



CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2017

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, 2017 and 2016 and the consolidated statements of comprehensive loss, changes in deficit and 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits 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, 2017 and 2016 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, 2017 has incurred a loss before discontinued operations of \$31,877,187 during the year ended December 31, 2017 and is in default of certain mortgage loans. 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.

Winnipeg, Manitoba
March 22, 2018

MNP LLP
Chartered Professional Accountants

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	<u>December 31</u> <u>2017</u>	<u>December 31</u> <u>2016</u>
ASSETS		
Non-current assets		
Investment properties (Note 5)	\$178,309,735	\$198,099,131
Loan receivable (Note 7)	4,000,000	4,000,000
Restricted cash (Note 8)	<u>2,400,176</u>	<u>2,650,066</u>
Total non-current assets	<u>184,709,911</u>	<u>204,749,197</u>
Current assets		
Cash	1,638,918	706,768
Rent and other receivables (Note 9)	459,234	394,131
Deposits and prepaids (Note 10)	<u>1,121,155</u>	<u>780,126</u>
	3,219,307	1,881,025
Assets held for sale (Note 11)	<u>34,199,238</u>	<u>38,772,107</u>
Total current assets	<u>37,418,545</u>	<u>40,653,132</u>
TOTAL ASSETS	<u>\$222,128,456</u>	<u>\$245,402,329</u>
LIABILITIES AND EQUITY		
Liabilities		
Non-current liabilities		
Long-term debt (Note 12)	<u>\$ 58,585,292</u>	<u>\$112,396,096</u>
Total non-current liabilities	<u>58,585,292</u>	<u>112,396,096</u>
Current liabilities		
Trade and other payables (Note 13)	8,815,147	3,207,534
Current portion of long-term debt (Note 12)	186,307,203	128,921,415
Deposits from tenants	<u>1,407,522</u>	<u>1,529,110</u>
	196,529,872	133,658,059
Liabilities held for sale (Note 11)	<u>3,655,117</u>	<u>3,953,317</u>
Total current liabilities	<u>200,184,989</u>	<u>137,611,376</u>
Total liabilities	<u>258,770,281</u>	<u>250,007,472</u>
Total deficit	<u>(36,641,825)</u>	<u>(4,605,143)</u>
TOTAL LIABILITIES AND EQUITY	<u>\$222,128,456</u>	<u>\$245,402,329</u>

Approved by the Board of Trustees

"Charles Loewen"

"Earl Coleman"

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Rentals from investment properties	\$ 19,052,202	\$ 18,328,212
Property operating costs	<u>10,248,700</u>	<u>10,513,925</u>
Net operating income	8,803,502	7,814,287
Interest income	189,425	149,576
Interest expense (Note 14)	(13,930,662)	(19,076,586)
Trust expense	(1,463,535)	(1,883,331)
Gain on sale of investment property (Note 11) (Note 5)	55,070	86,167
Fair value adjustments (Note 15)	<u>(25,530,987)</u>	<u>11,645,404</u>
Loss before discontinued operations	(31,877,187)	(1,264,483)
Loss from discontinued operations (Note 11)	<u>(159,495)</u>	<u>(465,641)</u>
Loss and comprehensive loss	\$ (32,036,682)	\$ (1,730,124)
Loss per unit before discontinued operations:		
Basic and diluted	<u>\$ (1.507)</u>	<u>\$ (0.060)</u>
Loss per unit from discontinued operations:		
Basic and diluted	<u>\$ (0.008)</u>	<u>\$ (0.022)</u>
Loss per unit:		
Basic and diluted	<u>\$ (1.515)</u>	<u>\$ (0.082)</u>

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CHANGES IN DEFICIT

	Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Issued capital (Note 17)		
Balance, beginning and end of year	<u>\$ 125,641,529</u>	<u>\$ 125,641,529</u>
Contributed surplus		
Balance, beginning and end of year	<u>17,027,907</u>	<u>17,027,907</u>
Cumulative deficit		
Balance, beginning of year	(64,124,544)	(62,394,420)
Loss and comprehensive loss	<u>(32,036,682)</u>	<u>(1,730,124)</u>
Balance, end of year	<u>(96,161,226)</u>	<u>(64,124,544)</u>
Cumulative distributions to unitholders		
Balance, beginning and end of year	<u>(83,150,035)</u>	<u>(83,150,035)</u>
Total deficit	<u>\$ (36,641,825)</u>	<u>\$ (4,605,143)</u>

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31	
	2017	2016
Operating activities		
Loss and comprehensive loss	\$ (32,036,682)	\$ (1,730,124)
Adjustments to reconcile income to cash flows		
Fair value adjustments (Note 15)	25,530,987	(11,645,404)
Fair value adjustment - Property and equipment (Note 11)	136,875	1,051,899
Gain on sale of properties (Note 5) (Note 11)	(55,070)	(139,427)
Accrued rental revenue	(7,775)	60,930
Interest income	(189,425)	(149,576)
Interest received	188,328	135,593
Interest expense	14,112,320	19,891,238
Interest paid	(9,469,392)	(11,301,370)
Cash used in operations	(1,789,834)	(3,826,241)
(Increase) in rent and other receivables	(32,829)	(38,610)
(Increase) decrease in deposits and prepaids	(350,175)	280,063
(Decrease) in tenant deposits	(126,138)	(254,838)
(Decrease) increase in trade and other payables	(363,354)	585,246
	<u>(2,662,330)</u>	<u>(3,254,380)</u>
Cash provided by (used in) financing activities		
Repayment of mortgage loans on refinancing	(4,475,000)	(5,800,000)
Repayment of long-term debt	(3,508,348)	(4,598,670)
Prepayment of mortgage loans	-	(12,956,865)
Proceeds of revolving loan facility (Note 20)	7,700,000	24,650,000
Repayment of revolving loan facility (Note 20)	-	(9,450,000)
Proceeds of Shelter Canadian Properties Limited advances (Note 20)	6,000,000	650,000
Repayment of Shelter Canadian Properties Limited advances (Note 20)	-	(650,000)
Expenditures on transaction costs	(665,641)	(698,291)
Repayment of defeased liability	-	(2,499,289)
	<u>5,051,011</u>	<u>(11,353,115)</u>
Cash (used in) provided by investing activities		
Capital expenditures on investment properties	(1,366,727)	(1,609,115)
Capital expenditures on investment properties held for sale	(4,076)	(29,868)
Capital expenditures on property and equipment	(214,390)	(453,533)
Decrease in defeasance assets	-	2,580,343
Proceeds of sale (Note 5) (Note 11)	(109,415)	13,746,212
Change in restricted cash (Note 8) (Note 11)	261,906	202,036
	<u>(1,432,702)</u>	<u>14,436,075</u>
Cash increase (decrease)	955,979	(171,420)
Add (deduct) decrease (increase) in cash from discontinued operations (Note 11)	(23,829)	470,675
	<u>932,150</u>	<u>299,255</u>
Cash, beginning of year	<u>706,768</u>	<u>407,513</u>
Cash, end of year	<u>\$ 1,638,918</u>	<u>\$ 706,768</u>

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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 due June 30, 2022	LRT.DB.G

On March 31, 2017, the Trust announced that it no longer satisfies the continued listing requirements of the TSX and that it does not anticipate satisfying such requirements in the foreseeable future. The Trust intends to transition the listings to the TSX Venture Exchange (TSXV), subject to the approval of the TSXV.

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, 2017 and 2016 ("Financial Statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Financial Statements were authorized for issue in accordance with a resolution of the Board of Trustees on March 22, 2018.

The Financial Statements of the Trust reflect the operations of the Trust and LREIT Holdings 32 Corporation (2016 - LREIT Holdings 32 Corporation and LREIT Holdings 39 Corporation), which is a wholly owned operating subsidiary under its control. The Financial Statements have been prepared on a historical cost basis except for investment properties 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 going concern basis assumes that the Trust will continue in operation for the foreseeable future and be able to realize its assets and settle its obligations in the normal course of business. There is significant doubt regarding the appropriateness of the going concern assumption and the use of accounting principles applicable to a going concern because of the material uncertainties caused by: the Trust's concentration of investment properties in Fort McMurray; the depressed rental apartment market in Fort McMurray during the past several years, primarily driven by the low level of oil sands development activity; the successive years of losses and cash deficiencies from operations, in particular from the operations in Fort McMurray; the limited availability of mortgage lending in Fort McMurray; the Trust's limited cash and working capital resources; the Trust's reliance on financing from Shelter Canadian Properties Limited ("Shelter") and/or its parent company, 2668921 Manitoba Ltd., in amounts and on terms which are favourable relative to the commercial lending market; and the Trust's highly leveraged capital structure.

The Trust incurred a loss before discontinued operations of \$31,877,187 for the year ended December 31, 2017 (2016 - \$1,264,483). The Trust incurred a cash deficiency from operating activities, after working capital adjustments, of \$2,662,330 for the year ended December 31, 2017 (2016 - \$3,254,380). After the deduction of capital expenditures, expenditures on transaction costs and regular principal repayments of long term debt, the Trust incurred a cash deficiency of \$8,421,512 for the year ended December 31, 2017 (2016 - \$10,643,857).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

In addition, excluding advances payable to Shelter, the current portion of long-term debt, the revolving loan balance outstanding, and held-for-sale assets and liabilities, the Trust has working capital of \$397,758 as at December 31, 2017 (December 31, 2016 - a working capital deficit of \$1,333,161).

As of December 31, 2017, the Trust was in default of four mortgage loans secured by a total of seven properties with an aggregate principal balance of \$46,896,076, as the lender of the mortgage loans indicated that there are service fees outstanding with respect to previous defaults under the loans and that until such fees are paid the loans remain in default. Subsequent to December 31, 2017, forbearance agreements were executed for three of these mortgage loans, secured by a total of six properties, in the aggregate principal amount of \$18,674,159. The forbearance agreements required an initial combined repayment of \$1,700,000, which was paid on March 5, 2018, and require future combined repayments of \$633,000, \$666,000 and \$333,000 in 2018, 2019 and 2020, respectively. The forbearance agreements expire May 1, 2021. LREIT continues to meet the debt service obligations of the mortgage that remains in default and the lender has taken no action to demand repayment or enforce its security under the loan.

Subsequent to December 31, 2017, a forbearance termination event on one mortgage loan secured by one property in the aggregate principal amount of \$25,582,975 was triggered due to non-compliance with a deadline set with respect to the condominium sales program. The lender has taken no action to demand repayment or enforce its security under the loan and has indicated that it will not take any action with respect to the default prior to March 31, 2018.

In the event that full repayment is demanded with respect to any of the mortgage loans in default, the Trust would not be able to satisfy the associated obligation with its current resources.

Pursuant to the terms of the Declaration of Trust, LREIT is not permitted to incur mortgage loan indebtedness if such indebtedness would result in the total mortgage loan indebtedness of LREIT exceeding 75% of the appraised value of LREIT's total property portfolio.

As a result of updated appraisals and the sale of one condominium unit at Lakewood Townhomes, the appraised value of LREIT's property portfolio was reduced from \$312,504,681 as at December 31, 2016 to \$286,719,362 as at December 31, 2017. At December 31, 2017, LREIT's mortgage indebtedness and the maximum balance under the revolving loan facility amounted to \$220,722,359, representing approximately 77% of the appraised value of LREIT's total property portfolio.

While LREIT's aggregate mortgage indebtedness exceeds the 75% of appraised value threshold, the Trust is not permitted to increase the outstanding balance of its mortgage loan debt; however, LREIT may continue to renew or refinance its debt at amounts equal to or less than the outstanding principal balance of the existing mortgage loan at the time of the renewal or refinancing and may also obtain financing from unsecured lenders.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

In response to the uncertainties that exist with respect to the Trust's ability to remain a going concern and in order to improve liquidity, meet ongoing funding obligations and sustain operations, management has achieved and is continuing to pursue debt restructuring arrangements with certain of its lenders, property sales under its divestiture program, cost reduction measures and other efforts to improve operating results.

During the year ended December 31, 2017, LREIT received \$6,000,000 of unsecured loan advances from Shelter. Subsequent to December 31, 2017, LREIT received an additional \$5,000,000 of unsecured loan advances from Shelter.

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$36,117,858. The renewal terms required an initial principal repayment of \$1,000,000, which was paid on March 16, 2018, and additional principal repayments of \$500,000 every six months commencing with September 1, 2018 and ending on March 1, 2020. The renewed mortgage loan bears interest at prime plus 3.30% and allows for the deferral of 40% of the monthly interest payments until the September 1, 2020 maturity date of the loan.

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$7,158,017. The renewal terms required an initial principal repayment of \$500,000, which was paid on March 16, 2018, and additional principal repayments of \$280,000 per each quarter in which the Trust fails to sell a unit under the property's condominium sales program. In exchange for each \$280,000 principal payment made during the term of the renewed first mortgage loan, the lender will discharge one condominium unit from its security. The renewed mortgage loan bears interest at prime plus 3.30% and matures on September 1, 2020.

Current divestiture activities focus on the sale of the remaining seniors' housing complex; the Lakewood Townhomes Condominium Sales Program; the property held for sale, inclusive of the establishment of a condominium sales program for the 32 townhouses that comprise part of the property; and other properties with consideration of the overall debt reduction requirements of the Trust. The timing and terms of property sales is uncertain.

Continuation of the Trust's operations into the foreseeable future is contingent upon a combination of events and/or conditions that are subject to material uncertainty and include, but are not limited to: the willingness and ability of Shelter and its parent company, 2668921 Manitoba Ltd., to provide additional advances under the revolving loan facility and/or provide other forms of financial support to the Trust; the willingness and ability of the Trust's lenders to participate in a restructuring of the Trust's debt to the degree and for the duration necessary to allow the Trust to stabilize its operations; the Trust's ability to renew or refinance debt as it matures; the timing and extent of a recovery of the Fort McMurray rental market, which in turn is highly dependent on the timing and extent of a recovery in oil prices; the improvement of cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio; and the ability of the Trust to complete additional property sales at prices which exceed the indebtedness related to such properties.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

The success of management's planned actions in response to the material uncertainty that exists with respect to the Trust's ability to remain a going concern, as described above, cannot be assured and may be subject to material change at any time.

If the going concern basis was not appropriate for these consolidated financial statements, adjustments would be necessary in the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classification used. These adjustments would be material.

Statement of compliance

The Financial Statements of the Trust have been prepared in accordance with IFRS using the same presentation and accounting policies under IFRS as disclosed in Note 3. The Financial Statements are based on IFRS standards issued and effective as at March 22, 2018.

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.

(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 value 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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(b) **Investment Properties (continued)**

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.

	<u>Method</u>	<u>Rate</u>
Buildings and improvements	Straight-line	2.5%
Furniture, equipment and appliances	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 value exceeds its recoverable amount and is recorded as an expense.

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 value of the asset or cash-generating unit (excluding goodwill) is increased to its recoverable amount but not beyond the carrying value 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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(d) **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.

(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 immediately available for use by the Trust, are carried as restricted cash.

(f) **Assets and liabilities of properties held for sale**

Investment properties held for sale

Investment properties are transferred to 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 Board of 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

Discontinued operations

A discontinued operation is a part of the Trust's business that:

- It has disposed or has classified as held for sale and that represents a major line of its 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 face of the Consolidated Statement of Comprehensive Loss and the assets and liabilities are presented separately on the face of the Consolidated Statement of Financial Position.

The Trust has classified the seniors' housing complex, which is owned by a wholly owned subsidiary company, as a discontinued operation. The Trust intends to dispose of assets, such as the seniors' housing complex, that do not meet the definition of assets of qualifying REITs, as defined by the Income Tax Act (Canada).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(f) **Assets and liabilities of properties held for sale (continued)**

Discontinued operations (continued)

Non-current assets and liabilities classified as held for sale are recorded as follows:

Investment Properties	- fair value
All other assets	- lower of carrying value or fair value less selling costs
Long-term Debt	- carrying value
All other liabilities	- carrying value

(g) **Mortgage loans and debentures**

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

(h) **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.

(i) **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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(j) **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.

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 Consolidated Statements of Comprehensive Loss 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 rewards 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.

(k) **Income taxes**

(i) **The Trust**

The Trust qualifies as a mutual fund trust and a 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 arising from its own activities.

(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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(k) **Income taxes (continued)**

(ii) **Wholly owned subsidiary companies (continued)**

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.

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.

(l) **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.

(m) **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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 Significant accounting policies (continued)

(n) 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.

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

<u>Financial Statement Item</u>	<u>Classification</u>	<u>Measurement</u>
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
Debentures	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 fair value through profit and loss. 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 loss and/or reversal are included in Consolidated Statements of Comprehensive Loss.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 *Significant accounting policies (continued)*

(o) **Future changes to significant accounting policies**

The following standards will be effective for subsequent annual periods. The Trust is currently evaluating the impact of these standards on its Financial Statements:

(i) IFRS 9 - Financial Instruments

IFRS 9 - Financial Instruments replaces IAS 39 - Financial Instruments: Recognition and Measurement. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classification options in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of its financial assets. The standard is effective for years beginning on or after January 1, 2018, with earlier adoption permitted. Management does not anticipate a significant impact on the consolidated financial statements as the single approach to classifying financial assets is not expected to result in a reclassification of LREIT's assets; changes to financial liabilities do not apply and the provisions on impairment and hedge accounting do not apply.

(ii) IFRS 15 - Revenue from Contracts with Customers

IFRS 15 - Revenue from Contracts with Customers replaces IAS 11 - Construction Contracts and IAS 18 - Revenue, as well as various IFRIC and SIC interpretations; specifies the steps and timing for entities to recognize revenue from contracts excluding lease contracts; enhances disclosure requirements; and is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. LREIT's primary source of revenue is generated from leases and such revenue is out of scope of IFRS 15. The other revenue sources are from coin income, miscellaneous income, food and housekeeping services and similar activities where the revenue generated and the service delivery occur at the same time. As a result, management does not anticipate a significant impact on the consolidated financial statements to result from the adoption of IFRS 15.

(iii) IFRS 16 - Leases

IFRS 16 - Leases replaces IAS 17 - Leases and requires lessees to account for leases on balance sheet by recognizing a right of use asset and a lease liability. Lessor accounting, however remains largely unchanged and the distinction between operating and finance leases is retained. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. LREIT's leasing activity is primarily comprised of the leasing of residential units under operating leases. LREIT also uses office equipment obtained under leases. As IFRS 16 has minimal impact on the lessor, and LREIT has minimal leasing activity as the lessee, management does not anticipate a significant impact on the consolidated financial statements.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

3 Significant accounting policies (continued)

(iv) IAS 40 - Investment Property ("IAS 40")

During December 2016, the IASB issued an amendment to IAS 40 clarifying certain existing IAS 40 requirements. The amendment requires that an asset be transferred to, or from investment property when, and only when, there is a change in use. A change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. In isolation, a change in management's intentions for the use of a property does not provide evidence of a change in use. These amendments are effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. Management does not anticipate a significant impact on the consolidated financial statements as a result of the clarifications in the amendment.

(p) Adoption of accounting standards

Amendments to IAS 7 - Statement of Cash Flows: Disclosures related to financing activities

This amendment requires disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. This amendment came into effect on January 1, 2017. The application of this amendment did not result in any material impact on these consolidated financial statements. Disclosure related to this amendment can be found in Note 22: *Reconciliation of liabilities arising from financing activities*.

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 value of the asset or liability affected. Management bases their judgments, estimates and assumptions on factors they believe to be reasonable in the circumstances, but which may be inherently uncertain and unpredictable.

(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:

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

(a) Judgments other than estimates (continued)

Business combinations (continued)

- 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

The Trust is a real estate investment trust for income tax purposes. 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 is satisfied that the Trust qualifies as a real estate investment trust.

Management expects that the Trust will continue to qualify as a real estate investment trust for 2017 and beyond. If the Trust were to fail to qualify as a real estate investment trust, 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 direct comparison method may occasionally be used when appropriate market comparables are available. The fair values are determined based on recent real estate transactions with similar characteristics and location to those of the assets of the Trust.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

(b) Estimates (continued)

Valuations of property (continued)

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 uncertainty exists in estimating the market value of investment property than in a more active market.

5 *Investment properties*

	Year Ended December 31	
	2017	2016
Balance, beginning of year	\$198,099,131	\$216,434,958
Additions - capital expenditures	1,366,727	1,609,115
Fair value adjustments (Note 15)	(20,878,973)	9,278,305
Dispositions	(277,150)	(277,152)
Investment properties transferred to held for sale (Note 11)	-	(28,946,095)
Balance, end of year	<u>\$178,309,735</u>	<u>\$198,099,131</u>

During 2017, the Trust did not sell any property classified as investment properties except one condominium unit at Lakewood Townhomes for gross proceeds of \$360,000. The sale resulted in net cash shortfall of \$109,415 after selling costs of \$27,780 and the mortgage loan repayment of \$441,635. The condominium unit had a carrying value of \$277,150 and the sale resulted in a gain on sale of investment properties of \$55,070.

During 2016, the Trust did not sell any property classified as investment properties except one condominium unit at Lakewood Townhomes for gross proceeds of \$370,000. The sale resulted in net cash shortfall of \$56,264 after selling costs of \$27,667 and the mortgage loan repayment of \$398,597. The condominium unit had a carrying value of \$277,152 and the sale resulted in a gain on sale of investment properties of \$65,181. In addition, \$28,946,095 was transferred to investment properties held for sale during 2016.

Investment properties have been valued using the methods and key assumptions in Note 6: *Valuations of investment properties and investment properties held for sale.*

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

6 *Valuations of investment properties and investment properties held for sale*

Investment properties and investment properties held for sale 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 normalized net operating income. The key assumptions are the capitalization rates, which are based on reports from external knowledgeable property valuers, and normalized net operating income, which is based on actual net operating income results, adjusted for atypical or non-recurring items and differences from market (as determined by reference to comparable properties, historical data, appraisals and rental market reports) that are considered short-term in nature. 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		December 31	
	2017		2016	
	Low	High	Low	High
Fort McMurray	8.25 %	8.25 %	8.25 %	8.25 %
Other	7.00 %	8.00 %	7.00 %	7.50 %

- (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 growth rates applied to the first year cash flows over the analysis period of the investment property, 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		December 31	
	2017		2016	
	Low	High	Low	High
Fort McMurray	10.25 %	10.25 %	10.25 %	10.25 %
Other	9.00 %	10.00 %	9.00 %	9.50 %

- (iii) *Direct comparison.* The direct comparison method may occasionally be used when appropriate information is available, typically from an appraiser or realtor, such as the sale price of a comparable property or an offer to purchase a given property. In certain situations, properties with condominium title may be valued based on the selling price of comparable condominium units, net of selling and condominium conversion costs. Key assumptions associated with the above methods include the appropriateness of each comparison as well as the extent of selling and condominium conversion costs. The direct comparison method was factored into the valuation analysis prepared for Lakewood Townhomes (2016 - Lakewood Townhomes).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

6 *Valuations of investment properties and investment properties held for sale (continued)*

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 methods 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. A decrease in the normalized income or growth rate, or an increase in the capitalization rate or the discount rate will result in a decrease 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 direct comparison method as noted above is a level 2 valuation method.

7 *Loan receivable*

The loan receivable is comprised of a \$4,000,000 vendor take-back second mortgage loan, bearing interest at 4.0% and due May 1, 2022. The loan requires interest only payments throughout the term and may be prepaid without penalty. The loan is secured by a second mortgage registered against Beck Court which was sold on May 1, 2016.

8 *Restricted cash*

	December 31 2017	December 31 2016
Tenant security deposits	\$ 1,401,120	\$ 1,522,458
Reserves required by mortgage loan agreements	999,056	1,127,608
	<u>\$ 2,400,176</u>	<u>\$ 2,650,066</u>

9 *Rent and other receivables*

	December 31 2017	December 31 2016
Rent receivable	\$ 199,956	\$ 303,373
Less: allowance for uncollectible accounts	<u>(56,339)</u>	<u>(109,748)</u>
	143,617	193,625
Other receivables	264,172	156,836
Deferred rent receivable	<u>51,445</u>	<u>43,670</u>
	<u>\$ 459,234</u>	<u>\$ 394,131</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

10 *Deposits and prepaids*

	December 31 2017	December 31 2016
Deposits		
Property tax deposits	\$ 581,091	\$ 182,037
Other	<u>4,170</u>	<u>4,135</u>
	585,261	186,172
Prepaid expenses	<u>535,894</u>	<u>593,954</u>
	<u>\$ 1,121,155</u>	<u>\$ 780,126</u>

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 Chateau St. Michael's seniors' housing complex in Moose Jaw, Saskatchewan, which is owned by a wholly owned subsidiary company, as discontinued operations. In addition, other properties have been targeted for sale and will be classified as investment properties held for sale, in accordance with IFRS, where a sale is determined to be highly probable.

The financial position, results of operations and cash flows for assets held for sale and discontinued operations are as follows:

	December 31 2017	December 31 2016
ASSETS		
Investment properties held for sale (a)	<u>\$ 26,695,124</u>	<u>\$ 31,343,062</u>
Assets in discontinued operations		
Property and equipment (b)	7,500,000	7,422,485
Bank indebtedness	(23,489)	(47,318)
Restricted cash	6,779	18,795
Rent and other receivables	1,098	24,502
Deposits, prepaids and other	<u>19,726</u>	<u>10,581</u>
	<u>7,504,114</u>	<u>7,429,045</u>
Assets held for sale	<u>\$ 34,199,238</u>	<u>\$ 38,772,107</u>
LIABILITIES		
Liabilities in discontinued operations		
Long term debt (c)	\$ 3,509,300	\$ 3,712,306
Trade and other payables	135,762	226,406
Deposits from tenants	<u>10,055</u>	<u>14,605</u>
Liabilities held for sale	<u>\$ 3,655,117</u>	<u>\$ 3,953,317</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

Income information relating to discontinued operations are as follows:

	Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Rental income	\$ 1,626,803	\$ 4,488,348
Property operating expenses	<u>1,467,765</u>	<u>3,140,698</u>
Net operating income	159,038	1,347,650
Interest expense (d)	(181,658)	(814,652)
Gain on sale (b)	-	53,260
Fair value adjustment	<u>(136,875)</u>	<u>(1,051,899)</u>
Loss from discontinued operations	<u>\$ (159,495)</u>	<u>\$ (465,641)</u>

Cash flow information relating to discontinued operations are as follows.

	Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Cash (outflow) inflow from operating activities	\$ (99,430)	\$ 271,130
Cash inflow (outflow) from financing activities	325,633	(4,672,304)
Cash (outflow) inflow from investing activities	<u>(202,374)</u>	<u>3,930,499</u>
Increase (decrease) in cash from discontinued operations	<u>\$ 23,829</u>	<u>\$ (470,675)</u>

(a) **Investment properties held for sale**

	December 31	December 31
	<u>2017</u>	<u>2016</u>
Woodland Park	<u>\$ 26,695,124</u>	<u>\$ 31,343,062</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

(a) *Investment properties held for sale (continued)*

	Year Ended December 31	
	<u>2017</u>	<u>2016</u>
Balance, beginning of period	\$ 31,343,062	\$ 31,960,000
Investment properties transferred to held for sale (Note 5)	-	28,946,095
Additions - capital expenditures	4,076	29,868
Fair value adjustments (Note 15)	(4,652,014)	2,367,099
Dispositions	-	<u>(31,960,000)</u>
Balance, end of period	<u>\$ 26,695,124</u>	<u>\$ 31,343,062</u>

Properties are classified as held for sale when it is expected that the carrying value will be recovered principally through sale rather than their continued use in accordance with the accounting policy in Note 3 (f).

Investment properties held for sale are carried at fair value, less selling costs, as at the financial statement date and reflect the prices that would reasonably be expected to be received for their sale in an orderly transaction between market participants that are motivated but not forced or otherwise compelled to enter into a transaction. Properties are actively marketed to recover appropriate values that reflect current market conditions and/or entity specific circumstances. The ultimate sales price obtained is subject to uncertainty and could be materially different from the fair value the property is recorded at as of the financial statement date. Gains or losses arising from differences between the sales price and the carrying value or arising from changes in the fair values between financial statement dates are included in income in the period in which they arise.

Investment properties held for sale have been valued using the methods and key assumptions in Note 6: Valuations of investment properties held for sale.

During 2017, the Trust did not sell any properties classified as held for sale.

During 2016, the Trust sold Beck Court and Willowdale Gardens on May 1, 2016:

<u>Property</u>	<u>Selling Price</u>	<u>Selling Costs and Other</u>	<u>Net Cash Proceeds after debt repaid/assumed</u>	<u>Carrying Value</u>	<u>Gain on Sale</u>
Beck Court	\$ 23,000,000	\$ (8,094)	\$ 3,471,953	\$(22,975,000)	\$ 16,906
Willowdale Gardens	<u>9,000,000</u>	<u>(10,920)</u>	<u>5,948,114</u>	<u>(8,985,000)</u>	<u>4,080</u>
	<u>\$ 32,000,000</u>	<u>\$ (19,014)</u>	<u>\$ 9,420,067</u>	<u>\$(31,960,000)</u>	<u>\$ 20,986</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

(b) Property and equipment

December 31 2017	Cost, Beginning of Period	Additions	Disposals	Accumulated Amortization	Carrying Value
Land	\$ 2,175,800	\$ -	\$ -	\$ -	\$ 2,175,800
Buildings and improvements	5,437,316	212,922	-	(902,210)	4,748,028
Furniture, equipment and appliances	<u>282,755</u>	<u>1,468</u>	<u>-</u>	<u>(38,898)</u>	<u>245,325</u>
	7,895,871	214,390	-	(941,108)	7,169,153
Fair value adjustments	<u>467,722</u>	<u>(136,875)</u>	<u>-</u>	<u>-</u>	<u>330,847</u>
	<u>\$ 8,363,593</u>	<u>\$ 77,515</u>	<u>\$ -</u>	<u>\$ (941,108)</u>	<u>\$ 7,500,000</u>

December 31 2016	Cost, Beginning of Period	Additions	Disposals	Accumulated Amortization	Carrying Value
Land	\$ 4,132,100	\$ -	\$ (1,956,300)	\$ -	\$ 2,175,800
Buildings and improvements	21,881,812	424,781	(16,869,277)	(902,210)	4,535,106
Furniture, equipment and appliances	<u>393,198</u>	<u>28,752</u>	<u>(139,195)</u>	<u>(38,898)</u>	<u>243,857</u>
	26,407,110	453,533	(18,964,772)	(941,108)	6,954,763
Fair value adjustments	<u>(3,116,002)</u>	<u>(1,051,899)</u>	<u>4,635,623</u>	<u>-</u>	<u>467,722</u>
	<u>\$ 23,291,108</u>	<u>\$ (598,366)</u>	<u>\$ (14,329,149)</u>	<u>\$ (941,108)</u>	<u>\$ 7,422,485</u>

On October 1, 2016, LREIT sold Elgin Lodge for gross proceeds of \$14,500,000. The sale resulted in net cash proceeds of \$4,382,409, after selling costs of \$117,591 and the repayment of mortgage loan debt of \$10,000,000. Elgin Lodge had a carrying value of \$14,329,149 and the sale resulted in a gain on sale of \$53,260. The net cash proceeds were used to repay the revolving loan.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017**

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

(c) Long term debt

	December 31 2017	December 31 2016
Secured debt		
Mortgage loan	\$ 3,515,916	\$ 3,716,431
Unamortized transaction costs	<u>(6,616)</u>	<u>(4,125)</u>
Total long term debt	<u>\$ 3,509,300</u>	<u>\$ 3,712,306</u>

(d) Interest expense

	Year Ended December 31 2017	2016
Mortgage loan interest	\$ 177,533	\$ 747,221
Amortization of transaction costs	<u>4,125</u>	<u>67,431</u>
	<u>\$ 181,658</u>	<u>\$ 814,652</u>

(e) Deferred tax

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 2017	2016
Property and equipment	<u>\$ 836,419</u>	<u>\$ 699,545</u>
Transaction costs	<u>\$ 9,865</u>	<u>\$ 12,954</u>

Unused tax losses expiring in:

2036	\$ -	\$ 26,601
2037	<u>58,736</u>	<u>-</u>
	<u>\$ 58,736</u>	<u>\$ 26,601</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

12 Long-term debt

	December 31 2017	December 31 2016
Secured debt		
Mortgage loans (a)	\$ 187,206,443	\$ 192,674,077
Revolving loan from 2668921 Manitoba Ltd. (b)	30,000,000	22,300,000
Debentures (c)	<u>24,810,800</u>	<u>24,810,800</u>
Total secured debt	242,017,243	239,784,877
Accrued interest payable	<u>3,846,114</u>	<u>2,610,724</u>
Unamortized transaction costs		
Mortgage loans	(960,035)	(1,047,413)
Revolving loan from 2668921 Manitoba Ltd.	<u>(10,827)</u>	<u>(30,677)</u>
Total unamortized transaction costs	<u>(970,862)</u>	<u>(1,078,090)</u>
	<u>244,892,495</u>	<u>241,317,511</u>
Less current portion		
Mortgage loans	(155,907,526)	(106,278,394)
Revolving loan from 2668921 Manitoba Ltd.	(30,000,000)	(22,300,000)
Accrued interest payable	(806,791)	(811,941)
Unamortized transaction costs	<u>407,114</u>	<u>468,920</u>
Total current portion	<u>(186,307,203)</u>	<u>(128,921,415)</u>
	<u>\$ 58,585,292</u>	<u>\$ 112,396,096</u>

Normal principal installments and principal maturities at face value based on contractual obligations are as follows:

Year ending December 31	<u>Mortgage Loans</u>			Total Long- term Debt	Weighted average interest rate of long-term debt
	Normal Principal Installments	Principal Maturities	Other Debt (1)		
2018	\$ 2,321,100	\$ 126,149,097	\$ 30,000,000	\$ 158,470,197	5.5 %
2019	1,444,651	45,355,610	-	46,800,261	5.7 %
2020	261,845	-	-	261,845	4.4 %
2021	273,539	-	-	273,539	4.4 %
Thereafter	<u>1,030,127</u>	<u>10,370,474</u>	<u>24,810,800</u>	<u>36,211,401</u>	<u>4.8 %</u>
	<u>\$ 5,331,262</u>	<u>\$ 181,875,181</u>	<u>\$ 54,810,800</u>	<u>\$ 242,017,243</u>	<u>5.4 %</u>

(1) Other debt includes a revolving loan with balance outstanding of \$30,000,000, maturing June 30, 2018, and Series G debentures with balance outstanding of \$24,810,800, due on June 30, 2022.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

12 Long-term debt (continued)

A forbearance agreement and four loan agreements have been negotiated with the lenders of five mortgage loans secured by five properties in Fort McMurray whereby the monthly debt service payments will be less than the interest expense for the balance of the mortgage term. The mortgages mature at various dates up to March 31, 2019. Over the period from January 1, 2018 to maturity, \$1,736,825 of accrued interest and fees are expected to be incurred and added to the outstanding mortgage principal.

(a) Mortgage loans

	Weighted average interest rates		Amount	
	December 31 2017	December 31 2016	December 31 2017	December 31 2016
First mortgage loans				
Fixed rate	4.7%	5.1%	\$ 102,020,638	\$ 80,471,688
Variable rate	6.4%	6.1%	<u>79,688,009</u>	<u>107,209,774</u>
Total first mortgage loans	5.4%	5.6%	<u>\$ 181,708,647</u>	<u>\$ 187,681,462</u>
Second mortgage loans				
Total second mortgage loans	9.0%	11.8%	<u>\$ 5,497,796</u>	<u>\$ 4,992,615</u>
All mortgage loans				
Fixed rate	4.9%	5.5%	\$ 107,518,434	\$ 85,464,303
Variable rate	6.4%	6.1%	<u>79,688,009</u>	<u>107,209,774</u>
Total mortgage loans	5.5%	5.8%	<u>\$ 187,206,443</u>	<u>\$ 192,674,077</u>

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.

As of December 31, 2017, the Trust was in default of the payment of service fees on four mortgage loans in the aggregate principal amount of \$46,896,076 secured by a total of seven properties in its Fort McMurray portfolio. Subsequent to December 31, 2017, forbearance agreements were executed for three of these mortgage loans, secured by a total of six properties, in the aggregate principal amount of \$18,674,159. The forbearance agreements expire May 1, 2021. LREIT continues to meet the debt service obligations of the mortgage that remains in default and the lender has taken no action to demand repayment or enforce its security under the loan.

Subsequent to December 31, 2017, a forbearance termination event on one mortgage loan secured by one property in the aggregate principal amount of \$25,582,975 was triggered due to non-compliance with a deadline set with respect to the condominium sales program. The lender has taken no action to demand repayment or enforce its security under the loan and has indicated that it will not take any action with respect to the default prior to March 31, 2018.

In the event that full repayment is demanded with respect to any of the mortgage loans in default, the Trust would not be able to satisfy the associated obligation with its current resources.

Additional information related to the default of mortgage loans is provided in Note 2: *Basis of presentation and continuing operations*.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

12 *Long-term debt (continued)*

(a) **Mortgage loans (continued)**

All mortgages which have matured prior to the date of the Financial Statements have been renewed, refinanced or are under a forbearance agreement.

(b) **Revolving loan**

The Trust receives advances under a revolving loan facility from 2668921 Manitoba Ltd. (the parent company of Shelter). The revolving loan is for a three year term, maturing June 30, 2018, with a maximum balance of \$30,000,000. On July 1, 2016, the interest rate was reduced from 12% to 5%. On November 14, 2016, the maximum balance was increased from \$18,000,000 to \$30,000,000. Advances on the revolving loan are made at the discretion of 2668921 Manitoba Ltd. and the revolving loan is payable on demand.

The loan is secured by mortgage charges against the title of the remaining seniors' housing complex and the assignment of a vendor take-back mortgage.

(c) **Debentures**

The Series G debentures bear interest at 5.0% (2016 - 5.0%) and are due on June 30, 2022. Interest is accrued and is payable on the due date.

At any time prior to the maturity date, the Series G Debentures are redeemable, in whole or in part, at a price equal to the principal amount thereof, plus accrued and unpaid interest, from time to time at LREIT's sole option on not more than 60 days' and not less than 30 days' prior notice.

In the event that LREIT sells any of its properties, LREIT is required to use the net proceeds of such sales to redeem the Series G Debentures in whole or in part. Prior to making any redemption of the Series G Debentures, LREIT is required to use the net proceeds of such sales for the following purposes: (i) payment of all mortgage indebtedness relating to such properties; (ii) payment of all ordinary course expenses and liabilities relating to such properties; (iii) payment of all expenses relating to the cost of sale of such property; and (iv) repayment of any amounts owing to 2668921 Manitoba Ltd. under the revolving loan facility and any other amounts owing to 2668921 Manitoba Ltd. or its affiliates, including Shelter.

Included in accrued interest payable under long-term debt at December 31, 2017 is a balance of \$3,039,323 (December 31, 2016 - \$1,798,783) in regard to the deferred interest on the Series G debentures.

13 *Trade and other payables*

	December 31 2017	December 31 2016
Accounts payable	\$ 2,230,589	\$ 2,390,614
Accrued payables	313,249	506,655
Prepaid rent	271,309	310,265
Advances from Shelter (Note 20)	6,000,000	-
	<u>\$ 8,815,147</u>	<u>\$ 3,207,534</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

14 *Interest expense*

	Year Ended December 31	
	2017	2016
Mortgage loan interest	\$ 10,453,899	\$ 11,878,008
Revolving loan interest	1,363,370	1,374,123
Debenture interest	1,240,540	1,798,783
Shelter advances interest	59,130	-
Amortization of transaction costs	813,723	4,025,672
	<u>\$ 13,930,662</u>	<u>\$ 19,076,586</u>

15 *Fair value adjustments*

Fair value adjustments consist of the following:

	Year Ended December 31	
	2017	2016
Fair value adjustments - investment properties (Note 5)	\$ (20,878,973)	\$ 9,278,305
Fair value adjustments - investment properties held for sale (Note 11)	<u>(4,652,014)</u>	<u>2,367,099</u>
	<u>\$ (25,530,987)</u>	<u>\$ 11,645,404</u>

16 *Per unit calculations*

	Year Ended December 31	
	2017	2016
Loss before discontinued operations	\$ (31,877,187)	\$ (1,264,483)
Loss from discontinued operations	<u>(159,495)</u>	<u>(465,641)</u>
Loss and comprehensive loss	<u>\$ (32,036,682)</u>	<u>\$ (1,730,124)</u>

	Year Ended December 31	
	2017	2016
Weighted average number of units:		
Units	20,557,320	20,466,506
Deferred units	<u>591,576</u>	<u>682,390</u>
Total basic and diluted	<u>21,148,896</u>	<u>21,148,896</u>

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

17 Units

	Year Ended December 31, 2017		Year Ended December 31, 2016	
	Units	Amount	Units	Amount
Redemption of deferred units (Note 19)	20,557,320	\$ 125,641,529	20,252,386	\$ 125,641,529
	-	-	304,934	-
	<u>20,557,320</u>	<u>\$ 125,641,529</u>	<u>20,557,320</u>	<u>\$ 125,641,529</u>

18 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 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, January 15, 2013 and May 19, 2014, 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.

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

	Year Ended December-31-17		Year Ended December 31, 2016	
	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price
Outstanding, beginning of period	240,000	\$ 0.99	446,000	\$ 0.71
Cancelled, July 10, 2016	-	-	(20,000)	0.60
Cancelled, July 10, 2016	-	-	(10,000)	0.65
Cancelled, December 12, 2016	-	-	(176,000)	0.34
Cancelled, February 18, 2017	(5,000)	1.11	-	-
Cancelled, November 19, 2017	<u>(40,000)</u>	<u>0.60</u>	<u>-</u>	<u>-</u>
Outstanding, end of period	<u>195,000</u>	<u>\$ 1.06</u>	<u>240,000</u>	<u>\$ 0.99</u>
Vested, end of period	<u>195,000</u>		<u>240,000</u>	

At December 31, 2017 the following unit options were outstanding:

Exercise price	Options outstanding	Options vested	Expiry date
\$ 0.65	20,000	20,000	January 15, 2018
1.11	<u>175,000</u>	<u>175,000</u>	May 19, 2019
	<u>195,000</u>	<u>195,000</u>	

Subsequent to December 31, 2017, 20,000 unit options were cancelled.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

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

The deferred units credited to a participant (including deferred units that have not yet vested) vest immediately and are 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.

	Year Ended December 31	
	2017	2016
Outstanding and vested, beginning of year	591,576	896,510
Redeemed during the year	-	(304,934)
Outstanding and vested, end of year	<u>591,576</u>	<u>591,576</u>

All deferred units outstanding as of December 31, 2017 were fully vested.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

20 *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 is a related party as it has entered into a property management and service agreement and provides management services to the Trust. 2668921 Manitoba Ltd., the parent company of Shelter, is a related party through common control as 2668921 Manitoba Ltd. is owned by a family member of a Trustee of the Trust.

Property management agreement

The Trust has entered into a property management agreement with Shelter, the current term of which expires on December 31, 2024. Under the property management agreement, Shelter administers the day-to-day operations of the Trust's portfolio of investment properties, except for the seniors' housing complex. The Trust pays property management fees equal to 4% of gross receipts from the investment properties owned by the Trust and compensation for reimbursable expenses. In regard to commercial properties, Shelter 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 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 fees under the property management agreement payable to Shelter of \$778,243 for the year ended December 31, 2017 (2016 - \$757,104).

Included in trade and other payables at December 31, 2017 is a balance of \$8,302 receivable from Shelter (December 31, 2016 - \$247,215 payable) in regard to outstanding amounts due under the property management agreement.

Services agreement

The Trust has entered into a services agreement with Shelter, the current term of which expires on December 31, 2024. Under the services agreement, Shelter 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 payable to Shelter of \$899,627 for the year ended December 31, 2017 (2016 - \$990,458).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

20 *Related party transactions (continued)*

Services fee and renovation fee for Lakewood Townhomes condominium sales program

The Trust has entered into an agreement with Shelter in regard to the condominium sales program at Lakewood Townhomes. Under the agreement, Shelter administers 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 is responsible for the payment of a fee to an external real estate broker for providing brokerage services. If it is necessary to increase the fee to the external real estate broker due to market conditions, the fee payable to Shelter increases by the amount of the increase in the 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 of \$20,895 for the year ended December 31, 2017 (2016 - \$19,425).

Financing

Revolving loan

A summary of the terms for the revolving loan facility from July 1, 2015 is provided in the following chart.

<u>Revolving Loan Term</u>		<u>Renewal Fees</u>	<u>Interest Rate</u>	<u>Maximum Interest Charge</u>	<u>Maximum Loan Commitment</u>
<u>From</u>	<u>To</u>				
July 1, 2015	June 30, 2016	25,000	12.00 %	6,480,000 *	18,000,000
July 1, 2016	November 13, 2016	-	5.00 %	6,480,000 *	18,000,000
November 14, 2016	June 30, 2018	-	5.00 %	6,480,000 *	30,000,000

* Notwithstanding the amendments to the revolving loan facility subsequent to July 1, 2015, the combined maximum interest charge allowable by 2668921 Manitoba Ltd. and any of its subsidiaries or affiliates including Shelter for the three-year term from July 1, 2015 to June 30, 2018 is \$6,480,000.

During the year ended December 31, 2017, the Trust received advances of \$7,700,000 (2016 - \$24,650,000) and repaid advances of nil (2016 - \$9,450,000) against the revolving loan, resulting in a balance of \$30,000,000 (December 31, 2016 - \$22,300,000). The revolving loan balance is included in current portion of long-term debt.

Interest on the revolving loan of \$1,363,370 for the year ended December 31, 2017 (2016 - \$1,374,123) is included in interest expense.

The revolving loan facility was considered and approved by the independent Trustees.

Shelter loan advances

During the year ended December 31, 2017, Shelter made unsecured loan advances totaling \$6,000,000 to LREIT, the terms of which provide for a 5% interest charge, consistent with the interest rate on advances under the revolving loan facility. During the year ended December 31, 2016, Shelter advanced \$650,000 on an interest-free basis as an interim funding measure.

During the year ended December 31, 2017, the Trust made repayments of nil (2016 - \$650,000), resulting in an outstanding unsecured loan balance of \$6,000,000 at December 31, 2017 (December 31, 2016 - nil). The unsecured loan is included in trade and other payables.

Interest on the Shelter advances of \$59,130 for the year ended December 31, 2017 (2016 - nil) is included in interest expense.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

20 *Related party transactions (continued)*

Financing (continued)

Nelson Ridge second mortgage loan

On March 31, 2016, 2668921 Manitoba Ltd. purchased the Nelson Ridge second mortgage loan. Immediately following the purchase, 2668921 Manitoba Ltd. extended the maturity date to March 31, 2017 and waived the requirement to pay interest until the amended maturity date. On April 1, 2017, the mortgage loan was renewed at an interest rate of 9% per annum and matures on March 31, 2019. The amended mortgage loan terms provide for the deferral and capitalization of interest payments until the maturity date.

As of December 31, 2017, the amount owing on the mortgage loan was \$5,497,796 (2016 - \$4,992,615), inclusive of accrued interest.

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, 2017 was \$134,000 (2016 - \$314,000).

Guarantees

Obligations, including certain mortgage loans payable, have been secured, guaranteed or indemnified by Shelter and/or its parent company, 2668921 Manitoba Ltd. No fees were charged to the Trust in regard to the guarantees.

21 *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 strives to avoid undue concentrations of risk. The Trust manages the risks, as follows:

Liquidity risk - defaults

As of December 31, 2017, the Trust was in default of four mortgage loans secured by a total of seven properties with an aggregate principal balance of \$46,896,076, as the lender of the mortgage loans indicated that there are service fees outstanding with respect to previous defaults under the loans and that until such fees are paid the loans remain in default. Subsequent to December 31, 2017, forbearance agreements were executed for three of these mortgage loans, secured by a total of six properties, in the aggregate principal amount of \$18,674,159. The forbearance agreements required an initial combined repayment of \$1,700,000, which was paid on March 5, 2018, and require future combined repayments of \$633,000, \$666,000 and \$333,000 in 2018, 2019 and 2020, respectively. The forbearance agreements expire May 1, 2021. LREIT continues to meet the debt service obligations of the mortgage that remains in default and the lender has taken no action to demand repayment or enforce its security under the loan.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

21 *Financial instruments and risk management (continued)*

Liquidity risk - defaults (continued)

Subsequent to December 31, 2017, a forbearance termination event on one mortgage loan secured by one property in the aggregate principal amount of \$25,582,975 was triggered due to non-compliance with a deadline set with respect to the condominium sales program. The lender has taken no action to demand repayment or enforce its security under the loan and has indicated that it will not take any action with respect to the default prior to March 31, 2018.

In the event that full repayment is demanded with respect to any of the mortgage loans in default, the Trust would not be able to satisfy the associated obligation with its current resources.

Liquidity risk - debt maturities

Liquidity risk arises from the possibility that the Trust will not have sufficient debt or equity capital available to refinance its debt as it matures or to meet its other obligations as they become due. Should the Trust default on its debt obligations, debt maturities may be accelerated by the lenders.

Liquidity risk is compounded by the material uncertainty that exists as of the date of this report with respect to the Trust's ability to remain a going concern. Continuation of the Trust's operations into the foreseeable future is contingent upon a combination of events and/or conditions that are subject to material uncertainty and include, but are not limited to: the willingness and ability of Shelter and its parent company, 2668921 Manitoba Ltd., to provide additional advances under the revolving loan facility and/or provide other forms of financial support to the Trust; the willingness and ability of the Trust's lenders to participate in a restructuring of the Trust's debt to the degree and for the duration necessary to allow LREIT to stabilize its operations; the Trust's ability to renew or refinance debt as it matures; the timing and extent of a recovery of the Fort McMurray rental market, which in turn is highly dependent on the timing and extent of a recovery in oil prices and in the near term is also dependent on the demand for rental accommodations during the post-fire rebuild; the improvement of cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio; and the ability of LREIT to complete additional property sales at prices which exceed the indebtedness related to such properties.

Liquidity risk is mitigated by the ongoing monitoring activities of the Trust's management; open communication with the Trust's lenders; the continued financial support from Shelter and its parent company, 2668921 Manitoba Ltd.; expansion of the Trust's divestiture program; and the staggering of mortgage maturity dates over a number of years.

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$36,117,858. The renewal terms required an initial principal repayment of \$1,000,000, which was paid on March 16, 2018, and additional principal repayments of \$500,000 every six months commencing with September 1, 2018 and ending on March 1, 2020. The renewed mortgage loan bears interest at prime plus 3.30% and allows for the deferral of 40% of the monthly interest payments until the September 1, 2020 maturity date of the loan.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

21 *Financial instruments and risk management (continued)*

Liquidity risk - debt maturities (continued)

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$7,158,017. The renewal terms required an initial principal repayment of \$500,000, which was paid on March 16, 2018, and additional principal repayments of \$280,000 per each quarter in which the Trust fails to sell a unit under the property's condominium sales program. In exchange for each \$280,000 principal payment made during the term of the renewed first mortgage loan, the lender will discharge one condominium unit from its security. The renewed mortgage loan bears interest at prime plus 3.30% and matures on September 1, 2020.

As at December 31, 2017, the weighted average term to maturity of the fixed rate mortgages on investment properties is 1.7 years (December 31, 2016 - 2.4 years).

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

December 31, 2017	Mortgage Loans			Other Payables (3)	Total
	Normal Principal Installments	Principal Maturities (1)	Other Debt (2)		
2018	\$ 2,321,100	\$126,149,097	\$ 30,000,000	\$ 14,068,783	\$172,538,980
2019	1,444,651	45,355,610	-	-	46,800,261
2020	261,845	-	-	-	261,845
2021	273,539	-	-	-	273,539
Thereafter	1,030,127	10,370,474	24,810,800	-	36,211,401
	<u>\$ 5,331,262</u>	<u>\$181,875,181</u>	<u>\$ 54,810,800</u>	<u>\$ 14,068,783</u>	<u>\$256,086,026</u>

(1) If the lenders of the one mortgage loan that is in default as of the date of this report and the forbearance agreement subject to a terminating event demanded repayment during 2018 and the chart above was adjusted to reflect the repayments, the total repayment obligations due in 2018 would increase to \$199,967,303, the total long-term debt due in 2019 would decrease to \$19,362,934, the total long-term debt due in 2020 and beyond would remain the same.

(2) Other debt includes a revolving loan with balance outstanding of \$30,000,000, maturing June 30, 2018, and Series G debentures with balance outstanding of \$24,810,800, due on June 30, 2022.

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

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, 2017 the percentage of fixed rate mortgage loans to total mortgage loans on investment properties was 57% (December 31, 2016 - 44%).

The Trust has variable rate mortgage loans on investment properties totaling \$79,688,009, or 43% of the total mortgage loans at December 31, 2017 (December 31, 2016 - \$107,209,774 or 56%). Should interest rates change by 1%, interest expense would change by \$796,880 per year.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

21 *Financial instruments and risk management (continued)*

Interest rate risk (continued)

As at December 31, 2017, the Trust has total mortgage principal maturities on investment properties which mature on or prior to December 31, 2020 of \$174,779,870 representing 93% of total mortgage loans. Should the amounts be refinanced upon maturity at an interest rate differential of 1%, interest expense would change by \$1,747,799 per year.

The Trust has not traded in derivative financial instruments.

Credit risk

Credit risk arises when the Trust has a risk of loss resulting from a default by third parties to an obligation.

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 and a reconciliation of allowance for doubtful accounts:

	December 31 <u>2017</u>	December 31 <u>2016</u>
<u>Rent receivable overdue:</u>		
0 to 30 days	\$ 98,925	\$ 76,506
31 to 60 days	35,456	55,348
More than 60 days	<u>65,575</u>	<u>171,519</u>
	<u>\$ 199,956</u>	<u>\$ 303,373</u>
	Year Ended December 31 <u>2017</u>	<u>2016</u>
Balance, beginning of period	\$ 109,748	\$ 31,502
Amount charged to bad debt expense relating to impairment of rent receivable	17,291	126,207
Amounts written off as uncollectible	<u>(70,700)</u>	<u>(47,961)</u>
Balance, end of period	<u>\$ 56,339</u>	<u>\$ 109,748</u>
Amount charged to bad debts as a percent of rentals from investment properties	0.09%	0.69%

The Trust continues to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable until such debts are extinguished or the lenders agree to release the Trust's covenants. At December 31, 2017, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$27,512,300 (December 31, 2016 - \$29,312,604) which expires in 2022 (December 31, 2016 - expires between 2017 and 2022). There have been no defaults by the primary obligor for debts on which the Trust has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in these consolidated financial statements.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

21 *Financial instruments and risk management (continued)*

Credit risk (continued)

Credit risks arise in the event that these parties default on repayment of their debt since they are guaranteed by the Trust. These credit risks are mitigated as the Trust has recourse under these guarantees in the event of a default by the borrowers, in which case the Trust's claim would be against the underlying real estate investments.

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.

Fair values

A comparison of the carrying value and fair value of the financial instruments of the Trust is provided below.

	Carrying Value		Fair Value	
	December 31 2017	December 31 2016	December 31 2017	December 31 2016
Financial assets				
Restricted cash	\$ 2,400,176	\$ 2,650,066	\$ 1,886,901	\$ 2,127,195
Cash	1,638,918	706,768	1,638,918	706,768
Rent and other receivables	459,234	394,131	459,234	394,131
Deposits	585,261	186,172	585,261	186,172
Financial liabilities				
Mortgages loans	187,206,443	192,674,077	204,615,479	209,179,279
Debentures	24,810,800	24,810,800	2,721,945	5,830,338
Trade and other payables	8,815,147	3,207,534	8,815,147	3,207,534
Deposits from tenants	1,407,522	1,529,110	1,407,522	1,529,110

The fair value of the financial assets and liabilities are included as 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. With the exception of debentures, the fair value of financial instruments were estimated using valuation methods that are classified as level 2 of the fair value hierarchy as the inputs are directly or indirectly observable market data using the following methods and assumptions:

- Cash, rent and other receivables, deposits, trade and other payables and deposits from tenants approximate their carrying value due to the short-term maturities of these instruments.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

21 *Financial instruments and risk management (continued)*

Fair values (continued)

- Restricted cash is estimated by discounting expected future cash flows using current market interest rates. Tenant security deposits included in restricted cash approximate their carrying value.
- In regard to mortgage loans:
 - The fair value of floating rate borrowings is estimated by discounting expected 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 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 current market interest rates used to calculate the fair value range between 4.55% and 5.84%.
- The fair value of debentures is based on quoted market prices. The valuation method is classified as level 1 of the fair value hierarchy as the inputs are from an active market.

22 *Reconciliation of liabilities arising from financing activities*

	Year Ended December 31, 2017		
	Total	Investment Properties	Seniors' Housing Complex
Regular repayment of principal on mortgage loans	\$ (3,508,348)	\$ (3,307,833)	\$ (200,515)
Repayment of mortgage loans on refinancing	(4,475,000)	(4,475,000)	-
Reduction of mortgage loans on sale of properties	(441,135)	(441,135)	-
Non cash - interest and fees capitalized, net of repayment	<u>2,756,334</u>	<u>2,756,334</u>	<u>-</u>
Decrease in mortgage loans	(5,668,149)	(5,467,634)	(200,515)
Total mortgage loans - December 31, 2016	<u>196,390,508</u>	<u>192,674,077</u>	<u>3,716,431</u>
Total mortgage loans - December 31, 2017	<u>\$190,722,359</u>	<u>\$187,206,443</u>	<u>\$3,515,916</u>

23 *Management of capital*

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

	December 31 <u>2017</u>	December 31 <u>2016</u>
Mortgage loans *	\$186,246,408	\$191,626,664
Revolving loan from 2668921 Manitoba Ltd. *	29,989,173	22,269,323
Debentures *	24,810,800	24,810,800
Deficit	<u>(36,641,825)</u>	<u>(4,605,143)</u>
	<u>\$204,404,556</u>	<u>\$234,101,644</u>

* Amounts are inclusive of unamortized transaction costs.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

23 *Management of capital (continued)*

The Trust manages capital in order to maintain 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 managed having regard to the overall mortgage debt limits as established by the Declaration of Trust. The Declaration of Trust provides for a restriction on the Trust incurring mortgage indebtedness if the incurrence of such mortgage indebtedness would result in total mortgage indebtedness of the Trust exceeding 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 to help sustain operations.

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

In order to maintain or adjust the capital structure the Trust may (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"). An operating segment is also established for Investment Properties Held for sale and/or sold. Prior period results have been restated to reflect these segments.

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

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

24 *Segmented financial information (continued)*

Year ended December 31, 2017:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	14,983,563	1,568,568	2,500,071	-	19,052,202
Property operating costs	8,086,147	1,230,211	932,342	-	10,248,700
Net operating income	6,897,416	338,357	1,567,729	-	8,803,502
Interest income	19,315	1,475	3,371	165,264	189,425
Interest expense	9,249,944	485,464	1,512,363	2,682,891	13,930,662
Loss before discontinued operations	(22,712,326)	(588,485)	(4,593,277)	(3,983,099)	(31,877,187)
Cash used in operating activities	(174,701)	26,762	631,397	(3,046,358)	(2,562,900)
Cash from (used in) financing activities	2,169,524	(24,464)	(738,868)	3,319,186	4,725,378
Cash from (used in) investing activities	(1,262,855)	(37,147)	74,473	(4,799)	(1,230,328)
Total assets excluding discontinued operations (Note 11) at December 31, 2017	170,345,640	12,318,910	27,141,421	4,818,371	214,624,342

Year ended December 31, 2016:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	13,262,742	1,631,872	3,433,598	-	18,328,212
Property operating costs	8,085,890	1,067,768	1,360,267	-	10,513,925
Net operating income	5,176,852	564,104	2,073,331	-	7,814,287
Interest income	12,906	1,189	4,287	131,194	149,576
Interest expense	11,898,758	536,098	2,692,483	3,949,247	19,076,586
Income (loss) before discontinued operations	3,965,768	(1,353,978)	1,811,058	(5,687,331)	(1,264,483)
Cash from (used in) operating activities	(1,620,035)	19,611	1,154,332	(3,079,418)	(3,525,510)
Cash from (used in) financing activities	3,297,374	11,625	(10,599,807)	609,997	(6,680,811)
Cash from (used in) investing activities	(1,668,245)	2,358	9,593,364	2,578,099	10,505,576
Total assets excluding discontinued operations (Note 11) at December 31, 2016	188,686,260	12,737,785	31,932,743	4,616,496	237,973,284

25 **Commitments**

Management Contracts

The Trust has retained the following third party manager to provide on-site management services to the seniors' housing complex:

<u>Property</u>	<u>Manager</u>	<u>Term Expiring</u>
Chateau St. Michael's	Integrated Life Care Inc.	October 31, 2018

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2017

27 *Subsequent events*

Forbearance terminating event

Subsequent to December 31, 2017, a forbearance termination event on one mortgage loan secured by one property in the aggregate principal amount of \$25,582,975 was triggered due to non-compliance with a deadline set with respect to the condominium sales program. The lender has taken no action to demand repayment or enforce its security under the loan and has indicated that it will not take any action with respect to the default prior to March 31, 2018.

Forbearance agreements

Subsequent to December 31, 2017, forbearance agreements were executed for three mortgage loans, secured by a total of six properties, in the aggregate principal amount of \$18,674,159. The forbearance agreements required an initial combined repayment of \$1,700,000, which was paid on March 5, 2018, and require future combined repayments of \$633,000, \$666,000 and \$333,000 in 2018, 2019 and 2020, respectively. The forbearance agreements expire May 1, 2021.

Mortgage renewal

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$36,117,858. The renewal terms required an initial principal repayment of \$1,000,000, which was paid on March 16, 2018, and additional principal repayments of \$500,000 every six months commencing with September 1, 2018 and ending on March 1, 2020. The renewed mortgage loan bears interest at prime plus 3.30% and allows for the deferral of 40% of the monthly interest payments until the September 1, 2020 maturity date of the loan.

Subsequent to December 31, 2017, LREIT agreed to renewal terms on a first mortgage loan with a principal balance outstanding as of December 31, 2017 of \$7,158,017. The renewal terms required an initial principal repayment of \$500,000, which was paid on March 16, 2018, and additional principal repayments of \$280,000 per each quarter in which the Trust fails to sell a unit under the property's condominium sales program. In exchange for each \$280,000 principal payment made during the term of the renewed first mortgage loan, the lender will discharge one condominium unit from its security. The renewed mortgage loan bears interest at prime plus 3.30% and matures on September 1, 2020.

Shelter advances

Subsequent to December 31, 2017, the Trust received advances from Shelter of \$5,000,000 and repaid nil, resulting in a balance of \$11,000,000 as of the date of the issuance of the Financial Statements.

Sale of condominium unit at Lakewood Townhomes

Subsequent to December 31, 2017, LREIT sold one condominium unit at Lakewood Townhomes for gross proceeds of \$322,000. The sale resulted in net cash proceeds of \$45,970 after selling costs of \$21,130 and mortgage loan repayment of \$254,900.