. The operating results for "Properties sold" pertain to the Siena Apartments, the Purolator Building and Nova Court which were sold on May 1, 2012, October 1, 2013 and December 31, 2013, respectively.

3. Income and Cash Flow

	Year Ended December 31		
	2013	2012	Increase (Decrease)
Net operating income			
Fort McMurray properties	$ 15,714,974	$ 14,196,751	$ 1,518,223
Other investment properties	5,614,907	5,757,307	(142,400)
Sub-total	21,329,881	19,954,058	1,375,823
Properties sold	1,832,176	2,375,127	(542,951)
Parsons Landing	1,046,712	100,044	946,668
Total net operating income	24,208,769	22,429,229	1,779,540
Interest income	1,272,740	969,607	303,133
Forgiveness of debt	-	859,561	(859,561)
Interest expense	(27,223,579)	(33,261,469)	6,037,890
Trust expense	(2,312,565)	(2,323,979)	11,414
Income recovery on Parsons Landing	2,622,629	3,278,987	(656,358)
Insurance proceeds	-	925,355	(925,355)
Loss before the following	(1,432,006)	(7,122,709)	5,690,703
Profit on sale of investment properties	221,642	915,531	(693,889)
Fair value gains	6,970,031	10,308,723	(3,338,692)
Fair value adjustment of Parsons Landing	8,929,707	(3,500,000)	12,429,707
Income before taxes and discontinued operations	14,689,374	601,545	14,087,829
Current income tax expense	-	49,763	(49,763)
Income before discontinued operations	14,689,374	551,782	14,137,592
Income from discontinued operations	830,212	19,546,526	(18,716,314)
Income and comprehensive income	$ 15,519,586	$ 20,098,308	$ (4,578,722)

	Year Ended December 31		
	2013	2012	Increase (Decrease)
Cash provided by (used in) operating activities	$ 1,625,477	$ (4,538,612)	$ 6,164,089

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

During 2013, the loss of LREIT, before profit on property sales, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations decreased by $5.7 Million compared to 2012. The decrease in loss is mainly due to a decrease in interest expense of $6.0 Million and an increase in the combined total of net operating income and income recovery on Parsons Landing of $1.1 Million, partially offset by a decrease in insurance proceeds of $0.9 Million and a decrease in forgiveness of debt of $0.9 Million.

An analysis of interest expense is provided below.

4. Interest Expense

	Year Ended December 31		
	2013	2012	Increase (Decrease)
Interest expense			
Investment properties	$ 27,223,579	$ 33,261,469	$(6,037,890)
Discontinued operations	747,837	4,525,056	(3,777,219)
Total interest expense	$ 27,971,416	$ 37,786,525	$(9,815,109)

Key Variables

	December 31	
	2013	2012
Weighted average interest rate of total mortgage loan debt		
Investment properties	5.4 %	7.3 %
Seniors' housing complexes	5.0 %	5.0 %
Combined operations	5.4 %	7.2 %

Key Events Affecting Interest Expense

Total interest expense for investment properties decreased by $6.0 Million or 18.0% during 2013, compared to 2012. The decrease is mainly due to the elimination of mortgage prepayment charges of $2.8 Million, a decrease in mortgage loan and swap mortgage loan interest of $3.5 Million and $0.5 Million, respectively, and a decrease in amortization of transaction costs of $0.2 Million, partially offset by a reduction in the gain related to the change in value of interest rate swaps of $0.7 Million and an increase in interest on acquisition payable of $0.1 Million.

Excluding prepayment penalties, interest expense for investment properties decreased by $3.2 Million during 2013.

After including interest expense for discontinued operations, total interest expense for 2013 decreased by $9.8 Million or 26%, compared to 2012. The decrease is mainly due to a decrease in mortgage loan interest of $5.4 Million, the elimination of mortgage prepayment charges of $4.0 Million, a decrease in amortization of transaction costs of $0.7 Million and a decrease in swap mortgage loan interest of $0.5 Million, partially offset by a reduction in the gain related to the change in value of interest rate swaps of $0.7 Million and an increase in interest on acquisition payable of $0.1 Million.

5. Financing

Mortgage Refinancing

During 2013, LREIT obtained $166.5 Million of new mortgage loan financing at a weighted average interest rate of 5.8%. The proceeds from the new financing, combined with the application of $4.4 Million of collateral deposits, were used to discharge $167.3 Million of existing mortgage loan financing with a weighted average interest rate of 8.4% and to fund a capital expenditure reserve account of $0.9 Million. The remaining proceeds were used for working capital purposes.

After accounting for mortgage loan prepayments of $2.8 Million, regular payments of principal of $7.3 Million, a lump-sum paydown of $1 Million and mortgage loan debt eliminated on the sale of properties of $10.1 Million, the total mortgage loan debt of LREIT decreased by $21.2 Million during 2013.

Debt Maturities

All mortgages which have matured prior to March 13, 2014 have been renewed or refinanced.

5. Financing (continued)

Debt Covenants

As of December 31, 2013, LREIT was in breach of a global debt service coverage requirement on one swap mortgage loan with a balance of $17.1 Million. The covenant breach is expected to be eliminated through modified loan terms.

6. Liquidity

	December 31 2013	December 31 2012
Unrestricted cash	$ 2,401,741	$ 1,254,278
Restricted cash	$ 4,241,811	$ 7,801,248
Working capital deficit	$ 4,259,858	$ 4,462,801

Key events affecting liquidity during 2013

- Ongoing funding requirements - the net cash outflow from operating activities, regular repayments of principal on long-term debt and capital expenditures was $9.8 Million.
- Net proceeds from property sales - during 2013 LREIT sold two investment properties and three condominium units resulting in net proceeds of $14.5 Million, after discharging mortgage loans of $10.1 Million. Subsequent to December 31, 2013, mortgage bonds with a face value of $10 Million were repaid from the sales proceeds of Nova Court.
- Sale of property transactions - a $3.2 Million mortgage loan receivable, pertaining to the sale of Riverside Terrace in December 2012, was collected and $1.7 Million of taxes on the sale were paid for a net amount of $1.5 Million.
- Mortgage refinancing - the net inflow from mortgage loan financing activities, excluding regular principal payments and including the net decrease in collateral deposits and transaction costs, was $0.5 Million.

7. Subsequent Events

Subsequent to December 31, 2013, the existing NHA mortgage loan debt of Beck Court in the amount of $8.8 Million was renewed for a one year term at 2.23% to December 31, 2014.

Subsequent to December 31, 2013, a second mortgage loan receivable in the amount of $0.5 Million pertaining to the sale of Nova Villa was paid in full.

Subsequent to December 31, 2013, mortgage bonds with a face value of $10,000,000 were redeemed.

Subsequent to December 31, 2013, the Trust received advances of $14,745,000 and repaid $650,000, resulting in a balance of $15,000,000 as of the date of the Financial Statements.

On March 6, 2014, the purchase of Parsons Landing was completed. The acquisition was funded by $39,290,000 of net proceeds from a 7.95%, $40,000,000 first mortgage loan maturing on April 30, 2015, an advance under the revolving loan and the balance in cash.

8. Risks and Uncertainties

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

- the working capital deficiency of the Trust;
- the concentration of properties in Fort McMurray;
- ability of LREIT to complete additional property sales;
- ability of LREIT to complete additional renewal and/or upward refinancing of mortgage debt; and
- reliance on Shelter Canadian and its parent 2668921 Manitoba Ltd. for interim funding.

As a result of the improvement in operating income in the Fort McMurray portfolio; the renewal or refinancing of mortgage loans; the completion of the Parsons Landing acquisition; and the successful completion of property sales over the past four years, management believes that LREIT has the financial capacity to continue operations for the next twelve months.

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.

CONTINUING OPERATIONS

The Financial Statements have been prepared using the going concern assumption.

The "going concern" basis of accounting is appropriate due to management's expectation of maintaining adequate liquidity, renewing maturing mortgage debt, meeting all mortgage principal and interest payment obligations, obtaining modified loan terms from lenders, the continued financial support of Shelter Canadian and its parent company 2668921 Manitoba Ltd., completing upward financing, reducing high interest debt and generating additional capital through the completion of property divestitures.

CAPITAL REQUIREMENTS - GENERAL

As of December 31, 2013, the unrestricted cash balance of LREIT was $2,401,741 and the working capital deficit was $4,259,858, representing a decrease of approximately $0.2 Million compared to the working capital deficit as of December 31, 2012. The amount due on the revolving loan from 2668921 Manitoba Ltd. in the amount of $905,000 is included in the calculation of the working capital deficit.

LREIT requires ongoing sources of cash to fund regular mortgage loan principal payments, transaction costs for debt financing and capital expenditures, net of the net cash inflow or outflow from operating activities. In addition, LREIT requires additional capital on a periodic basis to fund lump-sum debenture and mortgage bond repayments. Additional capital is also periodically required to fund the repayment of mortgage loans on refinancing to the extent that there is a variance between the repayment amount and the amount of new mortgage loan proceeds. As cash distributions on units were suspended in March 2009, the current funding requirements of LREIT do not encompass the funding of cash distributions.

The net cash inflow from the upward refinancing of properties and the revolving loan facility from 2668921 Manitoba Ltd., represent the primary funding sources for the cash outflow from operating activities, regular mortgage loan principal payments, transaction costs and capital expenditures. The net proceeds from property sales will be used to repay advances from 2668921 Manitoba Ltd. with any remaining proceeds to be applied to the redemption of the Series G debentures.

After accounting for regular payments of debt, transaction costs for debt financing, capital improvements and the cash inflow from operating activities, LREIT completed 2013 with a cash shortfall of $12.3 Million. The cash shortfall was funded by property sales.

Detailed information regarding the funding sources and funding commitments of LREIT are provided in the "Capital Resources and Liquidity" section of this report.

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 G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G". The second mortgage bonds and two series of warrants are listed on the Toronto Stock Exchange under the symbols "LRT.NT.A", "LRT.WT" and "LRT.WT.A", respectively.

The core business activities of LREIT include acquisition, development, financing, management and divestiture activities pertaining to real estate properties in Canada with a focus on multi-unit residential properties. Rental revenue from the leasing of the real estate properties is the primary source of revenue for LREIT.

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 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 investment properties of LREIT, pursuant to the terms of a Property Management Agreement.

Investment in Properties

As of December 31, 2013, the real estate portfolio of LREIT consists of 18 multi-family residential properties, one commercial property and one mixed residential/commercial property (the "investment properties"), as well as two seniors' housing complexes (the "discontinued operations") under "assets held for sale".

The Financial Statements of LREIT provide segmented results for investment properties, with "Fort McMurray", "Other Investment Properties", "Properties Sold" and "Parsons Landing" representing the segments. Operating results pertaining to general trust operations are disclosed separately in the segmented financial information.

Operations

LREIT seeks to maximize 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 has a continuous capital improvement program with respect to its properties. The program is designed to extend the useful life of the properties and improve the quality of tenants' physical surroundings. The capital improvement program encompasses major renovation or expansion projects at selected properties, as deemed appropriate. LREIT capitalizes all expenditures related to the improvement of its properties if the expenditures are incurred with the objective of enhancing net operating income in the future.

During 2011 and 2012, extensive improvements, consisting primarily of in-suite upgrades, were completed for the six downtown properties in Fort McMurray at a total two-year cost of approximately $2.6 Million. In 2013, improvements included exterior renovations as well as additional upgrades to suites. During the year ended December 31, 2013, improvements to the downtown properties in Fort McMurray amounted to $858,000. Capital expenditures also include the purchase of furniture for Parsons Landing in the amount of $1,521,000.

During 2013, LREIT also undertook improvements to Elgin Lodge at a total cost of approximately $252,000. The improvements mainly consisted of the reconfiguration and renovation of a number of units in order to improve the overall marketability of the property. As a result of the reconfiguration, the number of units of Elgin Lodge decreased by 9 units to 115 units.

Financing

The purchase price of the LREIT properties was primarily funded from the proceeds of mortgage loans with the remaining balance funded from other investment capital. The investment capital of LREIT has been primarily raised through the completion of trust unit or convertible debenture offerings as well as public offerings of investment units, comprised of second mortgage bonds and trust unit purchase warrants. LREIT also utilizes the upward refinancing of mortgage loan debt, second mortgage loans and bridge financing as sources of capital. As an interim source of funds, LREIT utilizes a revolving loan commitment from 2668921 Manitoba Ltd.

Pursuant to the terms of the Declaration of Trust, the total mortgage loan indebtedness of LREIT shall not exceed 75% of the appraised value of LREIT's total property portfolio. As of December 31, 2013, the total mortgage loan 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 2013, the mortgage loan debt service coverage ratio was 1.03, compared to 0.95 in 2012. The mortgage loan debt service coverage ratio includes net operating income, insurance recovery and interest on acquisition payable for Parsons Landing

Divestiture Program

General

LREIT initiated a divestiture program in 2009 targeting the sale of assets, with estimated gross proceeds in excess of $250 Million. The objective of the divestiture program is to reduce total debt, including debenture debt and higher cost mortgage loan financing, and to enable LREIT to improve its working capital position. The sale of properties under the divestiture program is also required in order for LREIT to generate sufficient cash inflows to meet its ongoing funding obligations and restore working capital.

Since the inception of the divestiture program to December 31, 2013, LREIT has sold 23 properties and 16 condominium units at a combined gross selling price of $260.8 Million.

	Properties Sold					
	2009	2010	2011	2012	2013	Total
Number of properties sold	13	5	-	3	2	23
Number of condominium units sold	-	-	4	9	3	16
Gross proceeds	$ 90,392,000	$ 40,835,000	$ 1,927,100	$102,896,400	$ 24,724,700	$ 260,775,200
Net proceeds at closing	$ 29,631,650	$ 17,563,501	$ 52,120	$ 21,927,121	$ 14,468,789	$ 83,643,181
Vendor take-back financing received	6,300,000	3,790,650	-	-	3,200,000	13,290,650
Total net proceeds	$ 35,931,650	$ 21,354,151	$ 52,120	$ 21,927,121	$ 17,668,789	$ 96,933,831

LREIT is currently pursuing the sale of the remaining seniors' housing complexes and/or other properties and continuing with the condominium sales program at Lakewood Townhomes.

Lakewood Townhomes Condominium Sales

In October, 2011, LREIT commenced a condominium sales program for the Lakewood Townhomes. After funding sale renovation costs, a contribution to the reserve fund of the condominium corporation and closing costs, net sales proceeds will be applied to reduce the first mortgage loan until such time that the first mortgage loan is repaid in full. The condominium sales program is expected to be substantially completed in 2016. The condominium sales program encompasses services and renovations fees payable to Shelter Canadian. Additional information regarding the fees payable to Shelter Canadian is provided in the section of this report titled "Related Party Transactions".

As of December 31, 2013, 16 condominium units have been sold at a combined gross selling price of $7.8 Million.

Distributions

LREIT suspended cash distributions in 2009.

TAXATION OVERVIEW

LREIT qualifies as a closed-end mutual fund trust for income tax purposes.

On January 1, 2011, LREIT became a specified investment flow-through trust ("SIFT trust") and was subject to the SIFT Rules. Under the SIFT Rules, certain distributions of income from a SIFT trust are not deductible in computing a SIFT trust's taxable income, and a SIFT trust is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception").

The REIT Exception is applied on an annual basis and the Trust did not qualify for the REIT Exception, and therefore was subject to the SIFT Rules, from the January 1, 2011 effective date to December 31, 2012. Prior to the end of 2012, the Trust disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of the non-qualifying properties and other transactions, the Trust qualifies for the REIT Exception in 2013 and intends to qualify for the REIT Exception in 2014 and in subsequent years.

If LREIT qualifies for the REIT Exception in a taxation year, LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, it is the policy of LREIT to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation.

Accordingly, on December 31, 2013, LREIT paid a "special" distribution in the form of additional trust units. In total, 6,448,598 trust units were issued under the distribution with a value of approximately $6.9 Million or $1.07 per unit, representing the closing market price of the units on December 31, 2013. 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.

Management has reviewed the SIFT Rules and the REIT Exception for the 2013 taxation year and has concluded that the Trust qualifies for the REIT Exception.

Additional details regarding the taxation of LREIT and the taxation of the Unitholders is provided in the "Taxation" section of this report.

PARSONS LANDING

Possession of Property and Closing/Financing Agreement

On September 1, 2008, the Trust acquired possession of Parsons Landing for a total cost of $63,200,000. As the permanent mortgage financing for the purchase of Parsons Landing was uncompleted and subsequently, as a result of the fire, the builder agreed to several extensions of the closing date. Under the terms of the purchase agreement, LREIT made additional payments on the balance owing of $500,000 on May 12, 2009, $2,000,000 on February 17, 2012, $3,000,000 on January 3, 2014 and $650,000 on January 31, 2014. The builder also agreed to provide a credit of $1,440,000, on closing, for furniture purchased by the Trust.

The builder also agreed to accept interest of $300,000 per month to the closing date and to forgive interest in excess of $300,000 per month, for the period from January 1, 2010 to the closing date, subject to the completion of the acquisition on the closing date, as extended.

Destruction of Property by Fire and Reconstruction

In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. Subsequent to the fire, the property was under reconstruction and was unoccupied. On June 1, 2013, occupancy permits were obtained for 84 of the 160 units and LREIT assumed control over the 84 units and commenced active rental operations. On October 3, 2013, the reconstruction of the remaining 76 units was completed and the entire project became fully operational.

Completion of the acquisition

On March 6, 2014, the purchase of Parsons Landing was completed. The acquisition was funded by $39,290,000 of net proceeds from a 7.95%, $40,000,000 first mortgage loan maturing on April 30, 2015, an advance under the revolving loan and the balance in cash. At closing, interest in excess of the $300,000 monthly payment in the amount of $27,866,454 was forgiven.

Impact on Financial Statements

The circumstances at Parsons Landing have impacted the Financial Statements of LREIT, as follows:

Insurance Recoveries

In June 2012, an agreement was reached with the builder under which the builder agreed to reconstruct the property and attend to the recovery of the insurance claims for property damage and revenue losses.

Effective from the date of the fire to May 31, 2013 insurance recoveries pertained to the rental losses for the entire property.

From June 1, 2013 to December 31, 2013, the insurance recovery for Parsons Landing gradually decreased as units were returned to active operations and leased-up. Insurance recoveries for rental losses will continue to decline as the lease-up process continues for the remaining vacant returned units.

Payable on acquisition of Parsons Landing

For the period from possession to the closing of the sale, the balance owing in regard to the acquisition of Parsons Landing was reflected in Trade and other payables and included an estimate in regard to the GST payable. Payments to the builder served to reduce the amount payable on acquisition. At December 31, 2013, the amount payable was reduced by $1,713,269 to reflect the $1,440,000 furniture credit and an adjustment of $273,269 to the GST estimate. The reduction in the amount payable balance is reflected as a purchase price adjustment of Parsons Landing in Investment properties.

As of December 31, 2013, the balance owing in regard to the acquisition of Parsons Landing, including GST and excluding accrued interest, was $44,006,731.

Fair value adjustment of Parsons Landing

Parsons Landing is classified as an investment property and is carried at fair value. The Financial Statements reflect the fair value adjustments throughout the reconstruction of the property.

During the first quarter of 2012 and in the absence of an agreement with the builder to reconstruct the property in a coordinated manner with the insurer, the investment property was written down from the carrying value of $47.8 Million at December 31, 2011 to $20.0 Million at March 31, 2012, which represented the fair value of the investment property after accounting for the loss in value resulting from the fire. The write-down of $27.8 Million was reflected as a loss in the Financial Statements for the first quarter of 2012 under the line title, "Impairment of investment property".

Throughout the reconstruction period, the fair value of Parsons Landing was determined based on historical results and normalized operating performance at comparable properties. A discount was also applied to reflect the timing difference between the date of the valuation and the future re-occupation of the property.

Net operating income and income recovery

During 2012, the Financial Statements reflect the "normal" operating revenues and expenses of Parsons Landing from January 1, 2012 to the date of the fire on February 5, 2012. From the date of the fire to June 1, 2013 the Financial Statements do not reflect any operating revenues or expenses for Parsons Landing, aside from certain continuing operating costs, including property taxes and insurance, which are paid to the builder through an "occupancy fee". From June 1, 2013 to December 31, 2013, the Financial Statements reflect revenues and costs related to the operation of the reconstructed units as the units became occupied.

For each quarter, from the second quarter of 2012 to December 31, 2013, the Financial Statements reflect an income recovery in regard to insurance proceeds from revenue losses. The income recovery relating to the period from February 6, 2012 to March 31, 2012 was recorded in the second quarter of 2012 as the agreement with the builder in regard to insurance losses was not finalized until June 2012. For the period from June 1, 2013 to December 31, 2013 the amount of the income recovery was comparatively lower due to the gradual lease-up of the units which were returned to active operations

The income recovery is recorded as a separate line item, "Income recovery on Parsons Landing" in the Income Statement.

Interest expense

Throughout 2012 and 2013, the Financial Statements reflect the $300,000 monthly interest payment.

Prior to June 1, 2013, the $300,000 monthly interest charge was funded from insurance proceeds. Effective June 1, 2013, upon the occupation of reconstructed suites, the funding of the $300,000 monthly interest charge from insurance proceeds was reduced on a proportionate basis.

REAL ESTATE PORTFOLIO

Portfolio Summary - December 31, 2013

As of December 31, 2013, the property portfolio of LREIT consists of 22 rental properties, 20 of which are classified as "Investment properties" on the Statement of Financial Position of the Trust, including all of the unsold condominium units at Lakewood Townhomes. The remaining two properties consist of two seniors' housing complexes which are accounted for as "property and equipment" under "discontinued operations" and classified under "Assets classified as held for sale" on the Statement of Financial Position of the Trust. The entire portfolio of 22 properties has a total purchase price of approximately $396.5 Million and encompasses 2,126 suites and 123,126 square feet of leasable commercial area.

Quarterly Changes in Property Portfolio

There were not any changes to the number of properties in the property portfolio between January 1, 2012 and March 31, 2012, however, the fire at Parsons Landing resulted in the temporary removal of 160 suites from rental operations at the beginning of February 2012. From June 1, 2013 to October 2, 2013, rental operations recommenced for 84 units at Parsons Landing and on October 3, 2013 rental operations recommenced for all of the remaining units. During the second quarter of 2012, LREIT sold one of the investment properties (Siena Apartments) and one of the seniors' housing complexes (Clarington Seniors' Residence). In the fourth quarter of 2012, a second seniors' housing complex (Riverside Terrace) was sold. In addition, nine condominium units were sold at the Lakewood Townhomes in 2012.

During the fourth quarter of 2013, LREIT sold the Purolator Building and Nova Court. In addition three condominium units at Lakewood Townhomes were sold during the year.

After accounting for property and condominium sales, the number of "revenue generating" suites in the investment property portfolio (including all of the unsold condominium units at Lakewood Townhomes and the 160 suites at Parsons Landing which were reconstructed and returned to rental operations) increased by 51 suites or 2.7% as of December 31, 2013, compared to December 31, 2012. During 2013, the number of suites at Elgin Lodge decreased from 124 suites to 115 as a result of the renovation and conversion of studio suites to one bedroom suites. The Elgin Lodge renovations are considered to be improvements to the revenue generating capacity of the property.

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

Composition of Property Portfolio of Investment Properties

The 20 properties which are classified as investment properties consist of one commercial property located in Airdrie, Alberta; one mixed-use residential and commercial property located in Winnipeg, Manitoba (Colony Square); 13 multi-family residential properties, including Parsons Landing, in Fort McMurray, Alberta; one multi-family property in Yellowknife, Northwest Territories; and four multi-family residential properties located in Thompson, Manitoba, Brandon, Manitoba, Edson, Alberta and Peace River, Alberta.

As noted above, the properties in "discontinued operations" consist of the two seniors' housing complexes.

Property Sales During 2013

On October 1, 2013, the Purolator Building was sold for $1.6 Million. After accounting for selling costs and the assumption of the first mortgage loan, the net proceeds were approximately $0.9 Million. The net proceeds were used for general working capital purposes.

On December 31, 2013, Nova Court was sold for gross proceeds of $21,680,000. After accounting for selling costs and the assumption of the first mortgage loan by the Purchaser, the net proceeds from the sale amounted to $13.6 Million. The net proceeds have been used to pay down the revolving loan and for general working capital purposes. The property was sold to another publicly traded entity that has a Director/Trustee and Chief Executive Officer in common. The purchase price was supported by an independent third party appraisal and the sale was approved by the independent Trustees.

Subsequent to December 31, 2013, the Trust repaid $10 Million of mortgage bonds which were secured against the Nova Court property. As of December 31, 2013, the Trust has a contingent liability in regard to the guarantee on the first mortgage loan, pending the completion of the mortgage loan assignment process.

Three condominium units at Lakewood Townhomes were also sold during the year.

Properties Held for Sale/Discontinued Operations

Discontinued operations is a segment or distinct line of business which is being disposed of by the Trust under a coordinated plan, or a subsidiary which was acquired for resale purposes. As LREIT is actively pursuing the disposition of all of its seniors' housing complexes, the two seniors' housing complexes of LREIT are categorized as "discontinued operations". All of the assets and liabilities of properties in discontinued operations are reflected on the Statement of Financial Position as "Assets or liabilities classified as held for sale".

Income from properties in discontinued operations is disclosed separately on the Income Statement.

The cash inflows and outflows from properties in discontinued operations are included with the cash inflows and outflows from investment properties in the Statement of Cash Flows. The increase or decrease in cash held in discontinued operations is separately deducted or added to the Statement of Cash Flows.

In regard to the condominium sales program at Lakewood Townhomes, the rental revenues, operating costs and interest expense which are attributable to units sold, are included with investment properties.

Loans and Receivables

As of December 31, 2013, "Loans and receivables" consist of a 12.5% second mortgage loan of $8.5 Million and an interest free mortgage loan of $275,000, due May 8, 2014 both of which pertain to the sale of Clarington Seniors' Residence on May 9, 2012, and a 5% second mortgage loan of $500,000 arising from the sale of Nova Villa, due October 1, 2014.

During 2013, the loan receivable of $3.2 Million pertaining to the sale of Riverside Terrace was prepaid in full. The secured note receivable of $250,000 was written down by $205,000 during 2013 and the remaining balance of $45,000 has been assured by the Canadian Imperial Bank of Commerce.

Subsequent to December 31, 2013, the mortgage loan receivable in the amount of $500,000 was received in full.

FAIR VALUE MEASUREMENT

General

The fair value of the investment property portfolio of LREIT is determined quarterly based on the same valuation techniques that are used by independent valuation professionals. The capitalized net operating income method and discounted cash flow methods are typically emphasized although the direct comparison method may occasionally be used when appropriate market comparables are available. In addition, periodic external appraisals and market reports serve to substantiate and guide the internal valuation process of LREIT, particularly with respect to key assumptions, including capitalization rates and discount rates.

Fair value estimates are also sensitive to changes in forecasted net operating income and temporary fluctuations have the potential to skew fair value estimates. As a result, actual operating results are normalized to reflect stabilized future expectations regarding capital expenditures, vacancy rates, inflation, operating costs and rental market conditions. Normalization adjustments are based on appraisals, market reports, historic performance and management projections.

Parsons Landing

Throughout the reconstruction period, the fair value of Parsons Landing was determined based on historical results and normalized operating performance at comparable properties. A discount was also applied to reflect the timing difference between the date of the valuation and the future re-occupation of the property.

Effective June 1, 2013, 84 suites were returned to active rental operations, providing more meaningful valuation inputs as well as evidence of improved operating performance. On October 3, 2013, active rental operations recommenced for the entire property.

As of December 31, 2013, the fair market value of Parsons Landing has been calculated at $53.0 Million, representing an increase of $8.7 Million, compared to the balance at December 31, 2012. The fair value increase during 2013 is comprised of an increase of $2.6 Million during the first half of 2013 and a $6.1 Million increase during the second half of 2013. The increase in value during the second half of 2013 reflects improved revenue and vacancy expectations, based on actual leasing results, as well as a reduction in the present value discount attributable to the passage of time.

The income statement of LREIT for 2013 discloses a fair value adjustment for Parsons Landing of $8,929,707. The fair value adjustment reflects the increase in fair market value during the year, net of capital expenditures and accounts payable adjustments.

In 2012, LREIT recorded a net impairment loss of $3.5 Million in regard to the carrying value of Parsons Landing.

Other Investment Properties
During 2013, the fair value gain on the portfolio of investment properties, excluding Parsons Landing, amounted to $6,970,031 compared to $10,308,723 during 2012.

Summary of Quarterly Results

Quarterly Analysis

	2013			
	Q4	Q3	Q2	Q1
Rentals from investment properties	$ 10,115,906	$ 10,417,760	$ 10,026,210	$ 9,768,888
Net operating income	$ 6,023,275	$ 6,405,204	$ 6,086,722	$ 5,693,568
Income (loss) for the period before taxes and discontinued operations	$ (669,080)	$ 13,422,853	$ 2,979,923	$ (1,044,322)
Income (loss) and comprehensive income (loss)	$ (509,164)	$ 13,505,324	$ 3,335,654	$ (812,228)
PER UNIT				
Net operating income				
- basic	$ 0.311	$ 0.339	$ 0.323	$ 0.303
- diluted	$ 0.237	$ 0.337	$ 0.319	$ 0.300
Income (loss) for the period before taxes and discontinued operations				
- basic	$ (0.035)	$ 0.711	$ 0.158	$ (0.056)
- diluted	$ (0.035)	$ 0.706	$ 0.156	$ (0.056)
Income (loss) and comprehensive income (loss)				
- basic	$ (0.026)	$ 0.716	$ 0.177	$ (0.043)
- diluted	$ (0.026)	$ 0.711	$ 0.175	$ (0.043)

Quarterly Analysis

	2012			
	Q4	Q3	Q2	Q1
Rentals from investment properties	$ 9,432,387	$ 9,206,783	$ 9,387,902	$ 10,383,920
Net operating income	$ 5,294,467	$ 5,355,272	$ 5,820,776	$ 5,958,714
Income (loss) for the period before taxes and discontinued operations	$ (778,548)	$ (3,078,641)	$ 30,876,865	$ (26,418,131)
Income (loss) and comprehensive income (loss)	$ 16,185,773	$ (2,298,800)	$ 32,297,230	$ (26,085,895)
PER UNIT				
Net operating income				
- basic	$ 0.282	$ 0.287	$ 0.314	$ 0.321
- diluted	$ 0.280	$ 0.285	$ 0.312	$ 0.320
Income (loss) for the period before taxes and discontinued operations				
- basic	$ (0.041)	$ (0.165)	$ 1.664	$ (1.425)
- diluted	$ (0.041)	$ (0.165)	$ 1.655	$ (1.425)
Income (loss) and comprehensive income (loss)				
- basic	$ 0.862	$ (0.123)	$ 1.741	$ (1.407)
- diluted	$ 0.857	$ (0.123)	$ 1.731	$ (1.407)

Revenue and Operating Income

The quarterly rental revenue and operating income results for 2012 were primarily affected by a decrease in the number of revenue-generating properties due to the fire at Parsons Landing on February 5, 2012, the sale of the Siena Apartments on May 1, 2012 and the sale of condominium units at Lakewood Townhomes. A major renovation program at the downtown Fort McMurray properties also resulted in the removal of a number of units from the revenue stream during 2012.

The improvement of rental market conditions in Fort McMurray due to increased activity in the oil sands industry was the main factor affecting revenue and operating income growth during 2013. Revenue and operating income were also affected by the return of suites to active rental operations at Parsons Landing as well as the sale of the Purolator Building on October 1, 2013. The sale of Nova Court on December 31, 2013 will have an impact on revenue and operating income in 2014.

Net Income (Loss) before Taxes and Discontinued Operations

After accounting for operating income, quarterly variances in interest expense represent the main "ongoing" factor affecting quarterly variances in income/loss before taxes and discontinued operations, particularly in regard to total interest expense on mortgage loans. Interest expense on mortgage loans includes interest on mortgage loans, mortgage bonds and the revolving loan commitment. The main variables affecting decreases in interest expense on mortgage loans have been the discharge of mortgage loan debt on the sale of properties and periodic lump-sum paydowns or prepayments of mortgage loan debt as well as a decrease in the weighted average interest rate. The main variables affecting increases in interest expense have been the upward refinancing of mortgage loan debt. In certain quarters of 2012, prepayment penalties have also served to increase interest expense.

Quarterly changes in the weighted average interest rate of mortgage loan debt and changes in the interest rate on the revolving loan, as well as changes in the amount withdrawn on the revolving loan, are also contributing factors in regard to quarterly variances in interest expense.

As the investment properties of LREIT are carried at fair market value, net income from investment properties is also affected by quarterly variances in fair value gains on investment properties. Periods in which fair value gains have been most significant include the second quarter of 2012 when fair value gains served to increase income by approximately $7.1 Million and the third quarter of 2013 when fair value gains served to increase income by $7.7 Million.

Changes in the fair market value of Parsons Landing, which are recorded separately as "Fair value adjustments", have also contributed to substantial variations in income from investment properties since the first quarter of 2012. The write-down of the carrying value of Parsons Landing in the first quarter of 2012 due to the fire and subsequent increases in the carrying value of the property, particularly in the second quarter of 2012 and the third quarter of 2013, had the largest impact on income from investment properties. Other transactions related to the fire at Parsons Landing have also contributed to variations in quarterly income, including rental losses, income recoveries and insurance proceeds.

Net Income (Loss)

The operations of the seniors' housing complexes of LREIT, as reflected in income from discontinued operations, have also contributed to substantial variations in quarterly net income. The primary factors affecting income from discontinued operations were the sale of the Clarington Seniors' Residence and the discharge of mortgage loan debt on Riverside Terrace during the second quarter of 2012, as well as the sale of Riverside Terrace in the fourth quarter of 2012.

ANALYSIS OF INCOME

Analysis of Income

	Year Ended December 31		Increase (Decrease) in income	
	2013	2012	Amount	%
Rentals from investment properties	$ 40,328,764	$ 38,410,992	$ 1,917,772	5.0 %
Property operating costs	16,119,995	15,981,763	(138,232)	(0.9)%
Net operating income	24,208,769	22,429,229	1,779,540	7.9 %
Interest income	1,272,740	969,607	303,133	31.3 %
Forgiveness of debt	-	859,561	(859,561)	(100.0)%
Interest expense	(27,223,579)	(33,261,469)	6,037,890	18.2 %
Trust expense	(2,312,565)	(2,323,979)	11,414	0.5 %
Income recovery on Parsons Landing	2,622,629	3,278,987	(656,358)	(20.0)%
Insurance proceeds	-	925,355	(925,355)	(100.0)%
Loss before the following	(1,432,006)	(7,122,709)	5,690,703	79.9 %
Profit on sale of investment properties	221,642	915,531	(693,889)	(75.8)%
Fair value gains	6,970,031	10,308,723	(3,338,692)	(32.4)%
Fair value adjustment of Parsons Landing	8,929,707	(3,500,000)	12,429,707	355.1 %
Income before taxes and discontinued operations	14,689,374	601,545	14,087,829	-
Current income tax expense	-	49,763	49,763	100.0 %
Income before discontinued operations	14,689,374	551,782	14,137,592	-
Income from discontinued operations	830,212	19,546,526	(18,716,314)	(95.8)%
Income and comprehensive income	$ 15,519,586	$ 20,098,308	$ (4,578,722)	(22.8)%

Analysis of Income per Unit

	Year Ended December 31		Change	
	2013	2012		
Income and comprehensive income				
- basic	$ 0.818	$ 1.079	$ (0.261)	(24)%
- diluted	$ 0.670	$ 1.073	$ (0.403)	(38)%
Income for the period before taxes and discontinued operations				
- basic	$ 0.774	$ 0.032	$ 0.742	2,319%
- diluted	$ 0.634	$ 0.032	$ 0.602	1,881%

Overall Results

During 2013, the loss of LREIT, before profit on property sales, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations decreased by $5,690,703 compared to 2012. The decrease in the loss is comprised of a $6,037,890 decrease in interest expense, a $1,779,540 increase in net operating income and a $303,133 increase in interest income, partially offset by a $925,355 decrease in insurance proceeds, a $859,561 decrease in gain in regard to the forgiveness of debt and a $656,358 decrease in the income recovery on Parsons Landing.

After accounting for fair value gains, profit on property sales and fair value adjustment of Parsons Landing, the income of LREIT before discontinued operations and taxes increased by $14,087,829 in 2013, compared to 2012.

After accounting for discontinued operations and income taxes, LREIT completed 2013 with comprehensive income of $15,519,586 compared to comprehensive income of $20,098,308 during 2012.

Per Unit Results

On a per unit basis, income before taxes and discontinued operations amounted to $0.774 per unit during 2013, compared to income of $0.032 per unit during 2012, representing an increase in income of $0.742 per unit.

As the weighted average number of units has not changed significantly, increasing by only 3% since December 31, 2011, the increase in income per unit mainly reflects the increase in the overall income of the Trust before discontinued operations.

The increase in income per unit mainly reflects the increase in the overall income of the Trust before discontinued operations. The per unit results were also partially affected by an increase in the weighted average number of units during 2013. During 2013, the weighted average number of units increased by 346,422 units or 1.9%. The increase largely reflects the exercise of trust unit purchase warrants during the fourth quarter of 2013.

Net Operating Income

Net operating income consists of rental revenue less property operating costs.

Rental Revenue

All of the rental revenue of LREIT is derived from the leasing of residential units or commercial space. Rental revenue includes revenue from all investment properties, and the rental revenue in regard to investment properties which are sold during the year, including condominium units at Lakewood Townhomes.

Investment Properties

The investment properties of LREIT are separated into four categories, as noted below.

Fort McMurray (Twelve properties)

Accounting for approximately 48% of the residential suites in the portfolio of investment properties, the twelve multi-residential buildings in the Fort McMurray property portfolio, excluding Parsons Landing, represent the most significant revenue component in LREIT's overall operations.

Other Investment Properties (Seven Properties)

The seven other investment properties consist of one mixed use residential/commercial property, one commercial property, and five multi-family residential rental properties located in Alberta, Manitoba, and the Northwest Territories.

An analysis of the average monthly rents and occupancy level for the Fort McMurray, Other investment properties, Properties sold and Parsons Landing is provided in the following sections of this report.

Properties Sold (Siena Apartments, the Purolator Building and Nova Court)

The operating results of properties sold are analysed separately as the properties do not contribute to the net operating income of the Trust, subsequent to the closing date of sale. The operating results for properties sold as disclosed in the analysis of net operating income pertain to the Siena Apartments, the Purolator Building and Nova Court.

Parsons Landing

As a result of the fire at Parsons Landing, the revenue generating capacity of the property was impaired. As a result, and in accordance with IFRS, Parsons Landing has been segregated from operating properties and analysed separately. Parsons Landing is expected to be reclassified to the Fort McMurray operating segment on January 1, 2015.

Prior to the reconstruction of the property, the income of the property consisted of accrued revenue in regard to the recovery of insurance proceeds for revenue losses. Commencing on June 1, 2013, the net income or loss from reconstructed and occupied units is reflected in operating income and accrued revenue for insurance proceeds is recorded in respect of unoccupied units.

In accordance with IFRS, the insurance recoveries are recorded as a separate line item, titled, "Income recovery on Parsons Landing" and are not included in the calculation of net operating income. As a result there is not any revenue or operating income disclosed for the "Parsons Landing" segment in 2013 or in 2012, aside from amounts which are attributable to the period before the fire occurred on February 5, 2012 and amounts related to the units which were reconstructed and occupied and therefore contributing to operating income.

In several instances throughout this report, the income recovery on Parsons Landing is combined with net operating income in order to derive an income amount for comparative purposes which includes all the income associated with Parsons Landing.

Discontinued Operations

At December 31, 2013, the property portfolio includes two seniors' housing complexes which are classified under discontinued operations. The following analysis excludes the revenue and operating costs of the seniors' housing complexes.

Rental Revenue

Analysis of Rental Revenue

	Year Ended December 31					
			Increase (Decrease)		% of Total	
	2013	2012	Amount	%	2013	2012
Fort McMurray	$ 24,422,889	$ 22,965,656	$ 1,457,233	6 %	61 %	60 %
Other investment properties	10,892,024	10,939,943	(47,919)	- %	27 %	28 %
Sub-total	35,314,913	33,905,599	1,409,314	4 %	88 %	88 %
Properties sold (1)	3,425,499	4,110,966	(685,467)	(17)%	8 %	11 %
Parsons Landing (2)	1,588,352	394,427	1,193,925	303 %	4 %	1 %
Total	$ 40,328,764	$ 38,410,992	$ 1,917,772	5 %	100 %	100 %

(1) Represents revenue from the Siena Apartments, the Purolator Building and Nova Court.

(2) The 2013 results represent revenue from Parsons Landing for 84 suites which were reconstructed and returned to rental operations on June 1, 2013, as well as a further 76 suites which were reconstructed and returned to rental operations on October 3, 2013. The 2012 results represent revenue from Parsons Landing for January 1, 2012 to February 5, 2012.

As disclosed in the chart above, the total revenue from the investment properties of LREIT, excluding properties sold and Parsons Landing, increased by $1,409,314 during 2013, compared to 2012. The increase is comprised of an increase in revenue from investment properties in Fort McMurray of $1,457,233, partially offset by a decrease in revenue from the Other investment properties of $47,919.

The increase in revenue from the Fort McMurray property portfolio reflects an increase in the average occupancy level, as well as an increase in the average rental rate. As disclosed in the charts below, the average occupancy level for the Fort McMurray portfolio increased from 90% during 2012, to 91% in 2013, while the average monthly rental rate increased by $111 or 5.0%. The decrease in the occupancy rate of the Fort McMurray property portfolio during the fourth quarter of 2013 is largely attributable to the tightening of market conditions in certain areas of Fort McMurray, as well as seasonal factors that tend to reduce demand for suites during the winter months.

The decrease in revenue from the Other investment properties is due to a decrease in the average occupancy level from 97% in 2012 to 93% in 2013, partially offset by an increase in the average monthly rental rate of $26 or 2.9%.

Occupancy Level, by Quarter

	2013				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	93 %	95 %	92 %	84 %	91 %
Other investment properties	95 %	94 %	92 %	90 %	93 %
Properties sold	100 %	100 %	100 %	99 %	100 %
Parsons Landing	n/a	n/a	n/a	n/a	n/a
Total	94 %	95 %	93 %	86 %	92 %

	2012				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	92 %	90 %	87 %	88 %	90 %
Other investment properties	98 %	96 %	96 %	97 %	97 %
Properties sold	100 %	100 %	99 %	100 %	100 %
Parsons Landing	n/a	n/a	n/a	n/a	n/a
Total	95 %	92 %	91 %	92 %	92 %

The occupancy level represents the portion of potential revenue that was achieved.

Average Monthly Rents, by Quarter

	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2013 12 Month Average
Fort McMurray	$2,259	$2,275	$2,318	$2,387	$2,329
Other investment properties	$922	$929	$931	$934	$929
Properties sold	$2,550	$2,546	$2,692	$2,299	$2,521
Parsons Landing	n/a	n/a	n/a	n/a	n/a
Total	$1,739	$1,749	$1,780	$1,786	$1,773

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2012 12 Month Average
Fort McMurray	$2,124	$2,191	$2,251	$2,293	$2,218
Other investment properties	$891	$898	$902	$919	$903
Properties sold	$2,729	$2,379	$2,174	$2,295	$2,438
Parsons Landing	n/a	n/a	n/a	n/a	n/a
Total	$1,704	$1,684	$1,704	$1,739	$1,709

Property Operating Costs

Analysis of Property Operating Costs

	Year Ended December 31		Increase (Decrease)	
	2013	2012	Amount	%
Fort McMurray	$ 8,707,915	$ 8,768,905	$ (60,990)	(1)%
Other investment properties	5,277,117	5,182,636	94,481	2 %
Sub-total	13,985,032	13,951,541	33,491	- %
Properties sold	1,593,323	1,735,839	(142,516)	(8)%
Parsons Landing	541,640	294,383	247,257	84 %
Total	$ 16,119,995	$15,981,763	$ 138,232	1 %

During 2013, property operating costs for the portfolio of investment properties, excluding properties sold and Parsons Landing, increased by $33,491, compared to 2012. The increase is comprised of an increase of $94,481 in the operating costs of the Other investment properties portfolio, partially offset by a decrease of $60,990 in the Fort McMurray portfolio.

Net Operating Income and Operating Margin

Analysis of Net Operating Income

	Net Operating Income							
	Year Ended December 31		Increase (Decrease)		Percent of Total		Operating Margin	
	2013	2012	Amount	%	2013	2012	2013	2012
Fort McMurray	$ 15,714,974	$ 14,196,751	$ 1,518,223	11 %	65 %	63 %	64 %	62 %
Other investment properties	5,614,907	5,757,307	(142,400)	(2)%	23 %	26 %	52 %	53 %
Sub-total	21,329,881	19,954,058	1,375,823	7 %	88 %	89 %	60 %	59 %
Properties sold	1,832,176	2,375,127	(542,951)	(23)%	8 %	11 %	53%	58%
Parsons Landing	1,046,712	100,044	946,668	946 %	4 %	-	66%	25%
Total	$ 24,208,769	$ 22,429,229	$ 1,779,540	8 %	100 %	100 %	60 %	58 %

After considering the increase in rental revenue and property operating costs, as analysed in the preceding sections of this report, the net operating income for the portfolio of investment properties, excluding properties sold and Parsons Landing, increased by $1,375,823 or 7% during 2013, compared to 2012.

The increase in net operating income is comprised of a $1,518,223 increase in net operating income from the Fort McMurray properties, partially offset by a $142,400 decrease in net operating income from the Other investment properties.

After accounting for the decrease in net operating income related to properties sold and the net operating income attributable to Parsons Landing, net operating income increased by $1,779,540 during 2013, compared to 2012.

During 2013, the net operating income from Parsons Landing combined with the income recovery on Parsons Landing amounted to $3,669,341, compared to $3,379,031 during 2012, representing an increase of $290,310. The income recovery consisted of the amount recovered under the insurance policy for revenue losses, less certain operating costs such as property taxes and insurance which were deducted from the gross insurance recovery through an "occupancy fee". In comparison, net operating income consists of total actual revenues less total actual operating costs.

Overall, the operating margin for the property portfolio, excluding properties sold and Parsons Landing, increased from 59% during 2012, to 60% during 2013. The increase in the overall operating margin reflects an increase in the operating margin for the Fort McMurray property portfolio.

The operating margin is a measurement of the relative profitability of the investment properties and represents the amount of net operating income which is derived from rental revenues, on a percentage basis. The operating margin is calculated by dividing net operating income by rental revenue.

Interest Income

Interest income is comprised almost exclusively of interest income on mortgage loans receivable, defeasance assets and cash.

During 2013 interest income amounted to $1,272,740 compared to $969,607 during 2012. The increase in interest income mainly reflects an increase in interest income related to mortgage loans receivable.

Forgiveness of Debt

The refinancing of the first mortgage loan for the Lakewood Apartments in January 2012 encompassed the forgiveness of debt in the amount of $859,561. In accordance with IFRS, the entire amount of the debt forgiveness was recognized as income in the first quarter of 2012.

Interest Expense

General

Interest expense includes interest expense for investment properties and discontinued operations. On the Income Statement, interest expense for investment properties is disclosed as a separate line item, while interest expense for discontinued operations is included in the line item "Income from discontinued operations". On the Statement of Cash Flows, "interest expense" and "interest paid" includes the total amount of interest for both investment properties and discontinued operations.

As disclosed in the following chart, total interest expense amounted to $27,971,416 during 2013, of which $27,223,579 pertains to investment properties and $747,837 pertains to discontinued operations.

Total interest expense for investment properties decreased by $6,037,890 or 18% during 2013, compared to 2012. The decrease is mainly due to the elimination of mortgage prepayment charges of $2,751,548, a decrease in mortgage loan and swap mortgage loan interest of $3,488,920 and $524,727, respectively, and a decrease in amortization of transaction costs of $167,029, partially offset by a reduction in the gain related to the change in value of interest rate swaps of $741,101 and an increase in interest on acquisition payable of $103,722.

Total interest expense for discontinued operations decreased by $3,777,219 or 83% during 2013, compared to 2012. The decrease is comprised of a decrease in mortgage loan interest of $1,952,908, the elimination of mortgage prepayment charges of $1,289,083, and a decrease in amortization of transaction costs of $535,228.

Interest expense encompasses a number of "non-cash" expenses, including amortization of transaction costs, accretion and the gain or loss related to the change in fair value of interest rate swaps. The $9,815,109 decrease in total interest expense during 2013, compared to 2012, is comprised of a $9,907,606 decrease in the cash component of interest expense, partially offset by a $92,497 increase in the "non-cash" component of interest expense.

Analysis of Interest Expense

	Year Ended December 31		Increase (Decrease)	
	2013	2012	Amount	%
Investment Properties				
Mortgage Loans				
Mortgage loan interest	$ 15,897,769	$ 19,386,689	$ (3,488,920)	(18)%
Swap mortgage loan interest	940,981	1,465,708	(524,727)	(36)%
Mortgage prepayment charges	-	2,751,548	(2,751,548)	(100)%
Amortization of transaction costs	2,166,884	2,412,014	(245,130)	(10)%
Change in value of interest rate swaps	(286,699)	(1,027,800)	741,101	72 %
Total - mortgage loans	18,718,935	24,988,159	(6,269,224)	(25)%
Mortgage Bonds				
Mortgage bond interest	1,440,000	1,440,000	-	- %
Accretion of debt component	454,177	400,524	53,653	13 %
Amortization of transaction costs	278,909	235,975	42,934	18 %
Total - mortgage bonds	2,173,086	2,076,499	96,587	5 %
Debentures				
Interest on debentures	2,367,153	2,371,295	(4,142)	- %
Amortization of transaction costs	260,683	225,516	35,167	16 %
Total - debentures	2,627,836	2,596,811	31,025	1 %
Acquisition Payable				
Interest on acquisition payable	3,703,722	3,600,000	103,722	3 %
Total - acquisition payable	3,703,722	3,600,000	103,722	3 %
Total interest expense - investment properties	27,223,579	33,261,469	(6,037,890)	(18)%
Discontinued Operations				
Mortgage Loans				
Mortgage loan interest	705,670	2,658,578	(1,952,908)	(73)%
Mortgage prepayment charge	-	1,289,083	(1,289,083)	(100)%
Amortization of transaction costs	42,167	577,395	(535,228)	(93)%
Total interest expense - discontinued operations	747,837	4,525,056	(3,777,219)	(83)%
Total - interest expense	$ 27,971,416	$ 37,786,525	$ (9,815,109)	(26)%

Cash and Non-cash Component				
Non-cash component				
Accretion	$ 454,177	$ 400,524	$ 53,653	13 %
Amortization of transaction costs	2,748,643	3,450,900	(702,257)	(20)%
Change in value of interest rate swaps	(286,699)	(1,027,800)	741,101	72 %
Total non-cash component	2,916,121	2,823,624	92,497	3 %
Cash component				
Interest	25,055,295	30,922,270	(5,866,975)	(19)%
Mortgage prepayment charges	-	4,040,631	(4,040,631)	100 %
Total cash component	25,055,295	34,962,901	(9,907,606)	(28)%
Total - interest expense	$ 27,971,416	$ 37,786,525	$ (9,815,109)	(26)%

Cash Component of Interest Expense - General

The cash component of interest expense consists of mortgage loan interest, including mortgage loan interest in discontinued operations, swap mortgage loan interest, mortgage prepayment charges, debenture interest, mortgage bond interest and interest on the revolving loan.

During 2013, the total cash component of interest expense decreased by $9,907,606 or 28%, compared to 2012. The decrease reflects a decrease of $6,665,615 in the cash component of interest expense for investment properties as well as a decrease of $3,241,991 in the cash component of interest expense for discontinued operations.

As a percentage of net operating income for both investment properties and discontinued operations and after including the income recovery on Parsons Landing, the cash component of interest on mortgage loans, swap mortgage loans and acquisition payable, decreased from 99% during 2012 to 75% during 2013. The decrease in the ratio is largely due to the elimination of mortgage prepayment charges, a decrease in the cash component of interest expense on mortgage loans and an increase in the combined total of net operating income from investment properties and the income recovery on Parsons Landing, partially offset by a decrease in net operating income from discontinued operations as a result of the sale of the Clarington Seniors' Residence in May 2012 and Riverside Terrace in December 2012.

After including the cash component of interest on mortgage bonds and debentures, the interest-to-net operating income ratio is 89% for 2013, compared to 112% for 2012. Excluding the prepayment charges which were incurred in the second and third quarters of 2012, the interest to net operating income ratio in 2012 is 99%.

Cash Component of Interest Expense - Investment Properties

Mortgage Loan Interest

Mortgage loan interest for investment properties decreased by $3,488,920 or 18.0% during 2013, compared to 2012, due to a decrease in interest expense on mortgage loan debt of $3,695,621, partially offset by an increase in interest expense on the revolving loan from 2668921 Manitoba Ltd. of $206,701. The decrease in interest expense on mortgage loan debt mainly reflects a decrease in the weighted average interest rate of mortgage loan debt.

Mortgage loan prepayment charges, which are disclosed separately on the preceding analysis, amounted to $2,751,548 in 2012, compared to nil in 2013.

Swap Mortgage Loan Interest

Swap mortgage loan interest decreased by $524,727 during 2013, compared to 2012 as a result of the sale of Siena Apartments in May 2012 and a lump sum prepayment of $4,287,000 on the Millennium Village swap mortgage loan in August of 2012.

The combined total of swap mortgage loan interest and mortgage loan interest decreased by $4,013,647 during 2013 compared to 2012.

Mortgage Bond Interest

Interest on the mortgage bonds amounted to $1,440,000 in 2012 and 2013.

Debenture Interest

During 2013, interest on debentures amounted to $2,367,153, compared to $2,371,295 during 2012.

Interest on Acquisition Payable

Interest expense associated with the balance owing on Parsons Landing is reflected in "interest on acquisition payable". Interest on acquisition payable amounted to $3,703,722 in 2013, compared to $3,600,000 in 2012 and reflects the $300,000 monthly payment to the builder and accrued interest on the GST payable on acquisition.

Cash Component of Interest Expense - Discontinued Operations

The cash component of interest expense for discontinued operations consists of interest payments on mortgage loans and mortgage prepayment charges. Mortgage loan interest payments for discontinued operations decreased by $1,952,908 or 73% during 2013, compared to 2012. The decrease is attributable to the debt reduction from the sale of the Clarington Seniors' Residence in May 2012 and Riverside Terrace in December 2012 and a reduction in mortgage loan debt due to regular repayments of principal. During 2012, mortgage prepayment charges amounted to $1,289,083 compared to nil in 2013.

Non-cash Component of Interest Expense

As indicated in the preceding chart, the non-cash component of interest expense increased by $92,497 during 2013, compared to 2012. The increase is comprised of an increase in accretion of $53,653 and a $741,101 reduction in the gain related to the change in the fair value of interest rate swaps, largely offset by a decrease in amortization of transaction costs of $702,257.

Transaction costs related to mortgage loans, mortgage bonds and debentures are capitalized and expensed through amortization charges. The actual cash outlay in regard to transaction costs is included in the determination of cash flow from financing activities.

The change in value of the swap mortgage loan provides an indication of the relative benefit of a fixed rate mortgage, compared to a variable rate mortgage, during a specified period of time. As the decrease in value during 2013 was less than the decrease in value during 2012, the change in value of the interest rate swaps resulted in an increase in interest expense during 2013, compared to 2012.

Trust Expense

During 2013, trust expense decreased by $11,414, compared to 2012. The decrease reflects a decrease in service fees, partially offset by a one-time charge of $205,000 associated with the write down of a loan receivable in 2013. The decrease in service fees reflects a reduction in the gross book value of the total assets of the Trust. (See "Related Party Transactions")

Profit on Sale of Investment Properties

The profit on sale of investment properties represents the extent to which the net proceeds from the sale of an investment property exceeds the carrying value of the property as determined at the end of the preceding year.

During 2013, LREIT sold two investment properties (the Purolator Building and Nova Court), and three condominium units, generating a profit on sale of $221,642. During 2012, LREIT sold one investment property (the Siena Apartments) and nine condominium units resulting in a profit on sale of $915,531.

During 2012, LREIT also sold two seniors' housing complexes (Clarington Seniors' Residence and Riverside Terrace) resulting in a profit on sale of $15,034,311. The profit on sale of the two seniors' housing complexes is included in "Income from discontinued operations" on the Income Statement.

Fair Value Gains

In 2013, fair value gains on investment properties, excluding Parsons Landing, amounted to $6,970,031 representing a decrease of $3,338,692 compared to 2012. The fair value gains are included in the income of the Trust.

During 2013, the carrying value of investment properties increased by $10,245,870, comprised of valuation gains of $6,970,031 and capital expenditures of $3,275,839.

The determination of the fair market value of investment properties is based on a comprehensive valuation process. Additional information regarding the fair market value of investment properties and the valuation process is provided in the "Fair Value Measurement" section of this report.

Fair Value Adjustment of Parsons Landing

The variance between the net impairment loss of $3,500,000 in 2012 compared to the fair value increase of $8,929,707 in 2013 served to increase income by $12,429,707 during 2013, compared to 2012.

Insurance Proceeds

During 2012, LREIT received insurance proceeds of $925,355 in regard to furniture and equipment losses at Parsons Landing, which served to increase income. During 2013, LREIT did not receive any insurance proceeds.

Discontinued Operations

Income from discontinued operations includes the net operating income, interest expense and income tax for the seniors' housing complexes, as well as gains resulting from the sale of properties.

Analysis of Income from Discontinued Operations

	Year Ended December 31 2013	Year Ended December 31 2012	Increase (Decrease)
Rental income	$ 5,152,227	$ 12,948,869	$ (7,796,642)
Property operating costs	3,682,675	7,319,163	3,636,488
Net operating income	1,469,552	5,629,706	(4,160,154)
Interest expense	747,837	4,525,056	3,777,219
Profit on sale	-	15,034,311	15,034,311
Tax expense (recovery)			
Current	177,237	1,960,834	1,783,597
Deferred	(285,734)	(5,368,399)	(5,082,665)
Income from discontinued operations	$ 830,212	$ 19,546,526	$ (18,716,314)

During 2013, LREIT generated income from discontinued operations of $830,212, compared to $19,546,526 during 2012, representing a decrease of $18,716,314. The decrease is mainly due to a decrease in profit on sale of $15,034,311, a decrease in net operating income of $4,160,154 and a decrease in tax recoveries of $3,299,068, partially offset by a decrease in interest expense of $3,777,219. The decrease in profit on sale, net operating income, interest expense and tax recoveries are primarily attributable to the sale of Riverside Terrace in December 2012 and the Clarington Seniors' Residence in May 2012. Interest expense was also comparatively high in the second quarter of 2012 due to the repayment of the first mortgage loan at Riverside Terrace, which resulted in a mortgage prepayment penalty of $1,289,083.

Notwithstanding the REIT Exception, operating income for discontinued properties is earned in subsidiary operating companies which are subject to income tax and deferred income tax. In the first quarter of 2013, the repayment of the $3.2 Million mortgage loan receivable, which arose from the sale of Riverside Terrace in December 2012, resulted in an income tax expense and deferred tax recovery.

Comparison to Preceding Quarter

Analysis of Income (Loss)

	2013			2012	
	Q4	Q3	Increase (Decrease) in income	Q4	Increase (Decrease) in income
Rentals from investment properties	$ 10,115,906	$ 10,417,760	$ (301,854)	$ 9,432,387	$ 683,519
Property operating costs	4,092,631	4,012,556	(80,075)	4,137,920	45,289
Net operating income	6,023,275	6,405,204	(381,929)	5,294,467	728,808
Interest income	340,701	303,792	36,909	354,645	(13,944)
Interest expense	(6,490,178)	(6,281,557)	(208,621)	(8,786,495)	2,296,317
Trust expense	(550,238)	(440,395)	(109,843)	(751,957)	201,719
Income recovery on Parsons Landing	350,295	630,704	(280,409)	885,329	(535,034)
Insurance proceeds	-	-	-	525,355	(525,355)
Income (loss) before the following	(326,145)	617,748	(943,893)	(2,478,656)	2,152,511
Profit (loss) on sale of investment properties	56,714	-	56,714	(129,776)	186,490
Fair value gains	(2,107,277)	7,652,786	(9,760,063)	1,329,884	(3,437,161)
Fair value adjustment of Parsons Landing	1,707,628	5,152,319	(3,444,691)	500,000	1,207,628
Income (loss) for the period before taxes and discontinued operations	(669,080)	13,422,853	(14,091,933)	(778,548)	109,468
Current income tax expense	-	-	-	49,763	(49,763)
Income (loss) for the period before discontinued operations	(669,080)	13,422,853	(14,091,933)	(828,311)	159,231
Income from discontinued operations	159,916	82,471	77,445	17,014,084	(16,854,168)
Comprehensive income (loss)	$ (509,164)	$ 13,505,324	$ (14,014,488)	$ 16,185,773	$ (16,694,937)

Comparison to Preceding Quarter

During the fourth quarter of 2013, LREIT incurred a loss of $326,145, before profit on sale of investment properties, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations, compared to income of $617,748 during the third quarter of 2013. The variance in quarterly results mainly reflects a decrease in net operating income of $381,929, a decrease in income recovery on Parsons Landing of $280,409, an increase in interest expense of $208,621 and an increase in trust expense of $109,843. Both the decrease in operating income and the decrease in income recovery are attributable to the reconstruction and return of the remaining 76 suites at Parsons Landing on October 3, 2013. As Parsons Landing is incurring a vacancy loss during the lease-up period for reconstructed suites, the decrease in income recovery exceeded the increase in operating income. Another factor contributing to the decrease in operating income is the decrease in the occupancy rate of the Fort McMurray property portfolio during the fourth quarter of 2013, which is largely attributable to the tightening of market conditions in certain areas of Fort McMurray as well as seasonal factors that tend to reduce demand for suites during the winter months.

The increase in interest expense is mainly due to an increase in interest on acquisition payable of $103,722 and an increase in mortgage loan interest in regard to upward mortgage loan financings which occurred in the fourth quarter of 2013.
After accounting for the decrease in fair value gains and fair value adjustment of Parsons Landing in the combined amount of $13,204,754 and an increase in profit on sale of investment properties of $56,714, the income of LREIT before income taxes and discontinued operations decreased by $14,091,933 during the fourth quarter of 2013, compared to the third quarter of 2013.

Income from discontinued operations increased by $77,445 during the fourth quarter of 2013, compared to the third quarter of 2013. The increase in income from discontinued operations mainly reflects a decrease in interest expense.

After accounting for discontinued operations and income tax expense, LREIT completed the fourth quarter of 2013 with a comprehensive loss of $509,164, compared to comprehensive income of $13,505,324 during the third quarter of 2013.

Comparison to Fourth Quarter of 2012

During the fourth quarter of 2013, the loss of LREIT, before profit on sale of investment property, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations, amounted to $326,145, compared to a loss of $2,478,656 during the fourth quarter of 2012, representing a decrease in the loss of $2,152,511. The decrease in the loss mainly reflects a decrease in interest expense and an increase in operating income, partially offset by a decrease in income recovery on Parsons Landing and a decrease in insurance proceeds.

The decrease in interest expense is mainly due to a decrease in the weighted average interest rate of mortgage loan debt. The increase in operating income is mainly due to the return of Parsons Landing to full rental operations and an increase in operating income for the Fort McMurray property portfolio.

Income from discontinued operations decreased by $16,854,168 during the fourth quarter of 2013, compared to the fourth quarter of 2012. The decrease in income from discontinued operations mainly reflects the sale of Riverside Terrace in December 2012.

After accounting for the variance in fair value gains/adjustments, profit on sale, income from discontinued operations and income tax expense, LREIT completed the fourth quarter of 2013 with a comprehensive loss of $509,164, compared to comprehensive income of $16,185,773 during the fourth quarter of 2012.

ANALYSIS OF CASH FLOWS

Operating Activities

Cash Flow from Operating Activities

The net cash flow from operating activities is equal to the cash component of net operating income less net interest paid, the cash component of trust expense and the net increase or decrease in working capital items (disclosed as "working capital adjustments") for both investment properties and the seniors' housing complexes classified as discontinued operations. The calculation of the cash component of net operating income excludes "accrued rent receivable", while the calculation of the cash component of trust expense excludes "unit based compensation" and the expense change related to the write down of a note receivable. Net interest paid consists of interest paid, net of interest received.

"Interest paid" on the Statements of Cash Flows is based on the cash component of interest expense for both investment properties and discontinued operations, excluding prepayment penalties, and after adjusting for the change in accrued interest during the period.

Due to the exclusion of prepayment penalties and non-cash expenses such as amortization of transaction costs, accretion of mortgage bonds and change in fair value of interest rate swaps, there is a substantial difference between interest expense on the Income Statement and interest paid on the Statement of Cash Flows. Quarterly variances in accrued interest in regard to the Series G debentures and mortgage bonds also serve to reduce "interest paid" by approximately $950,000 in the first and third quarters of the year, compared to the second and fourth quarters of the year.

2013 vs 2012 Comparatives

Cash from Operating Activities

	Year Ended December 31		Increase
	2013	2012	(Decrease)
Net operating income			
Investment properties	$ 24,208,769	$ 22,429,229	$ 1,779,540
Discontinued operations	1,469,552	5,629,706	(4,160,154)
Total net operating income	25,678,321	28,058,935	(2,380,614)
Accrued rent receivable	82,342	371,443	(289,101)
Net operating income - cash basis	25,760,663	28,430,378	(2,669,715)
Income recovery on Parsons Landing	2,622,629	3,278,987	(656,358)
Insurance proceeds	-	925,355	(925,355)
Gain on debenture repurchases	(3,985)	-	(3,985)
Trust expense	(2,312,565)	(2,323,979)	11,414
Non-cash component of trust expense	306,093	131,318	174,775
Trust expense - cash basis	(2,006,472)	(2,192,661)	186,189
Interest paid			
Investment properties	(24,110,575)	(28,363,853)	4,253,278
Discontinued operations	(715,256)	(2,831,230)	2,115,974
Total interest paid	(24,825,831)	(31,195,083)	6,369,252
Interest received	660,459	617,668	42,791
Interest expense - cash basis	(24,165,372)	(30,577,415)	6,412,043
Income tax expense - current	(177,237)	(2,010,597)	1,833,360
Cash provided by (used in) operating activities, before working capital adjustments	2,030,226	(2,145,953)	4,176,179
Working capital adjustments, net	(404,749)	(2,392,659)	1,987,910
Cash provided by (used in) operating activities	$ 1,625,477	$ (4,538,612)	$ 6,164,089

During 2013, the net cash provided by operating activities, excluding working capital adjustments, amounted to $2,030,226 compared to a net cash outflow before working capital adjustments of $2,145,953 in 2012, representing an increase in cash flow before working capital adjustments of $4,176,179. The increase reflects a decrease in interest paid of $6,369,252 and a decrease in income tax expense of $1,833,360, partially offset by a decrease in the cash component of net operating income of $2,669,715, a decrease in the income recovery on Parsons Landing of $656,358 and a decrease in insurance proceeds of $925,355.

The sale of two senior's housing complexes in 2012 had a significant impact on income tax expense, interest paid and the cash component of net operating income. Interest paid was also affected by a decrease in the weighted average interest rate of mortgage loan debt.

Comparison to Third Quarter of 2013

Cash from Operating Activities

	Three Months Ended December 31, 2013	Three Months Ended September 30, 2013	Increase (Decrease)
Net operating income			
Investment properties	$ 6,023,275	$ 6,405,204	$ (381,929)
Discontinued operations	324,280	275,830	48,450
Total net operating income	6,347,555	6,681,034	(333,479)
Accrued rent receivable	70,344	97,017	(26,673)
Net operating income - cash basis	6,417,899	6,778,051	(360,152)
Income recovery on Parsons Landing	350,295	630,704	(280,409)
Gain on debenture repurchases	(3,985)	-	(3,985)
Trust expense	(550,238)	(440,395)	(109,843)
Non-cash component of trust expense	33,750	18,750	15,000
Trust expense - cash basis	(516,488)	(421,645)	(94,843)
Interest paid			
Investment properties	(6,169,778)	(4,895,664)	(1,274,114)
Discontinued operations	(164,122)	(178,291)	14,169
Total interest paid	(6,333,900)	(5,073,955)	(1,259,945)
Interest received	178,315	143,234	35,081
Interest expense - cash basis	(6,155,585)	(4,930,721)	(1,224,864)
Cash provided by operating activities, before working capital adjustments	92,136	2,056,389	(1,964,253)
Working capital adjustments, net	(1,658,419)	1,224,561	(2,882,980)
Cash provided by (used in) operating activities	$ (1,566,283)	$ 3,280,950	$ (4,847,233)

In comparison to the third quarter of 2013, the cash inflow from operating activities, excluding working capital adjustments, decreased by $1,964,253 in the fourth quarter of 2013. The decrease in cash inflow from operating activities, excluding working capital adjustments, is mainly due to an increase in interest paid of $1,259,945.

The increase in interest paid is mainly attributable to the timing of interest payments on the Series G debentures and mortgage bonds, which fluctuates by approximately $950,000 in the first and third quarters of the year, compared to the second and fourth quarters of the year. The main factors which affected the increase/decrease in the other variables are disclosed in other sections of this report.

Fourth Quarter Comparatives

Cash from Operating Activities

	Three Months Ended December 31		Increase
	2013	2012	(Decrease)
Net operating income			
Investment properties	$ 6,023,275	$ 5,294,467	$ 728,808
Discontinued operations	324,280	865,162	(540,882)
Total net operating income	6,347,555	6,159,629	187,926
Accrued rent receivable	70,344	(83,787)	154,131
Net operating income - cash basis	6,417,899	6,075,842	342,057
Income recovery on Parsons Landing	350,295	885,329	(535,034)
Insurance proceeds	-	525,355	(525,355)
Gain on debenture repurchases	(3,985)	-	(3,985)
Trust expense	(550,238)	(751,957)	201,719
Non-cash component of trust expense	33,750	75,068	(41,318)
Trust expense - cash basis	(516,488)	(676,889)	160,401
Interest paid			
Investment properties	(6,169,778)	(8,633,027)	2,463,249
Discontinued operations	(164,122)	(179,406)	15,284
Total interest paid	(6,333,900)	(8,812,433)	2,478,533
Interest received	178,315	249,120	(70,805)
Interest expense - cash basis	(6,155,585)	(8,563,313)	2,407,728
Income tax expense - current	-	(2,094,075)	2,094,075
Cash provided by (used in) operating activities, before working capital adjustments	92,136	(3,847,751)	3,939,887
Working capital adjustments, net	(1,658,419)	4,420,828	(6,079,247)
Cash provided by (used in) operating activities	$ (1,566,283)	$ 573,077	$ (2,139,360)

During the fourth quarter of 2013, the cash inflow from operations, excluding working capital adjustments, increased by $3,939,887 compared to the fourth quarter of 2012. The increase in the cash inflow mainly reflects a decrease in tax expense of $2,094,075, a decrease in interest paid of $2,478,533 and an increase in net operating income, on a cash basis, of $342,057, partially offset by a decrease in income recovery on Parsons Landing of $535,034 and a decrease in insurance proceeds of $525,355. The main factors which affected the increase/decrease in these variables are disclosed in the preceding sections of this report.

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 2013, the FFO deficiency decreased by $6,250,689, compared to 2012, while the AFFO deficiency decreased by $6,344,854. On a basic per unit basis, the FFO deficiency decreased by $0.336 per unit, while the AFFO deficiency decreased by $0.344 per unit.

The cash increase or decrease from discontinued operations is included in the calculation of FFO and AFFO.

Funds from Operations/Adjusted Funds from Operations *

	Year Ended December 31	
	2013	2012
Comprehensive income	$ 15,519,586	$ 20,098,308
Add (deduct):		
Deferred taxes	(285,734)	(5,368,399)
Profit on sale of properties	(221,642)	(15,949,842)
Taxes on sale of discontinued operations	-	1,750,000
Fair value gains	(6,970,031)	(10,308,723)
Fair value adjustment of Parsons Landing	(8,929,707)	3,500,000
Forgiveness of debt	-	(859,561)
Funds from operations (FFO) *	(887,528)	(7,138,217)
Add (deduct):		
Straight-line rent adjustment	82,342	371,443
Accretion of debt component of mortgage bonds	454,177	400,524
Write down of note receivable	205,000	-
Unit-based compensation	101,093	131,318
Change in fair value of interest rate swaps	(286,699)	(1,027,800)
Capital expenditures on investment properties	(3,275,839)	(2,906,894)
Capital expenditures on property and equipment	(255,686)	(38,368)
Adjusted funds from operations (AFFO) *	$ (3,863,140)	$ (10,207,994)
FFO per unit *		
- basic and diluted	$ (0.047)	$ (0.383)
AFFO per unit *		
- basic and diluted	$ (0.204)	$ (0.548)

* FFO and AFFO are non-IFRS 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 IFRS.

FFO has been calculated in accordance with the recommendations of RealPac. 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 IFRS for calculating earnings per unit.

AFFO is determined by taking the amounts reported as FFO and deducting what is commonly referred to as capital expenditures. Capital expenditures are referred to as expenditures that by standard accounting definitions are accounted for as capital in that the expenditure itself has a useful life in excess of the current financial year and also adds or maintains the value of the related asset.

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 IFRS 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 IFRS measurement of the cash flows of LREIT is the "net cash flow from operating activities", as disclosed in the Statement of Cash Flows in the Financial Statements. Accordingly, a reconciliation between the net cash flow from operating activities and distributable income is provided in the chart below.

Reconciliation Between Cash from Operating Activities and Distributable Loss

	Year Ended December 31	
	2013	2012
Cash provided by (used in) operating activities	$ 1,625,477	$ (4,538,612)
Changes in non-cash operating items	404,749	2,392,659
	2,030,226	(2,145,953)
Add (deduct):		
Capital expenditures on investment properties	(3,275,839)	(2,906,894)
Capital expenditures on property and equipment	(255,686)	(38,368)
Distributable loss	$ (1,501,299)	$ (5,091,215)
Per unit		
- basic and diluted	$ (0.079)	$ (0.273)

Distributable loss is comprised of cash from operating activities, excluding working capital adjustments, less capital expenditures, from both investment properties and discontinued operations.

Working capital adjustments are excluded from LREIT's calculation of distributable income as working capital adjustments are subject to significant temporary fluctuations which are typically reversed over time, mainly due to timing differences in accounts receivable and accounts payable.

After accounting for the increase in capital expenditures, and the increase in cash flow, excluding working capital adjustments, as previously discussed, LREIT completed 2013 with a distributable loss of $1,501,299, representing a decrease in the distributable loss of $3,589,916 compared to 2012.

Distributions

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

For information regarding the "special" trust unit distribution made on December 31, 2013, please refer to the "Taxation" section of this report.

Financing Activities

As disclosed in the Statement of Cash Flows, the financing activities of LREIT resulted in a cash outflow of $17,345,389 during 2013. Financing activities consist primarily of cash inflows and outflows related to the repayment and refinancing of mortgage loan debt, including transaction costs, and the revolving loan commitment, as well as cash inflows related to the exercise of warrants.

Details regarding transactions related to mortgage loan financing activities, the revolving loan and warrants are provided in other sections of this report.

Investing Activities

As disclosed in the Statement of Cash Flows, the investing activities of LREIT resulted in a net cash inflow of $16,103,532 during 2013. Investing activities representing a cash inflow include proceeds of sale of $14,468,789, proceeds from a mortgage loan receivable of $3,200,000, a decrease in restricted cash of $3,555,578 and a decrease in defeasance assets of $145,392. Investing activities representing a cash outflow include taxes paid on property sold in 2012 of $1,734,702 and capital expenditures on investment properties and discontinued operations of $3,275,839 and $255,686, respectively.

The cash inflow in regard to restricted cash mainly reflects a decrease in the total deposits/reserves retained by mortgage lenders as a result of the mortgage loan refinancings which occurred during 2013.

Cash Flow Summary

During 2013, the net cash inflow from operating, financing and investing activities was $1,147,464. After providing for the opening cash balance of $1,254,278, LREIT completed 2013 with a cash balance of $2,401,742.

CAPITAL RESOURCES AND LIQUIDITY

Sources of Funds - 2014

Working Capital/Existing Cash

As of December 31, 2013, the unrestricted cash balance of LREIT was $2,401,741 and the working capital deficit was $4,259,858, representing a decrease in the working capital deficit of approximately $0.2 Million compared to the working capital deficit as of December 31, 2012. The working capital deficit consists of current assets less current liabilities, excluding the amount payable on acquisition of Parsons Landing, the current portion of long-term debt, and assets and liabilities of a long-term nature which are included in current assets or liabilities under the "held for sale" classification. Working capital includes the tenant security deposit liability net of the security deposit balance in restricted cash; a reduction of $10 Million for the January 17, 2014 partial redemption of mortgage bonds and a reduction of $4.35 Million for the scheduled payments of the Parsons Landing acquisition payable paid in January and February 2014. The amount due on the revolving loan from 2668921 Manitoba Ltd. in the amount of $905,000 is included in the calculation of the working capital surplus.

Working capital is a commonly used financial measurement of an entity's liquidity and is generally derived by deducting current assets from current liabilities. Working capital is a non-IFRS measurement and the method which is used by LREIT for calculating the working capital surplus may differ from the method which is used by other issuers. Accordingly, the working capital surplus as calculated by LREIT may not be comparable to the working capital measurements which are provided by other issuers.

Cash Inflow from Operating Activities

The overall funding requirements of LREIT are affected by the level of cash inflows or outflows from operating activities. After accounting for regular payments of debt, transaction costs for debt financing, capital improvements and the cash inflow from operating activities, LREIT completed 2013 with a cash shortfall of $12.3 Million, compared to a shortfall of $19.3 Million during 2012. Although the extent of the shortfall is expected to be lower in 2014, LREIT will continue to require other sources of cash to meet its ongoing funding commitments.

Revolving Loan Commitment from 2668921 Manitoba Ltd.

LREIT utilizes a revolving loan commitment from 2668921 Manitoba Ltd. (the parent company of Shelter Canadian). Effective January 1, 2014, the revolving loan commitment was renewed for a nine-month term to September 30, 2014 at an interest rate of 12% with a maximum balance of $15 Million. As of the date of this report, the revolving loan is fully drawn.

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

Sale Proceeds

LREIT is pursuing property sales under its divestiture program.

The current expectations of management are that the remaining seniors' housing complex and/or other properties will be sold in 2014. The timing and extent of projected property sales cannot be reasonably predicted and there is no assurance that LREIT will sell properties proposed for sale on favourable terms or at all. The condominium sales program at the Lakewood Townhomes is expected to be substantially completed in 2016. The condominium sales program is not expected to represent a funding source in 2014, as the proceeds from sales are currently being applied to debt reduction.

Mortgage Loans Receivable

As of December 31, 2013, LREIT has mortgage loans receivable of $9.3 Million, all of which are due in 2014 and as a result, are included in "Rent and other receivables" on the Statement of Financial Position.

In February 2014, a 5% second mortgage loan receivable of $500,000 due October 1, 2014 was received in full.

Upward Refinancing of Mortgage Loans

The upward refinancing of mortgage loan debt represents a source of capital for LREIT. The opportunity to complete upward refinancings is limited, given the extent to which the existing property portfolio is leveraged and the maximum 75% mortgage loan debt to appraised value restriction pursuant to the terms of the Declaration of Trust.

Details regarding mortgage loan transactions in 2013 are disclosed in the "Mortgage Loans Payable" section of the MD&A.

Debt and/or Equity Offerings

LREIT may pursue 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.

Exercise of Warrants

During 2010, LREIT issued 6.78 Million trust unit purchase warrants with an exercise price of $1.00 and 16 Million trust unit purchase warrants with an exercise price of $0.75 and the warrants expire on March 9, 2015 and December 24, 2015, respectively. During the fourth quarter of 2013, 1,332,000 warrants were exercised, generating proceeds of $999,000. As of December 31, 2013, if all outstanding warrants were exercised, LREIT would receive additional proceeds of $17,649,750.

Uses of Funds - 2014

Parsons Landing

On March 6, 2014, the purchase of Parsons Landing was completed. The acquisition was funded by a 7.95%, $40,000,000 first mortgage loan maturing on April 30, 2015, an advance under the revolving loan and the balance in cash.

Long-term Debt Principal Payments

Summary of Total Debt Obligations by Year

A summary of the debt obligations of LREIT for 2014 and for the next five years, is provided in the following chart. The chart reflects mortgage payments in accordance with the payment terms specified by the applicable mortgage loan.

Summary of Contractual Obligations - Long-term Debt (1)

Payments Due by Period	Total	2014	2015/2016	2017/2018	2019 and beyond
Regular mortgage loans	$ 224,235,090	$ 101,829,683	$ 17,634,154	$ 77,333,919	$ 27,437,334
Mortgage loans payable on demand	4,478,175	4,478,175	-	-	-
Sub-total - Investment properties	228,713,265	106,307,858	17,634,154	77,333,919	27,437,334
Loans on properties held for sale	13,042,918	13,042,918	-	-	-
Total mortgage loan debt	241,756,183	119,350,776	17,634,154	77,333,919	27,437,334
Swap mortgage loan (2)	15,873,133	573,232	1,251,313	14,048,588	-
Debentures and mortgage bonds	40,873,800	-	40,873,800	-	-
Total	$ 298,503,116	$ 119,924,008	$ 59,759,267	$ 91,382,507	$ 27,437,334

(1) Swap mortgage loan and mortgage bonds are reflected at face value.

(2) The swap mortgage loan matures in 2018 and is in breach of a global debt service coverage requirement. Under IFRS, mortgages in breach of debt covenants are classified as a "current portion of long-term debt", regardless of the maturity date. If the above chart was adjusted to reflect the swap mortgage loan as a current liability, the total long-term debt due for 2014 would increase to $135,223,909.

Summary of Mortgage Loan Debt Due in 2014

The amount due for regular mortgage loans of $101,829,683 consists of six mortgage loans, with maturity dates in 2014, in the aggregate amount of $99,035,768, as well as regular principal payments of $2,793,915 for other mortgage loans. Subsequent to December 31, 2013, a maturing loan was renewed. Management expects that the remaining 5 mortgage loans in the amount of $90,272,830 will be renewed or refinanced by December 31, 2014 on similar terms.

The amount due for mortgage loans repayable on demand of $4,478,175 consists of one mortgage loan which has a fixed term to August 1, 2015 under a demand promissory note. An analysis of the mortgage loans is provided in the "Mortgage Loans Payable" section of the MD&A.

The mortgage loans on properties held for sale of $13,042,918 consists of the mortgage loan debt of Elgin Lodge and Chateau St. Michael's which mature on June 20, 2014 and June 1, 2014, respectively.

Principal Payments - Debentures and Mortgage Bonds

As of December 31, 2013, the total face value of the 9% Series G debentures is $24,873,800. The debentures mature on February 28, 2015. The terms of the debentures provide for the net proceeds from property sales to be applied to redeem the principal amount of the debentures after repayment of mortgage loan and mortgage bond indebtedness, if applicable, and any amounts owing to 2668921 Manitoba Ltd. from time to time under the revolving loan commitment. The extent of debenture repayments, if any, is dependent on the extent of property sales, the amount of mortgage loan and mortgage bond indebtedness related to the property sold and the balance of the revolving loan from 2668921 Manitoba Ltd.

During the second quarter of 2013, LREIT implemented a normal course issuer bid (NCIB) for the Series G debentures. The NCIB provides for the repurchase of debentures by LREIT to a maximum amount of $2,493,000 during the twelve month period ending June 16, 2014. As of December 31, 2013, debentures with a face value of $87,200 were purchased and cancelled.

As of December 31, 2013, the total face value of the mortgage bonds is $16,000,000. The second mortgage bonds mature on December 24, 2015. Subsequent to December 31, 2013, in conjunction with the sale of Nova Court, mortgage bonds with a face value of $10 Million were redeemed in full.

Reserves Required by Mortgage Loan Agreements

In accordance with mortgage loan agreements, cash deposits are provided to certain lenders to be held in escrow to fund future capital expenditures. As of December 31, 2013, cash deposits in regard to future capital expenditures amount to $1,757,624.

Capital Expenditures

Capital expenditures for investment properties and the seniors' housing complexes are expected to be approximately $3.3 Million for 2014.

Summary

Management expects that the proceeds from upward refinancings, supplemented by draws on the revolving loan commitment and periodic credit support from Shelter Canadian, as required, will be sufficient to fund the projected funding commitments of LREIT for the next 12 months. As of the date of this report, the revolving loan is fully drawn.

The net proceeds from property sales, after repayment of any related mortgage loan and mortgage bond indebtedness, will be used to repay any amounts owing to 2668921 Manitoba Ltd. with any remaining proceeds to be applied to the redemption of the Series G debentures.

CAPITAL STRUCTURE

Capital Structure - December 31, 2013

	December 31, 2013		December 31, 2012	
	Amount	%	Amount	%
Long-term debt	$ 153,444,803	37.9 %	$ 86,760,933	21.3 %
Current portion of long-term debt	133,787,529	33.1 %	219,463,616	53.9 %
Equity	117,452,013	29.0 %	100,829,954	24.8 %
Total capitalization	$ 404,684,345	100.0 %	$ 407,054,503	100.0 %

Long-term Debt

The long-term debt of LREIT includes mortgage loans, a swap mortgage loan, mortgage bonds, debenture debt, a defeased liability, mortgage guarantee fees payable and accrued interest payable, less unamortized transaction costs. On the Statement of Financial Position, the long-term debt of investment properties is separated into a current and non-current portion, while the long-term debt for the two seniors' housing complexes in discontinued operations is classified under "Liabilities classified as held for sale". The long-term debt for the seniors' housing complexes consists solely of mortgage loan debt, less unamortized transaction costs. The amount payable in regard to the acquisition of Parsons Landing is included in trade and other payables.

Change in Total Long-term Debt

As disclosed in the following chart, the total long-term debt of LREIT as of December 31, 2013 decreased by $21,227,761 or 6.6% compared to the total long-term debt as of December 31, 2012. The decrease mainly reflects a decrease in mortgage loan debt.

	December 31		Increase
	2013	2012	(Decrease)
Long-term debt - Investment properties			
Secured long-term debt			
Mortgages loans	$ 228,713,265	$ 247,654,245	$ (18,940,980)
Swap mortgage loans	17,061,239	17,888,836	(827,597)
Mortgage bonds	14,913,008	14,458,831	454,177
Debentures	24,873,800	24,961,000	(87,200)
Defeased liability	2,644,615	2,701,511	(56,896)
Total secured long-term debt	288,205,927	307,664,423	(19,458,496)
Mortgage guarantee fees	91,362	133,864	(42,502)
Accrued interest payable	1,975,830	1,746,367	229,463
Unamortized transaction costs	(3,040,787)	(3,320,105)	279,318
Total long-term debt - Investment properties	287,232,332	306,224,549	(18,992,217)
Total long-term debt - Properties held for sale	13,042,918	15,278,462	(2,235,544)
Total long-term debt	$ 300,275,250	$ 321,503,011	$ (21,227,761)

Swap Mortgage Loan

As of December 31, 2013, the amount of swap mortgage loan debt outstanding, excluding unamortized transaction costs was $17,061,239, representing a decrease of $827,597 in comparison to the amount outstanding as of December 31, 2012. The decrease is comprised of $540,899 of debt principal repayments and a $286,698 decrease in the fair value of the interest rate swap.

Mortgage Loans

Change in Total Mortgage Loan Debt

As of December 31, 2013, the mortgage loan debt of LREIT decreased by $21,193,691 compared to the amount payable as of December 31, 2012. As disclosed in the following chart, the decrease is attributable to regular repayments of principal, lump-sum principal prepayments, a net reduction of debt on refinancing and a reduction of mortgage loans on sale of properties.

	Year Ended December 31, 2013		
	Total	Investment Properties	Seniors' Housing Complexes
Proceeds of mortgage loan financing	$ 166,500,000	$ 166,500,000	$ -
Repayment of mortgage loans on refinancing	(167,263,300)	(167,263,300)	-
Net proceeds (repayment)	(763,300)	(763,300)	-
Regular repayment of principal on mortgage loans	(7,289,299)	(6,036,588)	(1,252,711)
Prepayment of mortgage loans	(2,998,500)	(1,998,500)	(1,000,000)
Reduction of mortgage loans on sale of properties	(10,142,592)	(10,142,592)	-
Decrease in mortgage loans	(21,193,691)	(18,940,980)	(2,252,711)
Total mortgage loans - December 31, 2012	262,949,874	247,654,245	15,295,629
Total mortgage loans - December 31, 2013	$ 241,756,183	$ 228,713,265	$ 13,042,918

Net Proceeds (Repayment) of Mortgage Loan Financing

Investment Properties

In January 2013, a 4.99%, $21 Million first mortgage loan was obtained for the six apartment properties in downtown Fort McMurray. After discharging the existing mortgage loan debt on the six apartment properties in downtown Fort McMurray of $20.4 Million, the net proceeds from refinancing were $600,000. The proceeds were used to fund a capital expenditure reserve account of $600,000.

In April 2013, a combined total of $96 Million of mortgage loan financing was obtained, comprised of a 3.7%, $42 Million first mortgage loan for Colony Square, a 6.00%, $39.7 Million first mortgage loan for Laird's Landing, and a 10.825%, $14.3 Million blanket second mortgage loan on Laird's Landing, Millennium Village and Willowdale Gardens. The proceeds from the financing, combined with the application of $2.7 Million in collateral deposits, were used to discharge $98.9 Million of existing mortgage loan financing, and fund a $250,000 replacement reserve account.

In October 2013, a 6.5%, $11 Million first mortgage loan and a 12%, $3 Million second mortgage loan were obtained for Lakewood Townhomes. The proceeds from the financing were used to discharge $9.8 Million of existing mortgage loan financing and to pay down the 10.825% blanket second mortgage loan.

In November 2013, a 5%, $31 Million first mortgage loan and a 11.75%, $4.5 Million second mortgage loan were obtained for Nelson Ridge. The proceeds from the financing were used to discharge $34.3 Million of existing mortgage loan financing and for general working capital purposes.

After accounting for the application of collateral deposits and transaction costs, the net inflow from mortgage financing activities was $0.5 Million during 2013.

Discontinued Operations (Seniors' Housing Complexes)

During the third quarter of 2013, the mortgage loan for Elgin Lodge was renewed for a one year term. The renewal encompassed a $1 Million lump-sum paydown of the loan.

The decrease in the mortgage loan debt for discontinued operations of approximately $2.3 Million, as disclosed in the preceding chart, reflects the $1 Million paydown, as well as regular principal payments.

Regular Repayments of Principal

During 2013, the cash outflow for regular repayments of mortgage loan principal for both investment properties and discontinued operations amounted to $7,289,299, compared to $7,681,749 during 2012.

Revolving Loan

As of December 31, 2013, the amount withdrawn on the revolving loan was $905,000, compared to $5,025,000 as of December 31, 2012. The revolving loan was paid down by $11 Million on December 31, 2013 from the net sale proceeds from Nova Court. Subsequent to December 31, 2013, $10 Million was drawn on the revolving loan in order to redeem $10 Million of mortgage bonds related to the sale of Nova Court in 2013. During 2013, the interest rate on the revolving loan was 12% (2012 - 9.75% to 12%). The revolving loan is included in "Trade and other payables" on the Statement of Financial Position of LREIT. Interest on the revolving loan commitment is included in mortgage loan interest.

Composition of Mortgage Loan Debt - December 31, 2013

Summary of Mortgage Loans Payable

Year of Maturity (Note 1)	Weighted Average Interest Rate (Note 2)	Amount December 31, 2013	Percentage of Total
Investment Properties			
Fixed rate			
2014	3.7 %	$ 35,290,136	14.6 %
2015	5.0 %	9,138,719	3.8 %
2016	9.1 %	7,724,963	3.2 %
2017	5.7 %	19,714,175	8.2 %
2018	4.1 %	62,099,640	25.7 %
2019	5.0 %	31,000,000	12.7 %
	4.7 %	164,967,633	68.2 %
Demand/variable rate	7.2 %	63,745,632	26.4 %
Principal amount		228,713,265	94.6 %
Discontinued Operations			
Demand/variable rate	5.0 %	13,042,918	5.4 %
Total		$ 241,756,183	100.0 %

(1) The year of maturity for the above noted schedule reflects the contractual obligation and does not reflect the IFRS requirement to disclose fixed term loans secured by a demand promissory note.

(2) As of December 31, 2013, the weighted average interest rate of the mortgage loan debt for investment properties, discontinued operations and total mortgage loan debt is 5.4%, 5.0% and 5.4%, respectively, compared to 7.3%, 5.0% and 7.2% at December 31, 2012.

The weighted average interest rate for mortgage loan debt excludes the interest on the revolving loan and interest on the acquisition payable on Parsons Landing. The interest payments on the acquisition payable represent an effective interest rate of 8%.

Mortgage Loan Debt Summary *

	2013			
	Q 4	Q 3	Q 2	Q 1
Weighted average interest rate				
Investment properties				
Fixed rate mortgage loans	4.7%	4.3%	4.5%	4.3%
Variable rate mortgage loans	7.2%	7.7%	7.7%	7.7%
Investment properties and discontinued operations				
Mortgage loans, swap mortgage loan, mortgage bonds, debentures, defeased liability and revolving loan	5.9%	6.2%	6.2%	7.0%
Ratio of mortgage loans and swap mortgage loan, compared to carrying value of income-producing properties and discontinued operations *	65%	64%	66%	67%
Ratio of mortgage loans, swap mortgage loan, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	76%	73%	76%	77%

	2012			
	Q 4	Q 3	Q 2	Q 1
Weighted average interest rate				
Investment properties				
Fixed rate mortgage loans	4.8%	4.9%	5.0%	5.5%
Variable rate mortgage loans	9.0%	9.0%	8.9%	8.9%
Investment properties and discontinued operations				
Mortgage loans, swap mortgage loan, mortgage bonds, debentures, defeased liability and revolving loan	7.4%	7.2%	6.8%	7.2%
Ratio of mortgage loans and swap mortgage loan, compared to carrying value of income-producing properties and discontinued operations *	68%	72%	73%	74%
Ratio of mortgage loans, swap mortgage loan, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	78%	81%	83%	82%

* Excludes the revolving loan, the amount payable on the acquisition of Parsons Landing and property value for Parsons Landing.

Long-term Debt Maturities

All mortgage loans for investment properties which have matured prior to March 13, 2014 have been renewed or refinanced

Debt Covenant Breaches

For investment properties, one swap mortgage loan with a principal balance of $17,061,239 is in breach of debt service coverage requirements as of December 31, 2013. The swap mortgage loan matures on May 1, 2018. The covenant breach is expected to be eliminated through modified loan terms.

A summary of the mortgage loan debt which matures during 2014 is provided in the "Capital Resources and Liquidity" section of this report.

Trust Units

Units Outstanding

Authorized	unlimited
Issued as of,	
- December 31, 2012	18,084,011
- December 31, 2013	19,423,011
- March 13, 2014	20,050,886

As of December 31, 2013, LREIT had 19,423,011 units outstanding, representing an increase of 1,339,000 units or 7.40%, compared to the number of units outstanding as of December 31, 2012.

The increase in the number of units outstanding mainly reflects the exercise of 1,332,000 warrants during 2013 for cash proceeds of $999,000.

The "special" distribution in the form of additional trust units on December 31, 2013 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.

A summary of the Distribution Reinvestment Plan (DRIP), the Normal Course Issuer Bid (NCIB), Unit Option Plan, the Deferred Unit Plan and the terms of the outstanding warrants of LREIT are provided in the Annual Information Form (AIF). The AIF is available on the SEDAR website at www.sedar.com.

OTHER LIABILITIES

Acquisition Payable

The amount payable on the acquisition of Parsons Landing is included in "Trade and other payables" on the Statement of Financial Position of LREIT. Interest on "acquisition payable" is included in interest expense.

As of December 31, 2013, the amount payable in regard to the acquisition of Parsons Landing, excluding accrued interest, was $44,006,731.

Subsequent to December 31, 2013, the amount payable on the acquisition of Parson Landing was reduced to a balance of $40,356,731 as a result of payments made on the outstanding balance of $3,000,000 on January 3, 2014 and $650,000 on January 31, 2014. On March 6, 2014, the purchase of Parsons Landing was completed, interest in excess of the $300,000 monthly payment in the aggregate amount of $27,866,454 was forgiven and the amount payable on the acquisition of Parsons Landing was paid in full.

Interest charges for the period from January 1, 2010 to December 31, 2013, amounted to $41,308,651 of which $10,030,320 pertains to 2013. Based on the actual events which have occurred since the initial payment deadline date, management expects that the entire amount of the "excess interest" which has accrued since January 1, 2010 will be forgiven and, as such, the Financial Statements for the year ended December 31, 2013 reflect the forgiveness of interest in the amount of $6,430,320. The recognition of the forgiveness of interest has resulted in the reduction of accrued interest payable by $26,908,651 for the 48 month period ended December 31, 2013. "Excess interest" represents the interest charges in excess of the $300,000 monthly interest payments which are required by the vendor. The interest of $300,000 per month represents an effective interest rate of 8%.

RELATED PARTY TRANSACTIONS

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, valuation adjustments and defeasance assets. The Services Agreement provides for payment of the fee to occur on a monthly basis, on the last day of each month. The Services Agreement expires December 31, 2019.

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 investment properties in the portfolio of LREIT and acts as the Property Manager for all of the properties, except for the seniors' housing complexes, where LREIT has retained third party managers to provide on site management services due to the nature of the operations. 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 investment properties where it acts as Property Manager. In regard to commercial properties, Shelter Canadian 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 is also entitled to tenant improvement and renovation fees equal to 5% of the total cost of such work. The Property Management Agreement expires December 31, 2019.

Property management fees are included in property operating costs. Leasing commissions and tenant improvement and renovation fees are capitalized to investment properties. During the period of major in-suite renovations or development operating costs are capitalized to the cost of buildings and properties under development.

During 2013, the fees payable to Shelter Canadian for investment properties included service fees of $1,435,351 and property management fees of $1,678,677.

Services fee and renovation fee for Lakewood Townhomes condominium sales program

LREIT has entered into an agreement with Shelter Canadian, in regard to the condominium sales program at Lakewood Townhomes. Under the agreement, Shelter Canadian will administer the sales program and completion of the in-suite renovations. LREIT pays a service fee equal to 5% of the gross sales proceeds. Shelter Canadian is responsible for the payment of a fixed fee to an external real estate broker for providing brokerage services. If it is necessary to increase the fixed fee due to market conditions, the fee payable to Shelter Canadian increases by the amount of the increase in the fixed rate. LREIT also pays a renovation fee equal to 5% of the cost of the in-suite upgrade costs for the condominium sales program.

During 2013, LREIT incurred service fees in regard to the condominium sales program of $75,847 and renovation fees of nil.

Loans

Revolving Loan

LREIT utilizes a revolving "operating" loan commitment from 2668921 Manitoba Ltd., the parent company of Shelter Canadian. As of December 31, 2013, the revolving loan commitment was secured by mortgage charges against the title to five investment properties, two seniors' housing complexes and the assignment of a mortgage loan receivable in the amount of $8,545,600.

A summary of the terms for the revolving loan commitment from January 1, 2012 are provided in the following chart.

Revolving Loan Term				Maximum	Maximum Loan
From	To	Renewal Fees	Interest Rate	Interest Charge	Commitment
January 1, 2012	March 31, 2012	$ -	9.75%	$ 162,594	$ 12,000,000
April 1, 2012	August 31, 2012	75,000	10.00%	625,000	15,000,000
September 1, 2012	December 31, 2012	150,000	12.00%	500,870	15,000,000
January 1, 2013	June 30, 2013	25,000	12.00%	379,916	12,000,000
July 1, 2013	December 31, 2013	25,000	12.00%	872,637	15,000,000
January 1, 2014	September 30, 2014	25,000	12.00%	1,181,357	15,000,000

Effective January 1, 2014, the revolving loan commitment from 2668921 Manitoba Ltd. was renewed for a term expiring September 30, 2014, with a maximum loan amount of $15 Million at an interest rate of 12%, subject to a maximum interest and fee payment of $1,206,357 for the period from January 1 to September 30, 2014. A renewal commitment fee of $25,000 was charged at the renewal.

The revolving loan is included in "Trade and other payables" on the Statement of Financial Position of LREIT. Interest on the revolving loan is included in interest expense and categorized under "mortgage loan interest". Renewal and extension fees are included in transaction costs.

Shelter Canadian

The Trust obtained interest-free advances from Shelter Canadian in 2011 and 2012. The interest-free advances payable, as at December 31, 2011, as well as 16,169,000 of additional interest-free advances in 2012 were repaid in 2012.

Approval

The terms of the revolving loan and interest-free advances and the granting of security were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the loans. All necessary regulatory approvals were obtained for the revolving loan and all renewals.

During 2013, interest on the loan commitment amounted to $1,170,123, compared to $963,422 during 2012.

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 which are considered in assessing whether LREIT has the ability to continue to operate, including: (i) the cash deficiency from operations sustained by LREIT in prior years, (ii) the breach of debt covenant requirements which, as of the date of this report, remains on one swap mortgage loan of $17,061,239, (iii) the impact of the timing of increased rental rates and the improvement in occupancy levels in Fort McMurray and the ability of the Trust to continue to secure financing on the Fort McMurray properties, (iv) the working capital deficiency, (v) the reliance on Shelter Canadian and its parent company 2668921 Manitoba Ltd. for interim funding, (vi) the significant concentration of properties in Fort McMurray, (vii) the successful completion of additional property sales under the divestiture program, and (viii) the ability to complete upward refinancings to generate additional funds.

The financial capacity of LREIT to continue operations is dependent on improving cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio, the completion of property sales and/or upward refinancings, the continued ability of the Trust to repay, renew or refinance debt at maturity, the renewal of the revolving loan commitment from 2668921 Manitoba Ltd., and/or the continued availability of interim funding from Shelter Canadian. In the event that the net proceeds from property sales are less than anticipated, or in the absence of additional upward refinancing and/or continued interim funding from Shelter Canadian and its parent company 2668921 Manitoba Ltd., prior to completion of additional property sales, LREIT may not have the ability to fund all of its debt obligations.

Management believes that the going concern assumption is appropriate for the Financial Statements as the increasing economic activity in Fort McMurray has resulted in improved occupancy levels, and as the Trust has sold 23 properties under its divestiture program, including 2 properties in 2013. In addition, the Trust has renewed or refinanced all mortgage loans which have matured as of the date of this report. The Trust also obtained Unitholder approval for the extension of the maturity date for the Series G debentures and eliminated all covenant breaches on mortgage loan debt, with the exception of one swap mortgage loan which is in breach of a debt service coverage requirement.

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.

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.

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 lender's exercise of foreclosure rights or sale.

Revolving Loan Commitment From 2668921 Manitoba Ltd.

The financial capacity of LREIT to continue operations is partially dependent on the ongoing renewal of the revolving loan commitment from 2668921 Manitoba Ltd. which is subject to ongoing regulatory approval. The periodic deferral of interest payments on the revolving loan by LREIT may be necessary in 2014 depending on the timing of upward refinancings or property sales.

Interest expense on the revolving loan from 2668921 Manitoba Ltd. is included in mortgage loan interest.

Credit Support from Shelter Canadian

Shelter Canadian has provided LREIT with interim funding on a periodic basis, pending the receipt of funds from financing activities. The interim funding has been provided in the form of interest-free advances and deferred service fees.

The continuation of interim funding from Shelter Canadian may be necessary to ensure the ongoing operations of LREIT pending the generation of cash inflows from upward refinancings or property sales to the extent required to restore working capital.

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

In 2009, LREIT initiated a divestiture program targeting the sale of assets, with a value in excess of $250 Million. The objective of the divestiture program is to reduce total debt, including debenture debt, and in particular higher cost interim mortgage loan financing. The sale of properties under the divestiture program is also required in order for LREIT to generate sufficient cash inflows to meet its ongoing funding obligations and restore working capital.

From January 1, 2009 to December 31, 2012 LREIT sold 21 properties and 13 condominium units at Lakewood Townhomes for a combined gross selling price of $236 Million.

During 2013, the Trust sold two properties and three condominium units at Lakewood Townhomes for a combined gross selling price of $24.7 Million.

The current expectations of management are that the remaining seniors' housing complexes and/or other properties will be sold in 2014. In addition, the condominium sales program for the Lakewood Townhomes is expected to be substantially completed in 2016.

There can be no assurance that LREIT will complete the divestiture program under the time frame or to the extent which is contemplated by management.

Concentration of the Portfolio of LREIT in One Market

The property portfolio of LREIT has significant exposure to the Fort McMurray, Alberta market. The sale of properties which are located outside of Fort McMurray will also serve to increase the exposure of LREIT's portfolio to the Fort McMurray market.

At December 31, 2013, there were 22 properties in the real estate portfolio of LREIT comprised of 20 properties in the investment property portfolio and 2 seniors' housing complexes which are reflected in discontinued operations. The investment property portfolio consists of one commercial property, 18 residential properties and one mixed residential/commercial property, comprising a total of 1,918 rental units. The residential property portfolio includes 13 properties that are located in Fort McMurray, including Parsons Landing, which is undergoing lease-up. The 13 properties in Fort McMurray comprise a total of 1085 suites, or 57% of the total residential suites in the investment property portfolio. The 13 properties have an aggregate carrying value of $315.9 Million, which represents approximately 75% of the total aggregate carrying value of the investment property portfolio.

The investment properties in Fort McMurray, excluding Parsons Landing, accounted for 61% of the total revenue of LREIT during 2013 and 65% of the net operating income. Parsons Landing returned to full rental operations on October 3, 2013.

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.

Based on the growth in the level of production in the oil sands industry and the resulting increase in occupancy levels of the Fort McMurray properties, the residential property market in Fort McMurray has improved; however, there can be no assurance as to the extent of the improvement and there is the possibility that market conditions may decline. LREIT financial results for future periods are subject to numerous uncertainties arising from a marked slowdown in the oil sands industry and a weak general economy.

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 downturn in general economic conditions, a more restrictive capital market, a change in legislation and numerous other factors beyond the control of LREIT.

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.

Mortgage Maturities

To the date of this report, all mortgage loans which have matured have been renewed or refinanced.

Covenant Breaches

As of December 31, 2013, LREIT is in breach of debt service covenant requirement associated with one swap mortgage loan of $17.1 Million. It is expected that the covenant breach will be eliminated through modified loan terms. The swap mortgage loan matures on May 1, 2018.

There is a risk that the lender for the swap mortgage loan, which remains in breach, could demand early repayment of the loan. Management does not anticipate that the lender will demand early repayment, provided that LREIT continues to be current with its scheduled payments and interest. Management expects LREIT to remain current with its scheduled payments of principal and interest.

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. The Trust does not currently pay cash distributions. To the extent that it does make cash distributions in the future, such 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.

LREIT currently qualifies as a mutual fund trust for income tax purposes. In accordance with the terms of the Declaration of Trust, the 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. The Declaration of Trust provides that if the Trustees determine that available cash is not sufficient to satisfy payment of distributions, the Trustees may declare that the distribution be satisfied through the issuance of additional units, followed by an immediate consolidation of units such that, subject to the Declaration of Trust, unitholders own the same number of units on a post-consolidation basis.

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

Tax Treatment of LREIT

The annual determination of LREIT's status in regard to qualifying for the REIT Exception has a significant impact on the tax treatment of the Trust. The determination as to whether LREIT qualifies for the REIT Exception is subject to uncertainty and, as such, there is a risk that the tax treatment of the Trust may be less favourable than anticipated. Details regarding the REIT exception are provided in the "Taxation" section of this report.

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

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

Conflicts of Interest

There are potential conflicts of interest to which Trustees and officers of LREIT are, or may become, subject to in connection with the operations of LREIT. Arni Thorsteinson, a Trustee and Chief Executive Officer of LREIT, is also a director and officer of Shelter and the director and the President of 2668921 Manitoba Ltd., the parent company of Shelter. Shelter provides Asset and Property Management services to LREIT and is also engaged in a wide range of real estate and other business activities, including the development and management of real estate. Kenneth Dando the Chief Financial Officer of LREIT is also an employee of Shelter.

Shelter and its affiliates and associates and its director and officers, including Mr. Thorsteinson, may become involved in transactions in which their interests actually, or are perceived to, conflict with the interests of LREIT. Such conflicts will be subject to the procedures and remedies set out in the CBCA.

Shelter has granted LREIT a right of first refusal to acquire interests in multi-family residential properties on the terms and conditions available to Shelter and/or its affiliates, subject to limited exceptions in the case of properties which are managed by Shelter and/or its affiliates outside of the LREIT portfolio.

Shelter also provides asset management services to Temple Hotels Inc ("Temple"), a corporation with a primary focus of acquiring hotel businesses and assets. Mr. Thorsteinson is a Director and President and Chief Executive Officer of Temple. Temple acquired Siena Apartments from LREIT in 2012 and Nova Court from LREIT on December 31, 2013.

Mr. Thorsteinson abstained from voting on the sale of Siena Apartments and Nova Court by LREIT to Temple. The sales were approved by the Independent Trustees of LREIT. In addition, an independent third party appraisal was obtained for both properties which supported the consideration received by 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 Financial Statements of LREIT, in accordance with IFRS, 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:

- determination of "fair value" of investment property: the determination of the fair value of investment properties requires the use of estimates on future cash flows from assets (considering the implication of lease terms, tenant profiles, capital expenditures anticipated within the year, property conditions and similar variables) and discount rates applicable to those assets. These estimates are based on local market conditions existing at the Statement of Financial Position date;

- determination of "fair value" of the swap mortgage loan: the fair value of the interest rate swap arrangement is based on the difference between the market rental rates for a fixed term mortgage loan with same maturity and the variable interest rate payable under the mortgage;

- the determination of the fair value of the mortgage bond; at inception, the fair value of the mortgage bond was based on market interest rates with the residual value used to value the trust unit purchase warrants;

- determination of recoverable amount for rent and other receivables: rent and other receivables are recognized at the lower of the original invoiced value or recoverable amount. An allowance for uncollectible receivables is recorded when there is objective evidence that the Trust will not be able to recover the amount in full;

- interest expense on the acquisition payable: interest expense on the acquisition payable reflects the estimate that excess interest will be forgiven. Excess interest for 2013 is $6,430,320. Cumulative excess interest from January 1, 2010 to December 31, 2013 is $26,908,651;

- 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 deferred income tax assets and liabilities are based on estimates; and

- determination of the status of the Trust for income tax purposes: qualification for the REIT exception is subject to uncertainties in the interpretation and application of the SIFT rules and can only be determined for a given year after the year has ended.

TAXATION

Taxation of LREIT

LREIT qualifies as a closed-end mutual fund trust for income tax purposes. Prior to the enactment of legislation relating to the federal income taxation of publicly listed or traded trusts, LREIT was not subject to taxation on its income for a year to the extent that such income was distributed to the unitholders of LREIT, and those unitholders were, and would have been, subject to taxation as appropriate on such distributed income.

New legislation relating to the taxation of specified investment flow-through trusts ("SIFT" trusts) was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2012, are referred to as the "SIFT Rules". LREIT became a SIFT trust and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, subject to the REIT Exception (discussed below), distributions of income from a SIFT trust are not deductible in computing a SIFT trust's taxable income, and a SIFT trust is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception"). The REIT Exception contains a number of technical tests related to the property and revenue of a trust which must be monitored on an ongoing basis.

The REIT Exception is applied on an annual basis. Previously, LREIT did not qualify for the REIT Exception and therefore was subject to the SIFT Rules in 2011 and 2012. Prior to the end of 2012, LREIT disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of certain non-qualifying properties and other transactions, it has been determined that LREIT qualifies for the REIT Exception in 2013.

If LREIT qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to LREIT during that year, and LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, LREIT intends to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation. Accordingly, on December 31, 2013, LREIT paid a "special" distribution in the form of additional trust units. In total, 6,448,598 trust units were issued under the distribution with a value of $6.9 Million or $1.07 per unit, representing the closing market price of the units on December 31, 2013. 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.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of LREIT. The determination as to whether LREIT qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that LREIT will qualify for the REIT Exception in 2014 and subsequent years. There can be no assurance that LREIT will qualify for the REIT Exception and that LREIT will not be subject to income taxes imposed by the SIFT Rules in 2014 or any subsequent year.

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

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. If LREIT qualifies for the REIT Exception in a taxation year, 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, if any. Distributions (if any) 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 (if any) 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, 2013, have represented a reduction in adjusted cost base of the units, with the exception of the special distributions paid by LREIT in December 2009, December 2010 and December 2013.

If LREIT does not qualify for the REIT Exception, 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

No changes were made to the design of the internal controls over financial reporting during 2013 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 2013 Annual Report of Lanesborough Real Estate Investment Trust, including Schedule I, and the delivery of the report to the Unitholders has been approved by the Trustees.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
March 13, 2014

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
MANAGEMENT'S DISCUSSION AND ANALYSIS
2013 ANNUAL REPORT

SCHEDULE I

Real Estate Portfolio as of December 31, 2013

Property Portfolio

Property	Location	Purchase Price	Acquisition Date	Suites/ Leasable Area - Sq. Ft.	Occupancy December 31 2013
INVESTMENT PROPERTIES					
RESIDENTIAL					
Alberta					
Nelson Ridge Estates	Fort McMurray	$ 40,575,000	April 2005	225	88 %
Gannet Place	Fort McMurray	6,873,700	June 2006	37	92 %
Lunar Apartments	Fort McMurray	4,457,100	June 2006	24	63 %
Parkland Apartments	Fort McMurray	2,230,200	June 2006	12	67 %
Skyview Apartments	Fort McMurray	5,385,800	June 2006	29	83 %
Snowbird Manor	Fort McMurray	6,314,500	June 2006	34	82 %
Whimbrel Terrace	Fort McMurray	6,873,700	June 2006	37	86 %
Laird's Landing	Fort McMurray	51,350,000	August 2006	189	70 %
Woodland Park	Fort McMurray	37,865,000	March 2007	107	82 %
Lakewood Apartments	Fort McMurray	34,527,719	July 2007	111	64 %
Lakewood Townhomes (1)	Fort McMurray	19,029,211	July 2007	48	58 %
Millennium Village	Fort McMurray	24,220,000	November 2007	72	71 %
Parsons Landing (2)	Fort McMurray	60,733,000	September 2008	160	63 %
Norglen Terrace	Peace River	2,500,000	October 2004	72	90 %
Westhaven Manor	Edson	4,050,000	May 2007	48	92 %
Manitoba					
Highland Tower (3)	Thompson	5,700,000	January 2005	77	86 %
Colony Square (4)	Winnipeg	29,907,700	October 2008	428	94 %
Willowdale Gardens	Brandon	4,326,000	January 2006	88	98 %
Northwest Territories					
Beck Court	Yellowknife	14,300,000	April 2004	120	88 %
Total - Residential		**361,218,630**	Total suites	**1,918**	
COMMERCIAL					
Retail and Office					
Colony Square (2)	Winnipeg, MB	7,931,600	October 2008	83,190	96 %
Light Industrial					
156 / 204 East Lake Blvd. (5)	Airdrie, AB	1,600,000	June 2003	39,936	- %
Total - Commercial		**9,531,600**	Total leasable area	**123,126**	
Total investment properties		**$ 370,750,230**			

Property Portfolio

Property	Location	Purchase Price	Acquisition Date	Suites/ Leasable Area - Sq. Ft.	Occupancy December 31 2013
SENIORS' HOUSING COMPLEXES					
Saskatchewan					
Chateau St. Michael's	Moose Jaw	$ 7,600,000	June 2006	93	97 %
Ontario					
Elgin Lodge (6)	Port Elgin	18,122,000	June 2006	115	68 %
Total seniors' housing complexes		**25,722,000**	Total suites	**208**	
Total real estate portfolio		**$ 396,472,230**			

Notes to the Property Portfolio:

(1) Lakewood Townhomes is comprised of 64 condominium units. The number of suites as of December 31, 2013 reflects the sale of four condominium units in 2011, nine condominium units in 2012 and three condominium units in 2013. Eight units are unoccupied and held as available for sale and are not included in the occupancy statistic.
(2) LREIT obtained possession of Parsons Landing on September 1, 2008. In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. On June 1, 2013, 84 of 160 units were reconstructed and returned to rental operations. On October 3, 2013, the remaining 76 units were reconstructed and returned to rental operations. On March 6, 2014, the purchase of Parsons Landing was completed.
(3) Includes the cost of major renovations and asset additions.
(4) Colony Square is comprised of one mixed residential/commercial property.
(5) Subsequent to December 31, 2013, a long term commercial lease for 100% of the property has been executed.
(6) During 2013, the number of suites at Elgin Lodge decreased from 124 suites to 115 as a result of the renovation and conversion of studio suites to one bedroom suites. The Elgin Lodge renovations are considered to be improvements to the revenue generating capacity of the property.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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 fulfil 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 statements and other financial information. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards and, where appropriate, reflect estimates based on management's best judgment in the circumstances.

The consolidated 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 free access to the Audit Committee.

MNP LLP, the independent auditors, appointed by the Unitholders, have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the consolidated financial statements.

"Arni C. Thorsteinson"

Arni C. Thorsteinson
Chief Executive Officer

"Kenneth J. Dando"

Kenneth J. Dando
Chief Financial Officer

March 13, 2014

To the Unitholders of Lanesborough Real Estate Investment Trust:

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

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

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

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

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that Lanesborough Real Estate Investment Trust as at December 31, 2013 has a working capital deficit of $4,259,858 and is in breach of a debt covenant. These conditions, along with other matters as set forth in Note 2, indicate the existence of a material uncertainty that may cast significant doubt about the Trust's ability to continue as a going concern.

MNP LLP

Winnipeg, Manitoba
March 13, 2014

Chartered Accountants

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31 2013	December 31 2012
ASSETS		
Non-current assets		
Investment properties (Note 5)	**$421,040,369**	$427,967,800
Loans and receivables (Note 6)	**-**	11,863,320
Defeasance assets (Note 7)	**2,879,978**	3,025,370
Restricted cash (Note 8)	**4,241,812**	7,801,248
Total non-current assets	**428,162,159**	450,657,738
Current assets		
Cash	**2,401,741**	1,254,278
Rent and other receivables (Note 9)	**10,129,493**	1,274,277
Deposits and prepaids (Note 10)	**893,063**	1,363,730
	13,424,297	3,892,285
Assets classified as held for sale (Note 11)	**26,485,863**	27,002,555
Total current assets	**39,910,160**	30,894,840
TOTAL ASSETS	**$468,072,319**	$481,552,578
LIABILITIES AND EQUITY		
Liabilities		
Non-current liabilities		
Long-term debt (Note 12)	**$153,444,803**	$ 86,760,933
Total non-current liabilities	**153,444,803**	86,760,933
Current liabilities		
Trade and other payables (Note 13)	**47,306,909**	54,040,678
Current portion of long-term debt (Note 12)	**133,787,529**	219,463,616
Deposits from tenants	**2,518,165**	2,428,393
	183,612,603	275,932,687
Liabilities classified as held for sale (Note 11)	**13,562,900**	18,029,004
Total current liabilities	**197,175,503**	293,961,691
Total liabilities	**350,620,306**	380,722,624
Total equity	**117,452,013**	100,829,954
TOTAL LIABILITIES AND EQUITY	**$468,072,319**	$481,552,578

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 COMPREHENSIVE INCOME

	Year Ended December 31	
	2013	**2012**
Rentals from investment properties	**$ 40,328,764**	$ 38,410,992
Property operating costs	**16,119,995**	15,981,763
Net operating income	**24,208,769**	22,429,229
Interest income	**1,272,740**	969,607
Forgiveness of debt	**-**	859,561
Interest expense (Note 14)	**(27,223,579)**	(33,261,469)
Trust expense	**(2,312,565)**	(2,323,979)
Profit on sale of investment properties	**221,642**	915,531
Fair value gains (Note 5)	**6,970,031**	10,308,723
Fair value adjustment of Parsons Landing (Note 5)	**8,929,707**	(3,500,000)
Income recovery on Parsons Landing (Note 5)	**2,622,629**	3,278,987
Insurance proceeds	**-**	925,355
Income before taxes and discontinued operations	**14,689,374**	601,545
Current income tax expense (Note 15)	**-**	49,763
Income before discontinued operations	**14,689,374**	551,782
Income from discontinued operations (Note 11)	**830,212**	19,546,526
Income and comprehensive income	**$ 15,519,586**	$ 20,098,308
Income per unit before discontinued operations:		
Basic	**$ 0.774**	$ 0.030
Diluted	**$ 0.634**	$ 0.029
Income per unit from discontinued operations:		
Basic	**$ 0.044**	$ 1.049
Diluted	**$ 0.036**	$ 1.044
Income per unit:		
Basic	**$ 0.818**	$ 1.079
Diluted	**$ 0.670**	$ 1.073

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Year Ended December 31	
	2013	**2012**
Issued capital (Note 17)		
Balance, beginning of year	**$107,978,701**	$107,860,241
Units issued on:		
- Payment of distributions	**6,900,000**	
- Exercise of options	**2,380**	-
- Exercise of warrants	**1,219,313**	160,195
Units purchased under normal course issuer bid	**-**	(41,735)
Balance, end of year	**116,100,394**	107,978,701
Contributed surplus		
Balance, beginning of year	**17,211,070**	17,108,697
Value of deferred units granted	**75,000**	75,000
Value of unit options granted	**26,093**	56,318
Warrants exercised	**(220,313)**	(28,945)
Balance, end of year	**17,091,850**	17,211,070
Cumulative earnings		
Balance, beginning of year	**43,090,218**	22,991,910
Income and comprehensive income	**15,519,586**	20,098,308
Balance, end of year	**58,609,804**	43,090,218
Cumulative distributions to unitholders	**-**	-
Balance, beginning of year	**(67,450,035)**	(67,450,035)
Distributions declared	**(6,900,000)**	-
Balance, end of year	**(74,350,035)**	(67,450,035)
Total equity	**$117,452,013**	$100,829,954

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31 2013	2012
Operating activities		
Income and comprehensive income	**$ 15,519,586**	$ 20,098,308
Adjustments to reconcile income to cash flows		
Fair value gains	**(6,970,031)**	(10,308,723)
Fair value adjustment of Parsons Landing	**(8,929,707)**	3,500,000
Profit on sale of properties	**(221,642)**	(15,949,842)
Write down of note receivable	**205,000**	-
Forgiveness of debt	**-**	(859,561)
Accrued rental revenue	**82,342**	371,443
Gain on debenture repurchases	**(3,985)**	-
Unit-based compensation	**101,093**	131,318
Deferred income tax expense	**(285,734)**	(5,368,399)
Interest income	**(1,272,740)**	(969,607)
Interest received	**660,459**	617,668
Interest expense	**27,971,416**	37,786,525
Interest paid	**(24,825,831)**	(31,195,083)
Cash from operations	**2,030,226**	(2,145,953)
Decrease in rent and other receivables	**134,017**	669,456
Decrease in deposits and prepaids	**482,084**	396,039
Increase (decrease) in tenant deposits	**83,595**	(757,585)
Decrease in trade and other payables	**(1,104,445)**	(2,700,569)
	1,625,477	(4,538,612)
Cash provided by (used in) financing activities		
Proceeds of mortgage loan financing	**166,500,000**	105,649,377
Repayment of mortgage loans on refinancing	**(167,263,300)**	(96,804,315)
Repayment of long-term debt	**(7,929,596)**	(8,574,301)
Prepayment of mortgage loans	**(2,998,500)**	(10,435,000)
Proceeds of revolving loan commitment	**13,880,000**	34,943,629
Repayment of revolving loan commitment	**(18,000,000)**	(41,918,629)
Proceeds of Shelter Canadian Properties Limited advances	**-**	16,169,000
Repayment of Shelter Canadian Properties Limited advances	**-**	(17,352,000)
Expenditures on transaction costs	**(2,452,158)**	(3,258,692)
Exercise of options	**2,380**	-
Exercise of warrants	**999,000**	131,250
Units purchased and cancelled under normal course issuer bid	**-**	(41,732)
Debentures purchased and cancelled under normal course issuer bid	**(83,215)**	(351,000)
	(17,345,389)	(21,842,413)
Cash provided by (used in) investing activities		
Capital expenditures on investment properties	**(3,275,839)**	(2,906,894)
Capital expenditures on property and equipment	**(255,686)**	(38,368)
Decrease in defeasance assets	**145,392**	142,823
Proceeds of mortgage loan receivable	**3,200,000**	-
Taxes paid on property sold	**(1,734,702)**	-
Proceeds of sale	**14,468,789**	21,927,121
Change in restricted cash	**3,555,578**	7,736,373
	16,103,532	26,861,055
Cash increase	**383,620**	480,030
Add (deduct) decrease (increase) in cash from discontinued operations (Note 11)	**763,844**	(396,371)
	1,147,464	83,659
Cash, beginning of year	**1,254,278**	1,170,619
Cash, end of year	**$ 2,401,742**	$ 1,254,278

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

1 Organization

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

The registered office for the Trust is located at 2600 Seven Evergreen Place, Winnipeg, Canada. The Trust is listed on the Toronto Stock Exchange ("TSX"). The following schedule reflects securities of the Trust, which trade on the TSX and the related trading symbols:

Units	LRT.UN
Series G Debentures	LRT.DB.G
Mortgage Bonds	LRT.NT.A
Trust unit purchase warrants expiring March 9, 2015	LRT.WT
Trust unit purchase warrants expiring December 23, 2015	LRT.WT.A

The Trust and its subsidiaries earn income from real estate investments in Canada.

2 *Basis of presentation and continuing operations*

The consolidated financial statements of the Trust for the years ended December 31, 2013 and 2012 ("Financial Statements"), have been prepared in accordance with International Accounting Standards ("IFRS"). The Financial Statements were authorized for issue in accordance with a resolution of the Board of Trustees on March 13, 2014.

The Financial Statements of the Trust reflect the operations of the Trust and LREIT Holdings 32 Corporation and LREIT Holdings 39 Corporation, which are wholly owned operating subsidiaries under its control. The Financial Statements have been prepared on a historical cost basis except for investment properties and certain financial instruments that are measured at fair value. The Financial Statements have been prepared on a going concern basis and have been prepared in Canadian dollars.

The 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 IFRS 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 generated cash from operating activities of $1,625,477 for the year ended December 31, 2013 (2012 - cash deficiency of $4,538,612). After deduction of capital expenditures and regular principal repayments of long term debt, the Trust incurred a cash deficiency of $9,835,645 for the year ended December 31, 2013 (2012 - $16,058,175). In addition, the Trust has a working capital deficit of $4,259,858 as at December 31, 2013 (December 31, 2012 - deficit of $4,462,801) and the Trust was in breach of debt service and other covenant requirements on one swap mortgage loan (December 31, 2012 - four mortgage loans and one swap mortgage loan).

The Trust is in breach of a 1.15 overall Trust debt service coverage requirement of a $17,061,239 swap mortgage loan on a property in Fort McMurray, Alberta. The Trust has notified the lender of the breach and is providing operating information to the lender on a monthly basis. The covenant breach may continue for the next 12 months and there can be no assurance that the covenant breach will be remedied.

There are no cross-default covenants between the mortgage loans noted above and the other mortgage loans, mortgage bonds or debentures of the Trust.

2 Basis of presentation and continuing operations (continued)

Continuation of operations is contingent upon improving cash flows from operations and in particular, the operating cash flows from the Fort McMurray portfolio, the continuation of the divestiture program, the continued ability of the Trust to renew or refinance its debt and the continued support of related parties in the form of the renewal of the revolving loan commitment, the provision of advances and the deferral of fees.

Management believes that the going concern assumption is appropriate for the Financial Statements as the Trust has successfully sold 23 properties, including two properties during the year ended December 31, 2013, the Trust has successfully renewed mortgage loans at maturity, the Trust has extended the maturity date for the Series G debentures to 2015 and the Trust has successfully eliminated covenant breaches on eight mortgage loans through refinancing and/or improved operations.

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 Financial Statements.

Statement of compliance
The Financial Statements of the Trust have been prepared in accordance with International Financial Reporting Standards (IFRS). The Trust follows accounting policies under IFRS as disclosed in Note 3. The Financial Statements are based on IFRS standards issued and effective as at March 13, 2013.

3 Significant accounting policies

(a) Principles of consolidation

The Financial Statements comprise the Financial Statements of the Trust and its subsidiaries. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Trust obtains control, and continue to be consolidated until the date that such control ceases. The Financial Statements of the subsidiaries are prepared for the same reporting period as the Trust, using consistent accounting policies.

All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Where property is acquired through the acquisition of corporate interests, management considers the substance of the assets and activities of the acquired entity in determining whether the acquisition represents the acquisition of a business.

Where an acquisition is not judged to be an acquisition of a business, it is not treated as a business combination and the cost to acquire the entity is allocated between the identifiable assets and liabilities of the entity based on their relative fair values at the acquisition date. Accordingly, no goodwill or additional deferred taxation arises. When an acquisition represents the acquisition of a business, the acquisition is accounted for as a business combination.

3 Significant accounting policies (continued)

(b) Investment Properties

The Trust follows IAS 40 "Investment Properties" and has chosen the fair value method of presenting investment properties in the Financial Statements.

Investment properties comprise completed properties and properties under construction or re-development held to earn rentals or for capital appreciation or both.

Investment properties are measured initially at cost including transaction costs. Transaction costs include transfer taxes, professional fees for legal services, initial leasing commissions to bring the property to the condition necessary for it to be capable of operating and similar costs. The carrying amount also includes the cost of replacing part of an existing investment property at the time that the cost is incurred if the recognition criteria are met.

Subsequent to initial recognition, investment properties are stated at fair value. Gains or losses arising from changes in the fair values are included in income in the period in which they arise. An investment property is derecognized upon sale.

The fair value of investment properties is determined by the Trust using recognized valuation techniques.

Investment properties held for sale are classified as assets held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

(c) Property and Equipment

Property and equipment are measured at cost less accumulated amortization and any accumulated impairment losses, in accordance with IAS 16 "Property and equipment".

The Trust provides for amortization of property and equipment in order to apply the cost of the assets over the estimated useful lives as follows.

	Method	Rate
Buildings	Straight-line	2.5%
Furniture and equipment	Straight-line	5% - 33.3%

Amortization is not recorded for property and equipment held in discontinued operations.

The Trust assesses at the end of each reporting period whether there is any indication that an asset may be impaired. Property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Assets that do not generate independent cash flows are combined into cash-generating units. Cash generating units are tested for impairment at the end of each reporting period and whenever there is an indication that the cash-generating unit may be impaired. If the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is assessed based on estimated future cash flows discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount and is recorded as an expense.

3 Significant accounting policies (continued)

(c) Property and Equipment (continued)

Assets or cash-generating units that have been impaired in prior periods are tested for possible reversal of impairment whenever events or changes in circumstances indicate that the impairment has reversed. If the impairment has reversed the carrying amount of the asset or cash-generating unit (excluding goodwill) is increased to its recoverable amount but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset in the prior periods. A reversal of an impairment loss is recognized in net income (loss). Impairment losses for goodwill are not reversed.

(d) Receivables

(i) Rent and other receivables

Rent and other receivables are recognized and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortized cost using the effective interest rate method. Provision is made when there is objective evidence that the Trust will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

(ii) Loans and receivables

Loans and receivables are recognized at amortized cost using the effective interest rate method. Under this method, fees, costs, discounts and premiums directly related to the loans and receivables are recognized in income over the expected life of the loans and receivables. All loans and receivables with maturities greater than 12 months after the Financial Statements date are classified as non-current assets. Provision is made when there is objective evidence that the Trust will not be able to recover balances in full.

(e) Cash

Cash comprises demand and short-term deposits at the bank with an original maturity of twelve months or less.

Cash deposits, which are not available for use by the Trust within a period of twelve months, are carried as restricted cash.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

3 Significant accounting policies (continued)

(f) Assets classified as held for sale

Held for sale assets
Investment Property is transferred to assets held for sale when it is expected that the carrying amount will be recovered principally through sale rather than from continuing use. For this to be the case the property must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such property and its sale must be highly probable.

For the sale to be highly probable:

- The Trustees must be committed to a plan to sell the property and an active program to locate a buyer and complete the plan must have been initiated
- The property must be actively marketed for sale at a price that is reasonable in relation to its current fair value
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification

Assets classified as held for sale are recorded as follows:

Investment Properties - fair value as stated in subparagraph (b) Investment Properties above
All other assets - lower of carrying value or fair value

Assets classified as held for sale are not depreciated or amortized.

Discontinued operations
A discontinued operation is a part of the business of the Trust that:

- Has been disposed of or has been classified as held for sale and that represents a major line of business or geographic area of operation;
- Is part of a single coordinated plan to dispose of such a line of business or area of operations, or
- Is a subsidiary acquired exclusively with a view to resell.

The results of discontinued operations are presented separately on the Statement of Comprehensive Income and the assets and liabilities are presented separately on the Statement of Financial Position.

(g) Mortgages loans and mortgage bonds

All mortgages loans and mortgage bonds are initially recognized at fair value less directly attributable transaction costs. After initial recognition, interest bearing loans and bonds are subsequently measured at amortized cost using the effective interest rate method. Under the effective interest rate method, any transaction fees, costs, discounts and premiums directly related to the loans and bonds are recognized in the Statement of Comprehensive Income over the expected life of the borrowings. Interest is recognized on an accrual basis. All mortgage loans and mortgage bonds with maturities greater than twelve months are classified as non-current liabilities. Notwithstanding the previous statement, mortgage loans and mortgage bonds with maturities greater than twelve months, but which are in breach of a debt covenant, and the debt becomes payable on demand as a result of said breach at the financial statement date, are classified as current liabilities.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

3 Significant accounting policies (continued)

(h) Debentures

Debentures are separated into debt and equity components based on the respective fair values at the date of issue. The value of the debt component is calculated at the estimated fair value of the future interest and principal payments due under the terms of the debentures. The value assigned to the equity component of debentures represents the value of the conversion feature.

Subsequent to initial recognition, the liability component of a debenture is measured at amortized cost using the effective interest method. The equity component of a debenture is not measured subsequent to initial recognition.

(i) 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. At the end of each reporting period, the estimate of unit options expected to vest is revised and compensation expense in regard to options granted to officers, employees and trustees is recognized.

(j) Tenant deposits

Tenant deposits liabilities are initially recognized at fair value. Where the time value of money is material, tenant deposits are carried at amortized cost, using the effective interest rate method. Any difference between the initial fair value and the amortized cost is included as a component of rentals from investment properties and recognized on a straight-line basis over the lease term.

(k) Revenue recognition

Management has determined that all of the leases with tenants are operating leases.

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 deferred rent receivable. Recoveries from tenants for property operating costs and property taxes are recognized as revenue during the period in which the applicable costs are incurred.

3 Significant accounting policies (continued)

(k) Revenue recognition (continued)

Incentives for lessees to enter into lease agreements are spread evenly over the lease term, even if payments are not made on such a basis. The lease term is the non-cancelable period of the lease together with any further term for which the tenant has the option to continue the lease, where, at the inception of the lease, it is reasonably certain that the tenant will exercise that option.

Premiums received to terminate leases are recognized in the income statement when they arise.

Meal and other revenue is recognized on the delivery of the meal or other service.

Interest income is recognized on an accrual basis using the effective interest method.

A property is regarded as sold and the gain or loss on sale is recognized when the significant risks and returns have been transferred to the buyer, which is normally upon closing on unconditional contracts. For conditional exchanges, sales are recognized only when all the significant conditions are satisfied.

(l) Income taxes

(i) The Trust

Effective January 1, 2013, the Trust qualifies as a mutual fund trust and real estate investment trust for income tax purposes. The Trust intends to pay or make payable in each year distributions to its unitholders in an amount that is required so that the Trust has no current tax expense for the year. As a result, the Trust does not account for income taxes for 2013.

For 2012, the Trust provided for current taxes and deferred taxes in the same manner as reported below for wholly owned subsidiaries. At December 31, 2012, the Trust adjusted the deferred tax balance to reflect the transition from a SIFT trust to a real estate investment trust for income tax purposes.

(ii) Wholly owned subsidiary companies

Current taxes
Current taxes for the current and prior periods are, to the extent unpaid, recognized as a liability. Current tax assets and liabilities for the current and prior periods are measured at amounts expected to be recovered from or paid to the taxation authorities, including interest. The tax rates and tax laws used to compute those amounts are the tax rates and tax laws which have been enacted or substantively enacted by the end of the reporting period.

Deferred taxes
Deferred tax assets and liabilities are recognized in respect of temporary differences between the tax base and carrying value of assets and liabilities, including accelerated capital allowances, unrelieved tax losses and other short-term temporary differences.

Deferred tax assets are recognized to the extent that it is regarded as probable that the benefit from the deductible temporary differences can be realized. The recoverability of all tax assets is assessed at the end of each reporting period.

3 Significant accounting policies (continued)

(l) Income taxes (continued)

(ii) Wholly owned subsidiary companies (continued)

Deferred tax (continued)
Deferred tax is calculated at the tax rates that are expected to apply in the periods in which that asset or liability will be settled, based on tax rates and tax laws enacted or substantively enacted at the end of the reporting period.

(m) Provisions

Provisions are recognized when the Trust has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will occur; and where a reliable estimate can be made of the amount of the obligation.

Where the effect of discounting is material, provisions are determined by discounting the expected future cash flows. The discount rate used is a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

The amount recognized as a provision is the best estimate at the reporting date of the expenditure required to settle the obligation.

(n) Per unit calculations

Basic per unit information is calculated using the weighted average number of units outstanding for the period, including vested deferred units. Diluted per unit information is calculated based on the weighted average diluted number of units for the period after 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 exercise of warrants to the extent that the warrants are dilutive. 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.

(o) Financial instruments

Financial instruments are measured at fair value on initial recognition. The measurement in subsequent periods and classification of financial assets and liabilities is dependent on the purpose for which the instruments were acquired or issued, their characteristics and the designation of such instruments by the Trust. Financial assets and financial liabilities classified as fair value through profit and loss are subsequently measured at fair value with gains and losses recognized in net income (loss). Financial instruments classified as held to maturity, loans and receivables, and other liabilities are subsequently measured at their amortized cost, using the effective interest method. Available for sale financial assets are subsequently measured at fair value with unrealized gains and losses recognized in other comprehensive income until disposition of the financial asset.

Financial instruments are derecognized when the Trust no longer controls the contractual rights that comprises a financial asset or when the obligation under a financial liability has been discharged, concluded or expired.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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

(o) Financial instruments (continued)

Based on the purpose for which assets and liabilities are acquired, the Trust has designated its financial instruments, as follows:

Financial Statement Item	Classification	Measurement
Loans and receivables	Loans and receivables	Amortized cost
Defeasance assets	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Cash	Loans and receivables	Amortized cost
Rent and other receivables	Loans and receivables	Amortized cost
Deposits	Loans and receivables	Amortized cost
Long term debt		
Mortgage loans	Other liabilities	Amortized cost
Mortgage bonds	Other liabilities	Amortized cost
Debentures	Other liabilities	Amortized cost
Swap mortgage loan	Fair value through profit and loss	Fair value
Defeased liability	Other liabilities	Amortized cost
Mortgage guarantee fees	Other liabilities	Amortized cost
Trade and other payables	Other liabilities	Amortized cost
Deposits from tenants	Other liabilities	Amortized cost

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 a default or delinquency in 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 income.

(p) Current and future changes to significant accounting policies

The following new standard was implemented with a January 1, 2013 effective date:

- IFRS 13 - Fair Value Measurement - The adoption of IFRS 13 did not require any change to the valuation techniques used by the Project to measure fair value and did not result in changes in the carrying value as at January 1, 2013.

The following new or amended standards have been issued by the International Accounting Standards Board (IASB):

- IFRS 9 - replaces IAS 39 - Financial Instruments: Recognition and Measurement, retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The effective date for the standard has been delayed indefinitely.

- IAS 40 - Investment Property: Clarifies that an entity applies judgment to determine whether the acquisition of investment property is the acquisition of an asset, a group of assets, or a business combination within the scope of IFRS 3. This judgement is based on the guidance in IFRS 3. Effective for annual periods beginning on or after July 1, 2014.

- IFRIC 21 - Levies: Clarifies that the obligating event giving rise to a liability to pay a levy is the activity described in the relevant legislation that triggers payment of the levy. Effective for year beginning on or after January 1, 2014.

The Trust is currently evaluating the impact of these standards on its Financial Statements.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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4 Significant accounting judgments, estimates and assumptions

The preparation of the Financial Statements of the Trust requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent liabilities at the Financial Statements date. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected.

(a) Judgments other than estimates

In the process of applying the accounting policies of the Trust, management has made the following judgments, which have the most significant effect on the amounts recognized in the Financial Statements:

Business combinations
The Trust acquires subsidiaries that own real estate. At the time of acquisition, the Trust considers whether the acquisition represents the acquisition of a business. The Trust accounts for an acquisition as a business combination when an integrated set of activities is acquired in addition to the property. More specifically, the following criteria are considered:

- The extent of the land and buildings owned by the subsidiary
- The extent to which significant processes are acquired and in particular the extent of ancillary services provided by the subsidiary (e.g., maintenance, cleaning, security, bookkeeping, meal services, etc.)
- Whether the subsidiary has allocated its own staff to manage the property and/or to deploy any processes (including all relevant administration such as invoicing, cash collection, provision of management information to the entity's owners and tenant information)

When the acquisition of subsidiaries does not represent a business, it is accounted for as an acquisition of a group of assets and liabilities. The cost of the acquisition is allocated to the assets and liabilities acquired based upon their relative fair values.

Operating lease contracts
The Trust has entered into leases with tenants. The Trust has determined, based on an evaluation of the terms and conditions of the arrangements, that it retains all the significant risks and rewards of ownership of the investment properties and accounts for the leases as operating leases.

Income taxes
For income tax purposes, the Trust was a specified investment flow-through trust (SIFT trust) for 2011 and 2012 and is a real estate investment trust for 2013. In order for the Trust to qualify as a real estate investment trust for a year, the property and revenue of the Trust must meet certain conditions. Management has assessed the property and revenue of the Trust against those conditions, and while uncertainties arise in the interpretation and application of any income tax law, management is satisfied that the Trust has met such conditions and that the Trust qualifies as a real estate investment trust for 2013.

4. *Significant accounting judgments, estimates and assumptions* (continued)

(a) Judgments other than estimates (continued)

Income taxes (continued)
Management expects that the Trust will continue to qualify as a real estate investment trust for 2014 and beyond. If the Trust were to fail to qualify as a real estate investment trust for any year for income tax purposes, the Trust would become a SIFT trust for that year and consequently would be unable to reduce its taxable income by issuing distributions to Unitholders. As a result, the Trust would be subject to a rate of income tax on its taxable income for the year which is substantially equivalent to the rate of income tax that is generally applicable to corporations. In addition, the Trust would be required to account for income taxes arising from all of its activities, and material adjustments to the consolidated financial statements could be required.

(b) Estimates

Valuations of property
Investment property is stated at fair value as at the financial statement date. Gains or losses arising from changes in the fair values are included in income in the period in which they arise. The valuations are prepared using recognized valuation techniques to determine the fair value of investment properties. The techniques comprise both the capitalized net operating income method and the discounted cash flow method. In certain cases, the fair values are determined based on recent real estate transactions with similar characteristics and location to those of the assets of the Trust.

The determination of the fair value of investment properties requires the use of estimates on future cash flows from assets (considering the implication of lease terms, tenant profiles, anticipated capital expenditures, property conditions and similar variables) and discount rates applicable to those assets. The estimates are based on local market conditions existing at the financial statement date.

Management uses their market knowledge and professional judgment as well as historic transactional comparables or external appraisals obtained. In these circumstances, a greater degree of certainty exists in estimating the market value of investment property than in a more active market in estimating the market values of investment property.

5 Investment properties

	Year Ended December 31 2013	2012
Balance, beginning of year	$427,967,800	$451,857,370
Additions - capital expenditures	3,275,839	2,906,894
Fair value gains	6,970,031	10,308,723
Dispositions (a)	(24,389,739)	(33,605,187)
Fair value adjustment of Parsons Landing (b)	8,929,707	(3,500,000)
Purchase price adjustment of Parsons Landing (b)	(1,713,269)	-
Balance, end of year	$421,040,369	$427,967,800

Investment properties have been valued using the following methods and key assumptions:

(i) *The capitalized net operating income method.* Under this method, capitalization rates are applied to net operating income. The key assumption is the capitalization rates which are based on reports from external knowledgeable property valuators. The capitalization rate reports provide a range of rates for various geographic regions and for various types and qualities of properties within each region.

The table below provides details of the range of capitalization rates used for valuing the investment properties of the Trust:

	December 31 2013		December 31 2012	
	Low	High	Low	High
Residential properties				
Fort McMurray	7.00 %	7.50 %	7.00 %	7.50 %
Yellowknife	6.75 %	6.75 %	7.50 %	8.75 %
Major Canadian cities	4.75 %	4.75 %	4.75 %	4.75 %
Impaired property	7.00 %	7.00 %	7.00 %	7.00 %
Other	6.25 %	8.00 %	6.25 %	8.00 %
Commercial properties	6.50 %	7.25 %	7.00 %	7.50 %

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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5 Investment properties (continued)

(ii) *The discounted cash flow method*. Under this method, discount rates are applied to the forecasted cash flows reflecting the initial terms of the leases for the specific property and assumptions as to renewal and new leasing activity. The key assumptions are the normalized first year cash flows, the inflation rates applied to the first year cash flows, and the discount rate applied over the useful life of the investment property.

The table below provides details of the range of discount rates used for valuing the investment properties of the Trust:

	December 31 2013		December 31 2012	
	Low	High	Low	High
Residential properties				
Fort McMurray	9.00 %	9.50 %	9.00 %	9.50 %
Yellowknife	8.75 %	8.75 %	9.50 %	10.75 %
Major Canadian cities	6.75 %	6.75 %	6.75 %	6.75 %
Impaired property	9.00 %	9.00 %	9.00 %	9.00 %
Other	8.25 %	10.00 %	8.25 %	10.00 %
Commercial properties	8.50 %	9.25 %	9.00 %	9.50 %

(iii) *Direct comparison*. For properties with condominium title, comparisons to the sale price of similar condominium units establishes gross sales proceeds from which the cost of completing a condominium conversion and sales program are deducted to achieve a property value. The key assumption is the cost of the condominium conversion and sales program. Direct comparison valuation analyses are prepared for Colony Square, Laird's Landing, Lakewood Apartments, Lakewood Townhomes, Millennium Village and Woodland Park.

(iv) *External appraisals and reports.* Independent valuations on all investment properties are carried out in order to reduce the risk that the carrying amount of each investment property does not differ materially from its fair value. The following schedule outlines the expected timetable for completion of appraisals:

Property Value	Number of Properties	Carrying Value at December 31, 2013	Valuation Update Timetable
Greater than $10 Million	9	$ 367,258,874	Three years
Less than $10 Million	11	53,781,495	Five years
	20	$ 421,040,369	

The Trust utilizes capitalization and discount rates within the ranges provided in market reports by knowledgeable property valuators. To the extent that the externally provided capitalization rate and discount rate ranges change from one reporting period to the next, or should another rate within the provided ranges be considered by the Trust to be more appropriate than the rate previously used, the fair value of the investment properties would increase or decrease accordingly.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

5 Investment properties (continued)

(iv) *External appraisals and reports.* (continued)

To assist in the determination of fair value at December 31, 2013, external appraisals were obtained in 2013 for 8 properties having an aggregate fair value of $292.7 Million representing 69.5% of the total carrying value of investment properties. Appraisals were obtained in 2012 for 10 properties having an aggregate fair value of $118.4 Million representing 28.1% of the total carrying value of investment properties. Appraisals were obtained in 2011 for 1 property having a fair value of $7.1 Million representing 1.7% of the total carrying value of investment properties. Appraisals were obtained in 2010 for 1 property having a fair value of $2.8 Million representing 0.7% of the total carrying value of investment properties.

(v) *Property sales*. The sale of properties provides valuable information on market conditions. Projects which are subject to an unconditional sale agreements are valued at the sale price less estimated selling expenses.

The valuation of investment properties considers all of the information generated by the above noted methods and assumptions and also considers anticipated capital expenditures.

The capitalized net operating income method and discounted cash flow method, as noted above, would be categorized as level 3 valuation method in the fair value hierarchy. The most significant inputs or variables to the valuation process, all of which are unobservable, are the normalized income, capitalization rate, discount rate and growth rate. An increase in the normalized income, or a decrease in the capitalization rate, the discount rate or the growth rate will result in an increase in the estimated fair value of investment properties. The fair value estimate is sensitive to all four assumptions, however, changes in the capitalization rate have the greatest impact on the fair value estimate. There are interrelationships between the capitalization rate, the discount rate and the growth rate.

The inputs used in the valuation at December 31, 2013 were:

Description	Input
Normalized net operating income (year 1)	$27,963,550
Weighted average capitalization rate	6.76%
Growth rate	2.00%
Weighted average discount rate	8.76%

The direct comparison method as noted above is a level 2 valuation method.

(a) Property dispositions

On October 1, 2013, the Trust sold the Purolator Building for gross proceeds of $1,600,000. On December 31, 2013, the Trust sold Nova Court for gross proceeds of $21,680,000. Revenue and expenses of the Purolator Building and Nova Court are carried in the "Properties Sold" operating segment in the December 31, 2013 Financial Statements and, prior to December 31, 2013, were carried in the "Other Investment Properties" operating segment.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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5 Investment properties (continued)

(a) Property dispositions (continued)

The following table reflects the results of the sale of condominium units at Lakewood Townhomes:

	Year Ended December 31 2013	2012
Units sold	3	9
Gross proceeds	$ 1,444,700	$ 4,396,400
Gain on sale	$ 247,011	$ 568,761

(b) Fair value adjustment of Parsons Landing

On September 1, 2008, the Trust acquired possession of Parsons Landing for a total cost of $63,200,000, including GST.

The permanent mortgage financing for the purchase of Parsons Landing was uncompleted and, as a result, the builder agreed to several extensions of the closing date under the purchase agreement, with a requirement for LREIT to make additional payments on the balance owing of $500,000 on May 12, 2009, $2 Million on February 17, 2012, $3 Million on January 3, 2014 and $650,000 on January 31, 2014. The builder also agreed to accept interest payments of $300,000 per month to the closing date and to forgive interest in excess of $300,000 per month, for the period from January 1, 2010 to the closing date, provided the purchase is completed on the closing date, as extended. On closing, the builder also agreed to provide a credit of $1,440,000 for furniture purchased by the Trust.

In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. In June 2012, an agreement was reached with the builder under which the builder agreed to reconstruct the property and attend to the recovery of the insurance claims for property damage and revenue losses.

The reconstruction and the return of 84 suites to the Trust, was completed effective June 1, 2013 and the reconstruction and the return of the remaining 76 suites to the Trust was completed effective October 3, 2013. The cost of the reconstruction was fully funded from insurance proceeds.

Subsequent to December 31, 2013, the acquisition was completed, the furniture credit was applied and interest in excess of the $300,000 per month payment in an aggregate amount of $27,866,454 was forgiven.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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5 Investment properties (continued)

(b) Fair value adjustment of Parsons Landing (continued)

Impact on Financial Statements
The Financial Statements reflect the following:

Investment properties
Parsons Landing is classified as an investment property and is carried at fair value. Adjustments to fair value in 2012 and 2013 reflect the destruction of the property and the subsequent reconstruction and re-leasing of the property.

Payable on acquisition of Parsons Landing
For the period from possession to the closing of the sale, the balance owing in regard to the acquisition of Parsons Landing was estimated and reflected in Trade and other payables. Payments to the builder served to reduce the amount payable on acquisition. At December 31, 2013, the amount payable estimate was reduced by $1,713,269 to reflect the $1,440,000 furniture credit and adjustments to GST. The reduction in the amount payable is reflected as a purchase price adjustment of Parsons Landing in Investment properties.

Net operating income and income recovery
The Financial Statements reflect operating revenues and expenses of Parsons Landing from January 1, 2012 to the date of the fire on February 5, 2012.

For the period from February 5, 2012 to May 31, 2013, the Financial Statements reflect revenue in regard to recovery of insurance proceeds for revenue losses. The revenue is reflected as "Income recovery on Parsons Landing" in the income of the Trust.

For the period from June 1, 2013 to December 31, 2013, the Financial Statements reflect rental revenues and property operating costs for occupied suites and recovery of insurance proceeds for unoccupied suites.

Interest expense
The Financial Statements reflect the monthly interest of $300,000.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

6 *Loans and receivables*

	December 31 2013	2012
Second mortgage loan due May 8, 2014, bearing interest at 12.5%, of which 5% shall be payable monthly and 7.5% shall be capitalized and added to the original principal balance of $7,500,000	$ 8,545,600	$ 7,888,320
Second mortgage loan due October 1, 2014, bearing interest at 5% and providing for monthly payments of interest only arising on the sale of property	500,000	500,000
Second mortgage loan	-	3,200,000
Interest free mortgage loan due on the earlier of the sale date of a condominium unit or the maturity date of May 8, 2014	275,000	275,000
Note receivable from a previous tenant	-	250,000
	9,320,600	12,113,320
Current portion of loans and receivables	(9,320,600)	(250,000)
	$ -	$ 11,863,320

7 *Defeasance assets and defeased liability*

In conjunction with the sale of Woodlily Court on September 1, 2010, an existing $2,818,509 mortgage loan payable was defeased ("Defeased Liability"). The Defeased Liability is due July 1, 2016, bears interest at 5.65%, is repayable in monthly payments of $17,191 and is amortized over 30 years. The Trust purchased Government of Canada bonds, Government of Canada treasury bills and Canada mortgage bonds ("Defeasance Assets") in the amount of $3,338,341 and pledged the Defeasance Assets as security to the debt holder. The Defeasance Assets mature on or before June 1, 2016, have a weighted average interest rate of 3.83% (December 31, 2012 - 3.79%) and have been placed in escrow. The Defeasance Assets and the Defeased Liability will be measured at amortized cost using the effective interest rate method of amortization until July 1, 2016 at which time the debt will be extinguished.

The following table reflects the effect of the Defeasance Assets and the Defeased Liability on income.

	Recorded as	Year Ended December 31 2013	2012
Interest income on Defeasance Assets	Interest income	$ 60,905	$ 63,475
Interest expense on Defeased Liability	Interest expense	(149,136)	(152,234)
Amortization of transaction costs	Interest expense	(10,011)	(9,647)
		$ (98,242)	$ (98,406)

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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8 *Restricted cash*

	December 31 2013	December 31 2012
Tenant security deposits	$ 2,484,188	$ 2,393,985
Reserves required by mortgage loan agreements	1,757,624	5,407,263
	$ 4,241,812	$ 7,801,248

9 *Rent and other receivables*

	December 31 2013	December 31 2012
Rent receivable	$ 223,314	$ 247,733
Less: allowance for uncollectible accounts	(32,751)	(20,051)
	190,563	227,682
Other receivables	348,828	444,751
Deferred rent receivable	269,502	351,844
	808,893	1,024,277
Current portion of loans and receivables	9,320,600	250,000
	$ 10,129,493	$ 1,274,277

10 *Deposits and prepaids*

	December 31 2013	December 31 2012
Deposits		
Property tax deposits	$ 368,647	$ 502,158
Other	10,630	11,380
Deposit with Canada Revenue Agency	-	153,709
	379,277	667,247
Prepaid expenses	513,786	696,483
	$ 893,063	$ 1,363,730

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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11 Assets and liabilities of properties held for sale

The Trust intends to dispose of assets, which do not meet the definition of assets of qualifying REITs as defined by the Income Tax Act (Canada). As a result, the Trust has classified the seniors' housing complexes, which are owned by wholly owned subsidiary companies, as discontinued operations.

Assets and liabilities classified as "held for sale" are as follows:

	December 31 2013	2012
ASSETS		
Assets in discontinued operations		
Property and equipment (a)	$ 26,370,800	$ 26,115,114
Cash	20,603	784,447
Restricted cash	43,986	40,128
Rent and other receivables	8,916	9,891
Deposits, prepaids and other	41,558	52,975
Assets classified as held for sale	$ 26,485,863	$ 27,002,555
LIABILITIES		
Liabilities in discontinued operations		
Long term debt (b)	$ 13,042,918	$ 15,278,462
Deferred tax (c)	-	285,734
Trade and other payables	261,399	2,200,048
Deposits from tenants	258,583	264,760
Liabilities classified as held for sale	$ 13,562,900	$ 18,029,004

Income and cash flow information relating to discontinued operations are as follows.

	Year Ended December 31 2013	2012
Rental income	$ 5,152,227	$ 12,948,869
Property operating expenses	3,682,675	7,319,163
Net operating income	1,469,552	5,629,706
Interest expense (d)	747,837	4,525,056
Profit on sale	-	15,034,311
Current tax expense	177,237	1,960,834
Deferred tax recovery	(285,734)	(5,368,399)
Income from discontinued operations	$ 830,212	$ 19,546,526

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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11 Non-current assets and non-current liabilities of properties held for sale (continued)

	Year Ended December 31 2013	2012
Cash inflow from operating activities	$ 388,915	$ 2,230,109
Cash inflow (outflow) from financing activities	841,487	(55,016,150)
Cash inflow (outflow) from investing activities	(1,994,246)	53,182,412
Increase (decrease) in cash from discontinued operations	$ (763,844)	$ 396,371

(a) Property and equipment

Clarington Seniors' Residence was sold on May 9, 2012 and Riverside Terrace was sold on December 6, 2012.

December 31, 2013	Cost, Beginning of Year	Additions/ Disposals	Accumulated Amortization	Net Book Value
Land	$ 4,132,100	$ -	$ -	$ 4,132,100
Buildings and improvements	22,966,242	232,028	(3,050,825)	20,147,445
Furniture, equipment and appliances	457,402	23,658	(280,546)	200,514
	27,555,744	255,686	(3,331,371)	24,480,059
Valuation adjustment	1,890,741	-	-	1,890,741
	$ 29,446,485	$ 255,686	$ (3,331,371)	$ 26,370,800

December 31, 2012	Cost, Beginning of Year	Additions/ Disposals	Accumulated Amortization	Net Book Value
Land	$ 6,098,190	$ (1,966,090)	$ -	$ 4,132,100
Buildings and improvements	71,782,003	(48,815,761)	(3,050,825)	19,915,417
Furniture, equipment and appliances	1,570,198	(1,112,796)	(280,546)	176,856
	79,450,391	(51,894,647)	(3,331,371)	24,224,373
Valuation adjustment	2,264,851	(374,110)	-	1,890,741
	$ 81,715,242	$ (52,268,757)	$ (3,331,371)	$ 26,115,114

11 Non-current assets and non-current liabilities of properties held for sale (continued)

(a) Property and equipment (continued)

The carrying value in property and equipment is comprised of the following:

	Year Ended December 31 2013	2012
Balance, beginning of year	$ 26,115,114	$ 78,383,871
Additions - capital expenditures	255,686	38,368
Disposals	-	(52,307,125)
Balance, end of year	$ 26,370,800	$ 26,115,114

(b) Long term debt

	December 31 2013	2012
Secured debt		
Mortgage loans	$ 13,042,918	$ 15,295,629
Unamortized transaction costs	-	(17,167)
Total long term debt	$ 13,042,918	$ 15,278,462

Certain of the mortgage loans are subject to covenants, including debt service coverage requirements. As of December 31, 2013, the Trust was in compliance with all mortgage covenants on properties held for sale.

(c) Deferred tax

Deferred tax liabilities consist of the following:

	December 31 2013	2012
Temporary differences between the accounting and tax bases of capital gains reserves	-	285,734

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11 Assets and liabilities of properties held for sale (continued)

(c) Deferred tax (continued)

The Trust has deductible temporary differences and unused tax losses related to discontinued operations for which no deferred tax asset is recognized as follows:

Deductible temporary differences:

	December 31 2013	December 31 2012
Property and equipment	$ 538,145	$ 517,576
Transaction costs	$ 62,939	$ 48,832

Unused tax losses expiring in:

	2013	2012
2026	$ -	$ 102,771
2027	43,366	402,868
2028	549,398	549,398
2029	447,270	572,355
2030	-	179,698
2031	73,375	104,821
2032	269,519	271,451
	$ 1,382,928	$ 2,183,362

(d) Interest expense

	Year Ended December 31 2013	Year Ended December 31 2012
Mortgage loan interest	$ 705,670	$ 2,658,578
Mortgage prepayment penalty	-	1,289,083
Amortization of transaction costs	42,167	577,395
	$ 747,837	$ 4,525,056

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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12 Long-term debt

	December 31 2013	December 31 2012
Secured debt		
Mortgage loans (a)	$ 228,713,265	$ 247,654,245
Swap mortgage loan (b)	17,061,239	17,888,836
Mortgage bonds (c)	14,913,008	14,458,831
Debentures (d)	24,873,800	24,961,000
Defeased liability	2,644,615	2,701,511
Total secured debt	288,205,927	307,664,423
Mortgage guarantee fees	91,362	133,864
Total debt	288,297,289	307,798,287
Accrued interest payable	1,975,830	1,746,367
Unamortized transaction costs		
Mortgage loans	(1,819,051)	(1,531,326)
Swap mortgage loan	(90,585)	(108,024)
Mortgage bonds	(754,795)	(1,033,704)
Debentures	(352,422)	(613,105)
Defeased liability	(23,934)	(33,946)
Total unamortized transaction costs	(3,040,787)	(3,320,105)
	287,232,332	306,224,549
Less current portion		
Mortgage loans	(106,307,858)	(201,725,598)
Mortgage bonds	(10,000,000)	-
Swap mortgage loan	(17,061,239)	(17,888,836)
Defeased liability	(60,167)	(56,896)
Mortgage guarantee fees	(44,587)	(42,502)
Accrued interest payable	(1,975,830)	(1,746,367)
Transaction costs	1,662,152	1,996,583
Total current portion	(133,787,529)	(219,463,616)
	$ 153,444,803	$ 86,760,933
Current portion of unamortized transaction costs		
Mortgage loans	$ 932,982	$ 1,340,398
Swap mortgage loan	90,585	108,024
Mortgage bonds	329,655	278,909
Debentures	298,539	259,240
Defeased liability	10,391	10,012
	$ 1,662,152	$ 1,996,583

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12 Long-term debt (continued)

Long-term debt has both fixed and variable interest rates. At December 31, 2013, the contractual weighted average interest rate for variable rate long-term debt was 7.2% and for fixed rate long-term debt was 4.7% (December 31, 2012 - variable - 9.0%, fixed - 4.8%).

Normal principal installments and principal maturities at face value are as follows:

	Mortgage Loans			
Year ending December 31	Normal Principal Installments	Principal Maturities	Debentures and Mortgage Bonds	Swap Mortgage Loan
2014	$ 3,757,920	$102,549,938	$ 10,000,000	$17,061,239
2015	2,883,996	4,380,521	30,873,800	-
2016	2,828,670	7,540,967	-	-
2017	2,794,525	18,008,989	-	-
2018	1,228,287	55,302,118	-	-
Thereafter	-	27,437,334	-	-
	$ 13,493,398	$215,219,867	$ 40,873,800	$17,061,239

Year ending December 31	Defeased Liability	Mortgage Guarantee Fees	Total Long-term Debt	Weighted average interest rate of long-term debt
2014	$ 60,167	$ 44,587	$133,473,851	6.1%
2015	63,602	46,775	38,248,694	8.5%
2016	2,520,846	-	12,890,483	7.5%
2017	-	-	20,803,514	5.6%
2018	-	-	56,530,405	4.1%
Thereafter	-	-	27,437,334	5.0%
	$ 2,644,615	$ 91,362	$289,384,281	6.0%

In accordance with IFRS, the $15,873,133 face value of the swap mortgage loan and the $1,188,106 fair value of the interest rate swap are reflected as current liabilities as the property is not in compliance with a loan covenant. In accordance with IFRS, a $4,478,175 term loan maturing on August 1, 2015 is reflected as a current liability as the loan document is a demand promissory note.

The Trust intends to renew or refinance all mortgage debt and debentures at market rates on maturity.

12 Long-term debt (continued)

(a) Mortgage loans

	Weighted average interest rates December 31		Amount December 31	
	2013	2012	2013	2012
First mortgage loans				
Fixed rate	4.5%	4.8%	$ 160,467,633	$ 97,891,938
Variable rate	6.1%	8.9%	50,239,345	107,325,680
Total first mortgage loans	4.9%	7.0%	210,706,978	205,217,618
Second mortgage loans				
Fixed rate	11.8%	n/a	4,500,000	-
Variable rate	11.1%	9.1%	13,506,287	42,436,627
Total second mortgage loans	11.3%	9.1%	18,006,287	42,436,627
Total	5.4%	7.3%	$ 228,713,265	$ 247,654,245

Certain of the mortgage loans are subject to covenants, including net operating income achievement, debt service coverage and restrictions on the registration of secondary charges against the title to a property. As of December 31, 2013, the Trust was in compliance with all mortgage loan covenants.

All mortgages which have matured prior to March 13, 2014 have been renewed or refinanced.

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

(b) Swap mortgage loan

The Trust has entered into an interest rate swap arrangement whereby the interest rate on a variable rate mortgage loan, in the amount of $17,061,239, has a fixed rate of 5.82% and matures in 2018.

The swap arrangement is used to hedge the exposure to the variable interest rate payment on a variable rate mortgage loan. The loan and interest rate swap have the same contractual terms. The aggregate fair value of the swap mortgage loan is as follows:

	December 31 2013	December 31 2012
Face value of mortgage loan, subject to swap	$ 15,873,133	$ 16,414,032
Fair value of interest rate swap	1,188,106	1,474,804
	$ 17,061,239	$ 17,888,836

The Trust is not in compliance with a debt service coverage requirement for the swap mortgage loan. In accordance with IFRS the total balance of $17,061,239 is included in current portion of long-term debt.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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12 Long-term debt (continued)

(b) Swap mortgage loan

The interest rate swap is a financial instrument classified at fair value through profit and loss. The financial statements therefore reflect a liability related to the swap at the net present value of future mortgage payments based on current interest rates with a corresponding charge to interest expense. At December 31, 2013 current interest rates were 2.52% (2012 - 2.53%). The fair value of the swap mortgage loan has been determined using Level 2 of the fair value hierarchy.

(c) Mortgage bonds

The face value of the 9% mortgage bonds due December 24, 2015 is $16,000,000 (December 31, 2012 - $16,000,000).

On December 23, 2010 and January 28, 2011, the Trust issued a total of 16,000 five year 9% mortgage bonds in the principal amount of $1,000, due December 24, 2015, and 16,000,000 trust unit purchase warrants for gross proceeds of $16,000,000. Each trust unit purchase warrant entitles the holder to purchase one unit at a price of $0.75 until December 24, 2015. The mortgage bonds are secured by second mortgage charges registered against four investment properties with a fair value of $38,192,000 (December 31, 2012 - five investment properties with a fair value of $54,717,000).

The carrying value of the mortgage bonds is summarized as follows:

	Year Ended December 31	
	2013	2012
Balance, beginning of year	$ 14,458,831	$ 14,058,307
Accretion	454,177	400,524
Balance, end of year	$ 14,913,008	$ 14,458,831

On the issue date, the value of the mortgage bonds was established based on the net present value of future interest and principal payments with an estimated cost of borrowing of 13.0%, a deferred tax liability of $470,623 was identified, and the residual value of $1,346,282 was assigned to the warrants.

Subsequent to December 31, 2013, mortgage bonds with a face value of $10,000,000 were repaid.

12 Long-term debt (continued)

(d) Debentures

The face value and carrying value of the 9.5% Series G debentures due February 28, 2015 is $24,873,800 (December 31, 2012 - $24,961,000).

Effective October 27, 2011, the Series G convertible debentures were extended as Series G debentures. The Series G debentures are redeemable, subject to notice requirements, and the Trust is required to redeem debentures from the net proceeds of property sales, after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing to 2668921 Manitoba Ltd. under the revolving loan commitment. The debentures are secured by a Personal Property Security Act registration against all of the assets and property of LREIT, subject to existing and future senior debt and permitted encumbrances.

On June 17, 2013, LREIT initiated a normal course issuer bid for the Series G debentures under which, the Trust is entitled to purchase up to $2,493,000 of Series G debentures. The normal course issuer bid expires on June 16, 2014.

During the period from June 17, 2013 to December 31, 2013, the Trust purchased and cancelled Series G debentures with a face value of $87,200 at an average price of $95.43 per $100.00.

The Trust is not required to purchase any debentures under the normal course issuer bid.

13 Trade and other payables

	December 31 2013	December 31 2012
Accounts payable - vendor invoices	$ 982,173	$ 1,300,506
Accrued payables	658,892	1,230,798
Prepaid rent	754,113	764,374
Payable on acquisition of Parsons Landing	44,006,731	45,720,000
Revolving loan from 2668921 Manitoba Ltd.	905,000	5,025,000
	$ 47,306,909	$ 54,040,678

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14 Interest expense

	Year Ended December 31 2013	2012
Mortgage loan interest	$ 15,897,769	$ 19,386,689
Swap mortgage loan interest	940,981	1,465,708
Mortgage prepayment penalties	-	2,751,548
Change in fair value of interest rate swaps	(286,699)	(1,027,800)
Mortgage bond interest	1,440,000	1,440,000
Accretion of mortgage bonds	454,177	400,524
Debenture interest	2,367,153	2,371,295
Amortization of transaction costs	2,706,476	2,873,505
Interest on acquisition payable	3,703,722	3,600,000
	$ 27,223,579	$ 33,261,469

15 Income taxes

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

	Year Ended December 31 2013	2012
Current tax expense	$ -	$ 186,591
Benefit from a previously unrecognized tax loss or temporary difference of a prior period used to reduce current tax expense	-	(136,828)
Current tax expense	-	49,763
Deferred tax expense relating to the origination and reversal of temporary differences or tax losses	-	1,228,380
Deferred tax expense arising from write-down of deferred tax assets	-	479,035
Deferred tax expense arising from the derecognition of deferred tax liabilities	-	(1,707,415)
Deferred tax expense	-	-
Income tax expense	$ -	$ 49,763

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15 Income taxes (continued)

The income tax expense of the Trust can be reconciled to its income tax expense that would be calculated using the statutory income tax rate as follows:

	Year Ended December 31 2013	2012
Income before income taxes and discontinued operations	$ 14,689,374	$ 601,545
Combined federal and provincial statutory income tax rate	26%	26%
Income tax expense calculated using the combined federal and provincial statutory income tax rate	$ 3,819,237	$ 156,401
Non-deductible unit-based compensation	26,284	34,143
Non-deductible interest and penalties	186,548	21,320
Taxable dividends received from wholly owned subsidiary	234,780	2,314,715
Undistributed income taxed at rate of 46.4%	-	359,805
Dividend tax credits	-	(768,618)
Net interest revenue and fees received from wholly owned subsidiaries	-	739,103
Interest revenue received from wholly owned subsidiaries	(128,110)	(160,746)
Recognition of previously unrecognized deferred tax assets	-	(136,828)
Write-down of previously recognized deferred tax assets	-	479,035
Derecognition of previously recognized deferred tax liabilities	-	(1,707,415)
Deferred tax assets and liabilities not recognized during the year	(2,290,246)	(90,831)
Non-taxable/allowable portion of capital gains	(908,679)	(1,258,468)
Amounts paid or payable to unitholders	(1,006,821)	-
Other	67,007	68,147
Income tax expense	$ -	$ 49,763

There were no temporary differences between the accounting and tax bases of investment properties, transaction costs, debentures and mortgage bonds, and interest rate swaps. There were no unused tax losses.

The Trust's deferred tax expense (recovery) recognized in income (loss) from investment properties, in respect of each type of temporary difference or in respect of unused tax losses, is as follows:

	Year Ended December 31 2013	2012
Investment properties	$ -	$ (1,306,711)
Transaction costs	-	479,035
Debentures and mortgage bonds	-	(504,840)
Unused tax losses	-	1,111,956
Interest rate swaps	-	220,560
	$ -	$ -

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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15 Income taxes (continued)

The Trust has temporary differences related to investment properties for which no deferred tax asset or liability is recognized as follows:

	December 31 2013	December 31 2012
Deductible temporary differences:		
Interest rate swaps	$ 1,188,106	$ 1,474,804
Transaction costs	$ 4,362,508	$ 5,051,684
Taxable temporary differences:		
Investment properties	$ 16,871,342	$ 8,584,403
Mortgage bonds	$ 1,086,992	$ 1,541,169

16 Per unit calculations

Per unit calculations reflect the following:

	Year Ended December 31 2013	Year Ended December 31 2012
Income before discontinued operations	$ 14,689,374	$ 551,782
Income from discontinued operations	830,212	19,546,526
Income	$ 15,519,586	$ 20,098,308

	Year Ended December 31 2013	Year Ended December 31 2012
Weighted average number of units:		
Units	18,211,934	17,983,061
Deferred units	765,279	647,730
Total basic	18,977,213	18,630,791
Weighted average diluted number of units	23,172,093	18,736,723

The weighted average diluted number of units at December 31, 2013, includes the dilutive effective of the warrants to the extent that the market price of the units exceeded the exercise price of the warrants of $0.75, effective October 21, 2013.

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17 Units

	Year Ended December 31, 2013		Year Ended December 31, 2012	
	Units	Amount	Units	Amount
Outstanding, beginning of year	18,084,011	$107,978,701	17,988,339	$107,860,241
Units issued on:				
- Exercise of unit options	7,000	2,380	-	-
- Exercise of warrants	1,332,000	1,219,313	175,000	160,195
- Payment of distribution	6,448,598	6,900,000	-	-
Consolidation of units	(6,448,598)	-	-	-
Purchased and cancelled under normal course issuer bid	-	-	(79,328)	(41,735)
Outstanding, end of year	19,423,011	$116,100,394	18,084,011	$107,978,701

Units issued on payment of distributions
As a result of realized capital gains, the Trust paid "special" distributions in the form of additional units on December 31, 2013. The distributions were followed by an immediate consolidation of units resulting in Unitholders holding the same number of units after the distributions as were held prior to the distributions.

Units purchased and cancelled under normal course issuer bid
In January 2012, LREIT renewed its normal course issuer bid for Trust units under which the Trust is entitled to purchase up to 1,383,378 units. The normal course issuer bid commenced January 12, 2012, expired on January 11, 2013, and was not renewed.

Units purchased by the Trust under its normal course issuer bid are cancelled. During the year ended December 31, 2013 the Trust purchased and cancelled nil units under the normal course issuer bid at a weighted average price of nil per unit (2012 - 79,328 and $0.53, respectively).

18 Warrants

On March 9, 2010, the Trust issued 6,780,000 trust unit purchase warrants. Each warrant entitles the purchaser to purchase one unit at a price of $1.00 until March 9, 2015.

On December 23, 2010 and January 28, 2011, the Trust issued a total of 16,000,000 trust unit purchase warrants. Each warrant entitles the purchaser to purchase one unit at a price of $0.75 until December 24, 2015.

The following schedules reflect the warrant outstanding:

Warrants expiring March 9, 2015:

	Year Ended December 31	
	2013	2012
Balance, beginning and end of year	6,780,000	6,780,000

On January 24, 2014, the Trust implemented a normal course issuer bid under which the Trust is entitled to purchase up to an aggregate of 678,000 trust unit purchase warrants due March 9, 2015. The normal course issuer bid commenced on January 24, 2014 and will expire on January 23, 2015. Subsequent to January 24, 2014, 30,200 warrants were purchased and cancelled.

18. Warrants (continued)

Warrants expiring December 24, 2015:

	Year Ended December 31	
	2013	2012
Balance, beginning of year	15,825,000	16,000,000
Warrants exercised	(1,332,000)	(175,000)
Balance, end of year	14,493,000	15,825,000

On January 24, 2014, the Trust implemented a normal course issuer bid under which the Trust is entitled to purchase up to an aggregate of 1,404,150 warrants due December 23, 2015. The normal course issuer bid commenced on January 24, 2014 and will expire on January 23, 2015. Subsequent to January 24, 2014, 77,500 warrants were purchased and cancelled.

Subsequent to December 31, 2013, 518,500 warrants were exercised at a price of $0.75 and 79,375 warrants were exercised at a price of $1.00.

19 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 and the deferred unit plan will be limited to 10% 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 TSX on the date of grant. Options granted to Trustees vest immediately. With the exception of options granted on November 19, 2012 and January 15, 2013, which vested immediately, options granted to senior officers and consultants vest on a straight-line basis over five years. The options will have a maximum term of five years from the date of grant.

On November 19, 2012, the Trust granted options to purchase 410,000 units at $0.60 per Trust unit. The options vested immediately and will expire five years from the date they were granted. The fair value of the options issued of $56,318 was calculated using the Black-Scholes option pricing model, assuming a weighted average volatility of 22.9% on the underlying trust units, a dividend yield rate of 0% and the risk free interest rate of 1.31%. The fair value of the options issued was charged to unit-based compensation.

On January 15, 2013, the Trust granted options to purchase 180,000 units at $0.65 per Trust unit. The options vested immediately and will expire five years from the date they were granted. The fair value of the options issued of $26,093 was calculated using the Black-Scholes option pricing model, assuming a weighted average volatility of 21.77% on the underlying trust units, a dividend yield rate of 0% and the risk free interest rate of 1.47%. The fair value of the options issued was charged to unit-based compensation.

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19 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, 2013		Year Ended December 31, 2012	
	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price
Outstanding, beginning of period	891,000	$ 1.69	571,000	$ 3.05
Cancelled, January 7, 2013	(231,000)	5.10	-	-
Issued, January 15, 2013	180,000	0.65	-	-
Exercised, February 15, 2013	(7,000)	0.34	-	-
Cancelled, July 15, 2013	(350,000)	0.60	-	-
Cancelled, July 15, 2013	(150,000)	0.65	-	-
Cancelled, June 8, 2012	-	-	(90,000)	5.30
Issued, November 19, 2012	-	-	410,000	0.60
Outstanding, end of period	333,000	$ 0.41	891,000	$ 1.69
Vested, end of period	333,000		891,000	

At December 31, 2013 the following unit options were outstanding:

Exercise price	Options outstanding	Options vested	Expiry date
$ 0.34	243,000	243,000	December 12, 2016
0.60	60,000	60,000	November 19, 2017
0.65	30,000	30,000	January 15, 2018
	333,000	333,000	

Subsequent to December 31, 2013, 30,000 unit options were exercised.

20 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 whole or in part, 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.

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20 Deferred unit plan (continued)

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 termination other than for cause, retirement, or death. 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.

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 totaled 98,606 for the year ended December 31, 2013 (2012 - 127,948). Aggregate deferred units outstanding and fully vested at December 31, 2013 were 824,090 (2012 - 725,484).

Unit-based compensation expense of $75,000 for the year ended December 31, 2013 (2012 - $75,000) relating to deferred units granted was recorded to expense the fair value of unit-based compensation. Unit-based compensation is recorded in trust expense.

21 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 2668921 Manitoba Ltd., the parent company to Shelter Canadian Properties Limited, is a related party as 2668921 Manitoba Ltd. is owned by a family member of an officer and Trustee of the Trust.

Management agreement
The Trust has entered into a property management agreement with Shelter Canadian Properties Limited, the current term of which expires on December 31, 2019. Under the property management agreement, Shelter Canadian Properties Limited will administer the day-to-day operations of the Trust's portfolio of investment properties, except for the seniors' housing complexes. The Trust pays property management fees equal to 4% of gross receipts from the investment 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 and tenant improvement fees are capitalized to investment properties; and, during the period of major in-suite renovations or development, renovation fees are capitalized to the cost of buildings and properties under development.

The Trust incurred property management fees payable to Shelter Canadian Properties Limited of $1,678,677 for the year ended December 31, 2013 (2012 - $1,547,632).

Included in trade and other payables at December 31, 2013 is a balance of $7,160 (December 31, 2012 - $29,337), payable to Shelter Canadian Properties Limited in regard to outstanding property management fees.

21 Related party transactions (continued)

Services agreement
The Trust has entered into a services agreement with Shelter Canadian Properties Limited, the current term of which expires on December 31, 2019. 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, fair value gains (losses) and defeasance assets. Service fees are included in trust expense.

The Trust incurred service fees of $1,435,351 for the year ended December 31, 2013 (2012 - $1,598,895).

Services fee and renovation fee for Lakewood Townhomes condominium sales program
The Trust has entered into an agreement with Shelter Canadian Properties Limited, in regard to the condominium sales program at Lakewood Townhomes. Under the agreement, Shelter Canadian Properties Limited will administer the sales program and the completion of the in-suite renovations. The Trust pays a service fee equal to 5% of the gross sales proceeds and Shelter Canadian Properties Limited is responsible for the payment of a fixed fee to an external real estate broker for providing brokerage services. If it is necessary to increase the fixed fee to the external real estate broker due to market conditions, the fee payable to Shelter Canadian Properties Limited increases by the amount of the increase in the fixed rate. The Trust also pays a renovation fee equal to 5% of the cost of the in-suite upgrade costs for the condominium sales program.

The Trust incurred service fees payable to Shelter Canadian Properties Limited of $75,847 for the year ended December 31, 2013 (2012 - $306,395). The Trust incurred renovation fees payable to Shelter Canadian Properties Limited of nil for the year ended December 31, 2013 (2012 - $3,534).

Financing
On January 1, 2012, the Trust had a $12 Million revolving loan commitment from 2668921 Manitoba Ltd. for general operating purposes. The loan commitment was increased to $15 Million on April 1, 2012, reduced to $12 Million effective January 1, 2013 and increased to $15 Million effective July 1, 2013. The loan matured December 31, 2013 and bore interest at 12%, subject to a maximum interest and fee payment of $404,916 for the period from January 1, 2013 to June 30, 2013 and $897,637 for the period from July 1, 2013 to December 31, 2013 (2012 - 9.75% to March 31, 2012, 10% from April 1, 2012 to August 31, 2012 and 12% from September 1, 2012 to December 31, 2012 subject to maximum interest and fee payments of $162,594, $625,000 and $650,870, respectively). The renewals at January 1, 2013 and July 1, 2013, encompassed extension fees of $25,000 and $25,000, respectively (2012 - $75,000 and $150,000 at April 1, 2012 and September 1, 2012, respectively).

During the year ended December 31, 2013, the Trust received advances of $13,880,000 (2012 - $34,943,629) and repaid advances of $18,000,000 (2012 - $41,918,629) against the revolving loan, resulting in a balance of $905,000 (2012 - $5,025,000). The revolving loan balance is included in trade and other payables.

Interest on the revolving loan of $1,170,123 for the year ended December 31, 2013 (2012 - $963,422) is included in interest expense.

21 Related party transactions (continued)

Effective January 1, 2014, the revolving loan commitment from 2668921 Manitoba Ltd. was renewed at an interest rate of 12% to September 30, 2014, subject to a maximum interest and fee payment of $1,206,357. The renewal encompassed a $25,000 extension fee. The loan is secured by mortgage charges against the title to five investment properties, two seniors' housing complexes and the assignment of a mortgage loan receivable in the amount of $8,545,600.

During the year ended December 31, 2012, Shelter Canadian Properties Limited advanced $16,169,000 on an interest-free basis as an interim funding measure. The Trust made repayments of $17,352,000, resulting in an outstanding balance of nil at December 31, 2012.

The revolving loan commitment and interest-free advances from Shelter Canadian Properties Limited were considered and approved by the independent Trustees.

Key management compensation
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Trust, directly or indirectly. The Trust does not pay any compensation directly to its key management personnel, other than securities-based compensation under the unit option plan. The services are provided to the Trust by Shelter Canadian Properties Limited pursuant to the Services Agreement. The estimated aggregate compensation for those services under the agreement for the year ended December 31, 2013 was $564,000 (2012 - $564,000). In addition, the Trust granted unit options to its key management personnel with a fair value of $11,456 (2012 - $48,076).

Guarantees
Certain of the mortgage loans payable have been guaranteed by Shelter Canadian Properties Limited and/or its parent company, 2668921 Manitoba Ltd. No fees were charged to the Trust in regard to the guarantees.

22 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:

Liquidity risk - debt covenant requirements
At December 31, 2013, the Trust is in breach of a 1.15 overall Trust debt service coverage requirement of a $17,061,239 swap mortgage loan on a property in Fort McMurray, Alberta. The Trust has notified the lender of the breach and is providing operating information to the lender on a monthly basis. The covenant breach may continue for the next 12 months and there can be no assurance that the covenant breach will be remedied.

There is no assurance that the lenders will not accelerate payment of the mortgage loans.

The Bond Indenture which governs the mortgage bonds of LREIT provides for the bonds to become payable on demand in the event that the Series G debentures or any of the first mortgages on Beck Court, Norglen Terrace, Highland Tower or Westhaven Manor are in default for more than ten days and the default results in the acceleration of debt payments.

There are no others cross-default covenants with respect to other mortgage loans of the Trust.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

22 Financial instruments and risk management (continued)

Liquidity risk - debt maturities (continued)
Liquidity risk arises from the possibility that the Trust will not have sufficient debt or equity capital available to complete the acquisition of Parsons Landing on the agreed date and 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.

As at December 31, 2013, the weighted average term to maturity of the fixed rate mortgages on investment properties is 3.4 years (2012 - 1.8 years).

The repayment obligations in regard to the financial liabilities of the Trust, at face value, are as follows:

	Mortgage Loans			
Year ending December 31	Normal Principal Installments	Principal Maturities	Debentures and Mortgage Bonds	Swap Mortgage Loan
2014 (1)	$ 3,757,920	$102,549,938	$ 10,000,000	$17,061,239
2015	2,883,996	4,380,521	30,873,800	-
2016	2,828,670	7,540,967	-	-
2017	2,794,525	18,008,989	-	-
2018	1,228,287	55,302,118	-	-
Thereafter	-	27,437,334	-	-
	$ 13,493,398	$215,219,867	$ 40,873,800	$17,061,239

Year ending December 31	Defeased Liability	Mortgage Guarantee Fees	Other Payables	Total
2014	$ 60,167	$ 44,587	$ 51,800,904	$185,274,755
2015	63,602	46,775	-	38,248,694
2016	2,520,846	-	-	12,890,483
2017	-	-	-	20,803,514
2018	-	-	-	56,530,405
Thereafter	-	-	-	27,437,334
	$ 2,644,615	$ 91,362	$ 51,800,904	$341,185,185

Other payables include trade and other payables, accrued interest payable and deposits from tenants.

(1) Mortgage loans principal maturities and swap mortgage loan principal maturities include mortgage loans which are not in compliance with loan covenants. In accordance with IFRS, the $15,873,133 face value of the swap mortgage loan and the $1,188,106 fair value of the interest rate swap are reflected as current liabilities. In accordance with IFRS, a $4,478,175 term loan maturing on August 1, 2015 is reflected as a current liability as the loan document is a demand promissory note.

22 Financial instruments and risk management (continued)

Interest rate risk

Interest rate risk arises from debt financing including the risk that the Trust will not be able to refinance the mortgage loans with terms as favourable as those of existing mortgage loans. The risk is minimized by having 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, 2013 the percentage of fixed rate mortgage loans to total mortgage loans was 72% (December 31, 2012 - 40%).

The Trust has variable rate mortgage loans on investment properties totaling $63,745,632, or 28% of the total mortgage loans at December 31, 2013 (December 31, 2012 - 60%). Should interest rates change by 1%, interest expense would change by $637,456 per year.

As at December 31, 2013, the Trust has total contractual mortgage principal maturities on investment properties which mature on or prior to December 31, 2016 of $52,153,818 representing 23% of total mortgage loans. Should the amounts be refinanced upon maturity at an interest rate differential of 1%, interest expense would change by $521,538 per year.

With the exception of an interest rate swap arrangement, 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 that 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.

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 2013	December 31 2012
Rent receivable overdue:		
0 to 30 days	$ 123,531	$ 149,415
31 to 60 days	38,555	44,760
More than 60 days	61,228	53,558
	$ 223,314	$ 247,733

22 Financial instruments and risk management (continued)

Credit risk (continued)
A reconciliation of allowance for doubtful accounts is as follows:

	Year Ended December 31 2013	2012
Balance, beginning of year	$ 20,051	$ 163,553
Amount charged to bad debt expense relating to impairment of rent receivable	48,664	85,622
Amounts written off as uncollectible	(35,964)	(229,124)
Balance, end of year	$ 32,751	$ 20,051
Amount charged to bad debts as a percent of rentals from investment properties	0.12%	0.22%

Market risk
Market risk is the risk that the fair values of financial instruments will fluctuate because of changes in market prices. The Trust does not have financial instruments that are affected by changes in market prices.

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 the financial instruments of the Trust are not exposed to other price risk.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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22 *Financial instruments and risk management (continued)*

Fair values
Except for the swap mortgage loan which is carried at fair value, a comparison of the carrying amounts and fair value of the financial instruments of the Trust is provided below.

	Carrying Value December 31		Fair Value December 31	
	2013	2012	2013	2012
Financial assets				
Loans and receivables	-	11,863,320	-	11,109,854
Defeasance assets	2,879,978	3,025,370	-	-
Restricted cash	4,241,812	7,801,248	4,241,812	7,801,248
Cash	2,401,741	1,254,278	2,401,741	1,254,278
Rent and other receivables	10,129,493	1,274,277	10,129,493	1,274,277
Deposits	379,277	667,247	379,277	667,247
Financial liabilities				
Mortgages loans	228,713,265	247,654,245	228,469,471	247,959,720
Mortgage bonds	14,913,008	14,458,831	15,226,306	14,898,857
Debentures	24,873,800	24,961,000	24,647,812	25,006,654
Defeased liability	2,644,615	2,701,511	-	-
Mortgage guarantee fees	91,362	133,864	91,362	133,864
Trade and other payables	47,306,909	54,040,678	47,306,909	54,040,678
Deposits from tenants	2,518,165	2,428,393	2,518,165	2,428,393

The fair value of the financial assets and liabilities are included at an estimate of the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- Cash, rent and other receivables, deposits, trade and other payables and deposits from tenants approximate their carrying amounts due to the short-term maturities of these instruments. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data.
- Loans and receivables and restricted cash are estimated by discounting expected future cash flows using current market interest rates. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data.
- The fair value of the defeasance assets and the defeased liability have a fair value of nil on a net basis as there was no cash flow impact to the Trust from the defeasance assets or defeased liability. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data.
- In regard to mortgages loans, mortgage bonds, debentures and mortgage guarantee fees:
  - The fair value of floating rate borrowings is estimated by discounting future cash flows using rates currently available for debt or similar terms and remaining maturities. Given the variable interest rate, the fair value approximates the carrying value before deducting unamortized transaction costs. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data.

22 Financial instruments and risk management (continued)

Fair values (continued)

- The fair value of the fixed rate borrowings is estimated by discounting expected future cash flows using current market interest rates and yield curve over the remaining term of the instrument. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data. The current market interest rates used to calculate the fair value range between 2.09% and 5.60%.
- The fair value of debt component of debentures are based on quoted market prices. The valuation method is classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data.

23 Management of capital

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

	December 31	
	2013	2012
Mortgage loans	$226,894,214	$246,122,919
Swap mortgage loan	16,970,654	17,780,812
Mortgage bonds	14,158,213	13,425,127
Debentures	24,521,378	24,347,895
Equity	117,452,013	100,829,954
	$399,996,472	$402,506,707

The Trust manages capital in order to safeguard its ability to continue as a going concern 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, debentures or other securities of the Trust.
- Mortgage debt financing is arranged to optimise 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 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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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23 Management of capital (continued)

In order to maintain or adjust the capital structure the Trust may (i) issue units, debentures or mortgage debt and other securities, such as trust unit purchase warrants; (ii) adjust the amount of distributions (if any) paid to unitholders; (iii) return capital to unitholders; (iv) purchase units, debentures or trust unit purchase warrants; and/or (v) reduce debt.

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

24 Segmented financial information

Operating segments are established on a geographic basis comprised of properties located in Fort McMurray and properties located in other areas ("Other Investment Properties"). Operating segments are also established for properties sold and properties acquired.

A Parsons Landing segment was established to disclose the operations of the impaired property as a result of a fire (Note 5).

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

Year ended December 31, 2013:

	Investment Properties					
	Fort McMurray	Other Investment Properties	Properties Sold	Parsons Landing	Trust	Total
Rental revenue	24,422,889	10,892,024	3,425,499	1,588,352	-	40,328,764
Property operating costs	8,707,915	5,277,117	1,593,323	541,640	-	16,119,995
Net operating income	15,714,974	5,614,907	1,832,176	1,046,712	-	24,208,769
Interest income	73,229	11,262	37,492	2,801	1,147,956	1,272,740
Interest expense	11,384,536	3,756,848	516,994	3,703,722	7,861,479	27,223,579
Income (loss) before discontinued operations	6,235,907	5,235,984	3,344,923	8,898,126	(9,025,566)	14,689,374
Cash from operating activities	5,728,756	2,015,236	1,388,337	300,516	(8,196,284)	1,236,561
Cash from financing activities	(3,620,136)	(884,323)	(15,602,893)	1,543,087	377,389	(18,186,876)
Cash from investing activities	(1,355,509)	(931,915)	14,399,089	(1,804,977)	7,791,090	18,097,778
Total assets excluding assets held for sale at December 31, 2013	267,258,190	107,485,081	366,541	53,557,016	12,919,628	441,586,456

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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24 Segmented financial information (continued)

Year ended December 31, 2012:

	Investment Properties					
	Fort McMurray	Other Investment Properties	Properties Sold	Parsons Landing	Trust	Total
Rental revenue	22,965,656	10,939,943	4,110,966	394,427	-	38,410,992
Property operating costs	8,768,905	5,182,636	1,735,839	294,383	-	15,981,763
Net operating income	14,196,751	5,757,307	2,375,127	100,044	-	22,429,229
Interest income	30,232	11,033	133,136	1,719	793,487	969,607
Interest expense	12,738,240	6,060,475	871,264	3,600,011	9,991,479	33,261,469
Income (loss) before discontinued operations	9,561,586	3,913,215	1,533,000	(2,891,357)	(11,564,662)	551,782
Cash from operating activities	3,014,865	2,147,541	1,671,012	(1,547,736)	(12,054,403)	(6,768,721)
Cash from financing activities	(3,353,744)	(2,051,774)	(13,471,079)	1,281,000	50,769,334	33,173,737
Cash from investing activities	561,664	10,898	11,601,876	289,799	(38,785,594)	(26,321,357)
Total assets excluding assets held for sale at December 31, 2012	265,210,801	102,891,363	21,454,228	44,342,231	20,651,400	454,550,023

25 Commitments

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
Chateau St. Michael's	Integrated Life Care Inc.	September 30, 2014
Elgin Lodge	Kingsway Arms Management Inc.	May 31, 2016

26 Contingencies

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 an estimate of the costs to satisfy such claims is recorded. Although the outcome of legal and other claims are not reasonably determined, management believes that any such outcome will not be material.

The Trust has guaranteed a mortgage loan in the amount of $8,055,177 on a property that was sold in 2013.

27 Subsequent events

Mortgage bond repayment
Subsequent to December 31, 2013, mortgage bonds with a face value of $10,000,000 were repaid.

Mortgage financing
Subsequent to December 31, 2013, the Trust renewed an $8,800,000, 4.97% first mortgage loan to January 1, 2015, at 2.23%.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2013

27 Subsequent events (continued)

Revolving loan
Subsequent to December 31, 2013, the Trust received advances of $14,745,000 and repaid $650,000, resulting in a balance of $15,000,000 as of the date of the Financial Statements.

Mortgage loans receivable
Subsequent to December 31, 2013, a mortgage loan receivable in the amount of $500,000 was received.

Parsons Landing
Subsequent to December 31, 2013, the amount payable on the acquisition of Parsons Landing was reduced to $40,356,731 as a result of payments made of $3,000,000 on January 3, 2014 and $650,000 on January 31, 2014.

Subsequent to December 31, 2013, the purchase of Parsons Landing was completed. The amount payable to the vendor on closing of $40,356,731 was funded by $39,290,000 of net proceeds from a 7.95%, $40,000,000 first mortgage loan maturing on April 30, 2015, an advance under the revolving loan, and the balance in cash.

28 Comparative figures

For comparative purposes, certain of the prior year figures have been reclassified.

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 the 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, Ms. Cheryl Barker, CA and Mr. Arni Thorsteinson, CFA. Mr. Loewen is the Chief Executive Officer of Online Business Systems and serves as Chairman of LREIT. Mr. Coleman is an entrepreneur, formerly President of Big Freight Systems Inc. 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 - Administration for Shelter Canadian.

Administrator of the Trust

Shelter Canadian 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 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 investment properties in the LREIT portfolio. Shelter Canadian manages all of the investment properties except for 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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Unit Listing

Toronto Stock Exchange (TSX)	
Unit trading symbol:	LRT.UN
Debenture trading symbol:	LRT.DB.G
Mortgage bond trading symbol:	LRT.NT.A
Trust unit purchase warrants trading symbols:	LRT.WT LRT.WT.A

Unitholder and Investor Contact

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