



**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2017**

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	<u>June 30 2017</u>	<u>December 31 2016</u>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Investment properties (Note 4)	\$188,940,623	\$198,099,131
Loan receivable	4,000,000	4,000,000
Restricted cash	<u>2,756,241</u>	<u>2,650,066</u>
<b>Total non-current assets</b>	<u>195,696,864</u>	<u>204,749,197</u>
<b>Current assets</b>		
Cash	925,453	706,768
Rent and other receivables	480,595	394,131
Deposits and prepaids	<u>1,320,544</u>	<u>780,126</u>
	2,726,592	1,881,025
Assets held for sale (Note 6)	<u>37,830,161</u>	<u>38,772,107</u>
<b>Total current assets</b>	<u>40,556,753</u>	<u>40,653,132</u>
<b>TOTAL ASSETS</b>	<u><b>\$236,253,617</b></u>	<u><b>\$245,402,329</b></u>
<b>LIABILITIES AND EQUITY</b>		
<b>Liabilities</b>		
<b>Non-current liabilities</b>		
Long-term debt (Note 7)	<u>\$ 44,241,396</u>	<u>\$112,396,096</u>
<b>Total non-current liabilities</b>	<u>44,241,396</u>	<u>112,396,096</u>
<b>Current liabilities</b>		
Trade and other payables (Note 8)	2,463,641	3,207,534
Current portion of long-term debt (Note 7)	202,297,457	128,921,415
Deposits from tenants	<u>1,562,186</u>	<u>1,529,110</u>
	206,323,284	133,658,059
Liabilities held for sale (Note 6)	<u>3,849,737</u>	<u>3,953,317</u>
<b>Total current liabilities</b>	<u>210,173,021</u>	<u>137,611,376</u>
<b>Total liabilities</b>	<u>254,414,417</u>	<u>250,007,472</u>
<b>Total deficit</b>	<u>(18,160,800)</u>	<u>(4,605,143)</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<u><b>\$236,253,617</b></u>	<u><b>\$245,402,329</b></u>

Approved by the Board of Trustees

*"Charles Loewen"*

*"Earl Coleman"*

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Rentals from investment properties	\$ 4,880,593	\$ 3,979,652	\$ 9,525,108	\$ 8,431,114
Property operating costs	<u>2,406,449</u>	<u>2,155,504</u>	<u>4,818,851</u>	<u>4,947,609</u>
<b>Net operating income</b>	<b>2,474,144</b>	<b>1,824,148</b>	<b>4,706,257</b>	<b>3,483,505</b>
Interest income	44,612	39,735	90,224	56,988
Interest expense (Note 9)	(3,713,754)	(5,764,385)	(7,400,008)	(11,420,565)
Trust expense	(357,490)	(558,510)	(772,968)	(1,114,940)
Gain on sale of investment property (Note 6) (Note 4)	-	20,986	58,377	20,986
Fair value adjustments (Note 10)	<u>(7,346,907)</u>	<u>24,952,489</u>	<u>(10,273,086)</u>	<u>21,848,260</u>
<b>Income (loss) before discontinued operations</b>	<b>(8,899,395)</b>	<b>20,514,463</b>	<b>(13,591,204)</b>	<b>12,874,234</b>
Income (loss) from discontinued operations (Note 6)	<u>(10,543)</u>	<u>(25,742)</u>	<u>35,547</u>	<u>15,190</u>
<b>Income (loss) and comprehensive income (loss)</b>	<b><u>\$ (8,909,938)</u></b>	<b><u>\$ 20,488,721</u></b>	<b><u>\$ (13,555,657)</u></b>	<b><u>\$ 12,889,424</u></b>
Income (loss) per unit before discontinued operations:				
Basic and diluted	<u>\$ (0.421)</u>	<u>\$ 0.970</u>	<u>\$ (0.643)</u>	<u>\$ 0.609</u>
Income (loss) per unit from discontinued operations:				
Basic and diluted	<u>\$ (0.001)</u>	<u>\$ (0.001)</u>	<u>\$ 0.002</u>	<u>\$ 0.001</u>
Income (loss) per unit:				
Basic and diluted	<u>\$ (0.422)</u>	<u>\$ 0.969</u>	<u>\$ (0.641)</u>	<u>\$ 0.610</u>

The accompanying notes are an integral part of these financial statements  
(unaudited)

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN (DEFICIT) EQUITY

	Six Months Ended June 30	
	2017	2016
<b>Issued capital</b> (Note 12)		
Balance, beginning and end of period	<u>\$ 125,641,529</u>	<u>\$ 125,641,529</u>
<b>Contributed surplus</b>		
Balance, beginning and end of period	<u>17,027,907</u>	<u>17,027,907</u>
<b>Cumulative deficit</b>		
Balance, beginning of period	(64,124,544)	(62,394,420)
Income (loss) and comprehensive income (loss)	<u>(13,555,657)</u>	<u>12,889,424</u>
Balance, end of period	<u>(77,680,201)</u>	<u>(49,504,996)</u>
<b>Cumulative distributions to unitholders</b>		
Balance, beginning and end of period	<u>(83,150,035)</u>	<u>(83,150,035)</u>
<b>Total (deficit) equity</b>	<u>\$ (18,160,800)</u>	<u>\$ 10,014,405</u>

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
<b>Operating activities</b>				
Income (loss) and comprehensive income (loss)	\$ (8,909,938)	\$ 20,488,721	\$ (13,555,657)	\$ 12,889,424
Adjustments to reconcile income to cash flows				
Fair value adjustments (Note 10)	7,346,907	(24,952,489)	10,273,086	(21,848,260)
Fair value adjustment - Property and equipment (Note 6)	-	141,448	-	355,942
Gain on sale of properties	-	(20,986)	(58,377)	(20,986)
Accrued rental revenue	(1,212)	24,892	11,848	55,375
Interest income	(44,612)	(39,735)	(90,224)	(56,988)
Interest received	44,591	26,414	90,483	43,371
Interest expense	3,757,446	5,995,852	7,492,306	11,884,585
Interest paid	(2,323,874)	(1,590,897)	(4,909,226)	(4,883,631)
Cash provided by (used in) operations	(130,692)	73,220	(745,761)	(1,581,168)
Increase in rent and other receivables	(139,932)	(460,790)	(75,170)	(364,106)
Increase in deposits and prepaids	(497,691)	(349,828)	(538,456)	(420,861)
Increase in tenant deposits	29,734	421,506	35,326	353,294
Increase (decrease) in trade and other payables	(112,546)	581,730	(745,883)	866,307
	(851,127)	265,838	(2,069,944)	(1,146,534)
<b>Cash provided by (used in) financing activities</b>				
Repayment of long-term debt	(878,861)	(430,367)	(1,746,405)	(1,621,721)
Prepayment of mortgage loans	-	(5,456,865)	-	(12,956,865)
Proceeds of revolving loan facility	2,100,000	500,000	4,900,000	11,400,000
Repayment of revolving loan facility	-	(3,900,000)	-	(3,900,000)
Proceeds of Shelter Canadian Properties Limited advances	-	650,000	-	650,000
Repayment of Shelter Canadian Properties Limited advances	-	(650,000)	-	(650,000)
Expenditures on transaction costs	(141,162)	(17,381)	(177,536)	(77,762)
	1,079,977	(9,304,613)	2,976,059	(7,156,348)
<b>Cash provided by (used in) investing activities</b>				
Capital expenditures on investment properties	(158,139)	(4,580)	(329,883)	(143,413)
Capital expenditures on investment properties held for sale	578	-	(1,766)	-
Capital expenditures on property and equipment	(127,272)	(141,448)	(146,523)	(355,942)
Decrease in defeasance assets	-	42,621	-	81,054
Proceeds of sale	-	9,420,067	(106,107)	9,420,067
Change in restricted cash	(51,865)	(374,224)	(93,670)	(338,586)
	(336,698)	8,942,436	(677,949)	8,663,180
<b>Cash increase (decrease)</b>	(107,848)	(96,339)	228,166	360,298
<b>Add (deduct) decrease (increase) in cash from discontinued operations (Note 6)</b>	20,581	430,538	(9,481)	180,857
	(87,267)	334,199	218,685	541,155
<b>Cash, beginning of period</b>	1,012,720	614,469	706,768	407,513
<b>Cash, end of period</b>	\$ 925,453	\$ 948,668	\$ 925,453	\$ 948,668

The accompanying notes are an integral part of these financial statements  
(unaudited)

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 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, 2018	LRT.DB.G

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

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

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

The interim condensed consolidated financial statements of the Trust for the three and six months ended June 30, 2017 and 2016 ("Financial Statements") have been prepared in accordance with International Accounting Standard 34 - *Interim Financial Reporting*. Accordingly, certain information and note disclosures normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") have been omitted or condensed. The Financial Statements were authorized for issue in accordance with a resolution of the Board of Trustees on August 8, 2017.

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 subsidiaries 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 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.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

The Trust incurred a loss before discontinued operations of \$8,899,395 for the three months ended June 30, 2017 (2016 - an income of \$20,514,463) and \$13,591,204 for the six months ended June 30, 2017 (2016 - an income of \$12,874,234). The Trust incurred a cash deficiency from operating activities, after working capital adjustments, of \$851,127 for the three months ended June 30, 2017 (2016 - generated cash of \$265,838) and \$2,069,944 for the six months ended June 30, 2017 (2016 - \$1,146,534). 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 \$2,155,983 for the three months ended June 30, 2017 (2016 - \$327,938) and \$4,472,057 for the six months ended June 30, 2017 (2016 - \$3,345,372).

In addition, the Trust has working capital of \$256,499 as at June 30, 2017 (December 31, 2016 - a working capital deficit of \$1,333,161).

As of June 30, 2017, the Trust is current with respect to all debt service payments, with the exception of one matured mortgage loan with an expired forbearance agreement. The mortgage loan matured in December 2015 and subsequently operated under a forbearance agreement which matured on February 28, 2017 and was being overheld pending the completion of a review of an extension request.

During the second quarter of 2017, the lender of the mortgage loan applied for receivership over the mortgaged property. Due to a defect in the security of the lender, the lender was not able to place the property into receivership; however, the Alberta Court of Queen's Bench held that the guarantee provided by LREIT on the original mortgage loan was enforceable and granted summary judgement against LREIT in respect of the guarantee obligation. As a result, the lender may pursue the enforcement options available to an unsecured creditor, including a new application for receivership that would encompass LREIT's beneficial ownership of the property. The Trust is unable to satisfy the full repayment of the mortgage loan with its current resources and continues to seek a settlement with the lender in the form of extended financing or by the divestiture of the property.

In addition, five mortgage loans on eight properties with an aggregate principal balance of \$64,262,183, which were previously in default of debt service payments, are presented as being in default as the lender of the mortgage loans has indicated that there are service fees outstanding and that until such fees are paid the loans will continue to remain in default. As a result of the lender's position, the financial statements as at June 30, 2017 reflect the five mortgage loans affected as being in default. Management expects that an agreement with respect to the servicing fees will be negotiated and any default remedied. In the interim, LREIT continues to meet the debt service obligations of these mortgages and the lender has taken no action to enforce the loans. In the event that full repayment is demanded 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 (as defined in the Declaration of Trust) 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 \$287,339,362 as at June 30, 2017. As at June 30, 2017, LREIT's mortgage indebtedness and the maximum balance under the revolving loan facility amounted to \$225,852,422, representing approximately 79% of the appraised value of LREIT's total property portfolio.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

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.

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, pursuing additional property sales under its divestiture program and is continuing with cost reduction measures and other efforts to improve operating results.

Current divestiture activities focus on the sale of the remaining seniors' housing complex, the one property classified as held for sale, the Lakewood Townhomes Condominium Sales Program, and the sale of other properties as opportunities are identified and with consideration of the overall cash needs 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 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 ability of the Trust to complete additional property sales at prices which exceed the indebtedness related to such properties.

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 the December 31, 2016 audited financial statements. The Financial Statements are based on IFRS standards issued and effective as at August 8, 2017.

### **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:



# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### **Future changes to significant accounting policies (continued)**

##### *(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.

##### *(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.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 3 *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.

In the process of applying the Trust's accounting policies, management has applied the same methodologies in making significant accounting judgments, estimates and assumptions as disclosed in the Trust's consolidated financial statements for the year ended December 31, 2016.

### 4 *Investment properties*

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Balance, beginning of period	\$195,391,325	\$184,523,467	\$198,099,131	\$216,434,958
Additions - capital expenditures	158,139	4,580	329,883	143,413
Fair value adjustments (Note 10)	(6,608,841)	20,541,470	(9,211,241)	17,437,241
Dispositions	-	-	(277,150)	-
Investment properties transferred to held for sale (Note 6)	-	-	-	(28,946,095)
Balance, end of period	<u>\$188,940,623</u>	<u>\$205,069,517</u>	<u>\$188,940,623</u>	<u>\$205,069,517</u>

During the first six months of 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 \$106,107 after selling costs of \$24,472 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 \$58,377.

During the first six months of 2016, the Trust did not sell any property classified as investment properties, however, \$28,946,095 was transferred to investment properties held for sale.

Investment properties have been valued using the methods and key assumptions in Note 5: *Valuations of investment properties and investment properties held for sale.*

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 5 *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:

	June 30 2017		December 31 2016	
	Low	High	Low	High
Fort McMurray	8.25 %	8.25 %	8.25 %	8.25 %
Other	5.25 %	8.00 %	5.25 %	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:

	June 30 2017		December 31 2016	
	Low	High	Low	High
Fort McMurray	10.25 %	10.25 %	10.25 %	10.25 %
Other	7.25 %	10.00 %	7.25 %	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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 6 *Assets and liabilities of properties held for sale*

The Trust intends to dispose of assets which do not meet the definition of assets of qualifying REITs as defined by the Income Tax Act (Canada). As a result, the Trust has classified the seniors' housing complex, 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:

	June 30 2017	December 31 2016
<b>ASSETS</b>		
<b>Investment properties held for sale (a)</b>	<b>\$ 30,282,983</b>	<b>\$ 31,343,062</b>
<b>Assets in discontinued operations</b>		
Property and equipment	7,569,008	7,422,485
Bank indebtedness	(37,837)	(47,318)
Restricted cash	6,290	18,795
Rent and other receivables	1,098	24,502
Deposits, prepaids and other	8,619	10,581
	<u>7,547,178</u>	<u>7,429,045</u>
<b>Assets held for sale</b>	<b><u>\$ 37,830,161</u></b>	<b><u>\$ 38,772,107</u></b>
<b>LIABILITIES</b>		
<b>Liabilities in discontinued operations</b>		
Long term debt	\$ 3,608,967	\$ 3,712,306
Trade and other payables	223,915	226,406
Deposits from tenants	16,855	14,605
<b>Liabilities held for sale</b>	<b><u>\$ 3,849,737</u></b>	<b><u>\$ 3,953,317</u></b>

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

Income information relating to discontinued operations are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Rental income	\$ 429,217	\$ 1,338,258	\$ 855,377	\$ 2,716,663
Property operating expenses	<u>396,068</u>	<u>991,085</u>	<u>727,532</u>	<u>1,881,511</u>
<b>Net operating income</b>	33,149	347,173	127,845	835,152
Interest expense	(43,692)	(231,467)	(92,298)	(464,020)
Fair value adjustment	<u>-</u>	<u>(141,448)</u>	<u>-</u>	<u>(355,942)</u>
<b>Income (loss) from discontinued operations</b>	<u>\$ (10,543)</u>	<u>\$ (25,742)</u>	<u>\$ 35,547</u>	<u>\$ 15,190</u>

Cash flow information relating to discontinued operations are as follows.

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Cash inflow (outflow) from operating activities	\$ (1,138)	\$ 146,174	\$ 64,796	\$ 458,833
Cash inflow (outflow) from financing activities	94,611	(434,306)	78,703	(282,190)
Cash outflow from investing activities	<u>(114,054)</u>	<u>(142,406)</u>	<u>(134,018)</u>	<u>(357,500)</u>
<b>Increase (decrease) in cash from discontinued operations</b>	<u>\$ (20,581)</u>	<u>\$ (430,538)</u>	<u>\$ 9,481</u>	<u>\$ (180,857)</u>

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

	June 30 2017	December 31 2016
Woodland Park	<u>\$ 30,282,983</u>	<u>\$ 31,343,062</u>

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 6 Assets and liabilities of properties held for sale (continued)

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

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Balance, beginning of period	\$ 31,021,627	\$ 60,906,095	\$ 31,343,062	\$ 31,960,000
Investment properties transferred to held for sale (Note 4)	-	-	-	28,946,095
Additions - capital expenditures	(578)	-	1,766	-
Fair value adjustments (Note 10)	(738,066)	4,411,019	(1,061,845)	4,411,019
Dispositions	-	(31,960,000)	-	(31,960,000)
Balance, end of period	<u>\$ 30,282,983</u>	<u>\$ 33,357,114</u>	<u>\$ 30,282,983</u>	<u>\$ 33,357,114</u>

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

During the first six months of 2016, the Trust sold Beck Court on May 1, 2016 and Willowdale Gardens on May 1, 2016:

Property	Selling Price	Selling Costs and Other	Net Cash Proceeds after debt repaid/assumed	Carrying Value	Gain(Loss) on Sale
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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 7 Long-term debt

	June 30 2017	December 31 2016
<b>Secured debt</b>		
Mortgage loans (a)	\$ 192,237,154	\$ 192,674,077
Revolving loan from 2668921 Manitoba Ltd. (b)	27,200,000	22,300,000
Debentures	24,810,800	24,810,800
Total secured debt	244,247,954	239,784,877
<b>Accrued interest payable</b>	3,219,092	2,610,724
<b>Unamortized transaction costs</b>		
Mortgage loans	(902,263)	(1,047,413)
Revolving loan from 2668921 Manitoba Ltd.	(25,930)	(30,677)
Total unamortized transaction costs	(928,193)	(1,078,090)
	<u>246,538,853</u>	<u>241,317,511</u>
<b>Less current portion</b>		
Mortgage loans	(174,638,559)	(106,278,394)
Revolving loan from 2668921 Manitoba Ltd.	(27,200,000)	(22,300,000)
Accrued interest payable	(800,039)	(811,941)
Unamortized transaction costs	341,141	468,920
Total current portion	<u>(202,297,457)</u>	<u>(128,921,415)</u>
	<u>\$ 44,241,396</u>	<u>\$ 112,396,096</u>

#### (a) Mortgage loans

	Weighted average interest rates		Amount	
	June 30 2017	December 31 2016	June 30 2017	December 31 2016
<b>First mortgage loans</b>				
Fixed rate	5.1%	5.1%	\$ 79,472,023	\$ 80,471,688
Variable rate	6.1%	6.1%	107,474,451	107,209,774
Total first mortgage loans	5.7%	5.6%	<u>\$ 186,946,474</u>	<u>\$ 187,681,462</u>
<b>Second mortgage loans</b>				
Total second mortgage loans	9.0%	11.8%	<u>\$ 5,290,680</u>	<u>\$ 4,992,615</u>
<b>All mortgage loans</b>				
Fixed rate	5.3%	5.5%	\$ 84,762,703	\$ 85,464,303
Variable rate	6.1%	6.1%	107,474,451	107,209,774
Total mortgage loans	5.7%	5.8%	<u>\$ 192,237,154</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.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 7 Long-term debt (continued)

#### (a) Mortgage Loans (continued)

As of June 30, 2017, the Trust was in default of five mortgage loans in the aggregate principal amount of \$64,262,183 related to eight properties in its Fort McMurray portfolio.

Except for one matured mortgage loan with an expired forbearance agreement on one property with a principal balance of \$25,623,154, all mortgage loans that matured prior to the date of the Financial Statements have been renewed or refinanced.

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

#### (b) Revolving loan

The Trust obtained a revolving loan from 2668921 Manitoba Limited (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.

### 8 Trade and other payables

	June 30 2017	December 31 2016
Accounts payable	\$ 1,829,022	\$ 2,390,614
Accrued payables	255,222	506,655
Prepaid rent	379,397	310,265
	<u>\$ 2,463,641</u>	<u>\$ 3,207,534</u>

### 9 Interest expense

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Mortgage loan interest	\$ 2,772,892	\$ 2,925,779	\$ 5,536,113	\$ 6,239,348
Revolving loan interest	325,726	479,969	622,493	943,953
Debenture interest	310,135	589,256	620,270	1,178,513
Amortization of transaction costs	305,001	1,769,381	621,132	3,058,751
	<u>\$ 3,713,754</u>	<u>\$ 5,764,385</u>	<u>\$ 7,400,008</u>	<u>\$ 11,420,565</u>



# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 10 Fair value adjustments

Fair value adjustments consist of the following:

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Fair value adjustments - investment properties (Note 4)	\$ (6,608,841)	\$ 20,541,470	\$ (9,211,241)	\$ 17,437,241
Fair value adjustments - investment properties held for sale (Note 6)	<u>(738,066)</u>	<u>4,411,019</u>	<u>(1,061,845)</u>	<u>4,411,019</u>
	<u>\$ (7,346,907)</u>	<u>\$ 24,952,489</u>	<u>\$ (10,273,086)</u>	<u>\$ 21,848,260</u>

### 11 Per unit calculations

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Income (loss) before discontinued operations	\$ (8,899,395)	\$ 20,514,463	\$ (13,591,204)	\$ 12,874,234
Income (loss) from discontinued operations	<u>(10,543)</u>	<u>(25,742)</u>	<u>35,547</u>	<u>15,190</u>
Income (loss)	<u>\$ (8,909,938)</u>	<u>\$ 20,488,721</u>	<u>\$ (13,555,657)</u>	<u>\$ 12,889,424</u>
	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Weighted average number of units:				
Units	20,557,320	20,497,004	20,557,320	20,374,695
Deferred units	<u>591,576</u>	<u>651,892</u>	<u>591,576</u>	<u>774,201</u>
Total basic and diluted	<u>21,148,896</u>	<u>21,148,896</u>	<u>21,148,896</u>	<u>21,148,896</u>

### 12 Units

	Six Months Ended June 30, 2017		Year Ended December 31, 2016	
	Units	Amount	Units	Amount
Redemption of deferred units	20,557,320	\$ 125,641,529	20,252,386	\$ 125,641,529
	<u>-</u>	<u>-</u>	<u>304,934</u>	<u>-</u>
	<u>20,557,320</u>	<u>\$ 125,641,529</u>	<u>20,557,320</u>	<u>\$ 125,641,529</u>

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 13 Unit option plan

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

	Six Months Ended June-30-17		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	-	-
Outstanding, end of period	<u>235,000</u>	<u>\$ 0.98</u>	<u>240,000</u>	<u>\$ 0.99</u>
Vested, end of period	<u>235,000</u>		<u>240,000</u>	

At June 30, 2017 the following unit options were outstanding:

<u>Exercise price</u>	<u>Options outstanding</u>	<u>Options vested</u>	<u>Expiry date</u>
\$ 0.60	40,000	40,000	November 19, 2017
0.65	20,000	20,000	January 15, 2018
1.11	<u>175,000</u>	<u>175,000</u>	May 19, 2019
	<u>235,000</u>	<u>235,000</u>	

### 14 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 an officer and 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 complexes. The Trust pays property management fees equal to 4% of gross receipts and compensation for reimbursable expenses from the investment properties owned by the Trust. 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.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 14. *Related party transactions (continued)*

#### **Property management agreement (continued)**

The Trust incurred fees under the property management agreement payable to Shelter of \$205,469 for the three months ended June 30, 2017 (2016 - \$186,350) and \$395,927 for the six months ended June 30, 2017 (2016 - \$360,405).

Included in trade and other payables at June 30, 2017 is a balance of \$9,639 payable to Shelter (December 31, 2016 - \$247,215) 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 \$224,529 for the three months ended June 30, 2017 (2016 - \$257,717) and \$449,121 for the six months ended June 30, 2017 (2016 - \$517,851).

#### **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 nil for the three months ended June 30, 2017 (2016 - nil) and \$18,900 for the six months ended June 30, 2017 (2016 - nil).

#### **Financing**

##### *Revolving loan*

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

Revolving Loan Term		Renewal Fees	Interest Rate	Maximum Interest Charge	Maximum Loan Commitment
From	To				
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 maximum interest charge allowable for the three-year term from July 1, 2015 to June 30, 2018 is \$6,480,000.

During the six months ended June 30, 2017, the Trust received advances of \$4,900,000 (2016 - \$11,400,000) and repaid advances of nil (2016 - \$3,900,000) against the revolving loan, resulting in a balance of \$27,200,000 (December 31, 2016 - \$22,300,000). The revolving loan balance is included in current portion of long-term debt.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### **Financing (continued)**

##### *Revolving loan (continued)*

Interest on the revolving loan of \$325,726 for the three months ended June 30, 2017 (2016 - \$479,969) and \$622,493 for the six months ended June 30, 2017 (2016 - \$943,953) is included in interest expense.

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

##### *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 June 30, 2017, the amount owing on the mortgage loan was \$5,290,680, inclusive of accrued interest.

#### **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.

### 15 *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 June 30, 2017, the Trust is current with respect to all debt service payments, with the exception of one matured mortgage loan with an expired forbearance agreement. The mortgage loan matured in December 2015 and subsequently operated under a forbearance agreement which matured on February 28, 2017 and was being overheld pending the completion of a review of an extension request.

During the second quarter of 2017, the lender of the mortgage loan applied for receivership over the mortgaged property. Due to a defect in the security of the lender, the lender was not able to place the property into receivership; however, the Alberta Court of Queen's Bench held that the guarantee provided by LREIT on the original mortgage loan was enforceable and granted summary judgement against LREIT in respect of the guarantee obligation. As a result, the lender may pursue the enforcement options available to an unsecured creditor, including a new application for receivership that would encompass LREIT's beneficial ownership of the property. The Trust is unable to satisfy the full repayment of the mortgage loan with its current resources and continues to seek a settlement with the lender in the form of extended financing or by the divestiture of the property.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### **Liquidity risk - defaults (continued)**

In addition, five mortgage loans on eight properties with an aggregate principal balance of \$64,262,183, which were previously in default of debt service payments, are presented as being in default as the lender of the mortgage loans has indicated that there are service fees outstanding and that until such fees are paid the loans will continue to remain in default. As a result of the lender's position, the financial statements as at June 30, 2017 reflect the five mortgage loans affected as being in default. Management expects that an agreement with respect to the servicing fees will be negotiated and any default remedied. In the interim, LREIT continues to meet the debt service obligations of these mortgages and the lender has taken no action to enforce the loans. In the event that full repayment is demanded 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, 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; expansion of the Trust's divestiture program; and the staggering of mortgage maturity dates over a number of years.

As at June 30, 2017, the weighted average term to maturity of the fixed rate mortgages on investment properties is 1.9 years (December 31, 2016 - 2.4 years).

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### Liquidity risk - debt maturities (continued)

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

June 30, 2017	Mortgage Loans				Total
	Normal Principal Installments	Principal Maturities (1)	Other Debt (2)	Other Payables (3)	
2017	\$ 2,402,166	\$ 51,808,082	\$ -	\$ 7,244,919	\$ 61,455,167
2018	1,497,810	91,614,451	27,200,000	-	120,312,261
2019	385,225	32,593,434	-	-	32,978,659
2020	261,845	-	-	-	261,845
Thereafter	1,303,667	10,370,474	24,810,800	-	36,484,941
	<u>\$ 5,850,713</u>	<u>\$186,386,441</u>	<u>\$ 52,010,800</u>	<u>\$ 7,244,919</u>	<u>\$251,492,873</u>

(1) If the lenders of the five mortgage loans that are in default as of the date of this report demanded repayment during 2017 and the chart above was adjusted to reflect the repayments, the total repayment obligations due in 2017 would increase to \$108,351,242, the total long-term debt due in 2018 would decrease to \$100,853,513, the total long-term debt due in 2019 would decrease to \$5,541,332, and 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 \$27,200,000, 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 June 30, 2017 the percentage of fixed rate mortgage loans to total mortgage loans was 44% (December 31, 2016 - 44%).

The Trust has variable rate mortgage loans on investment properties totaling \$107,474,451, or 56% of the total mortgage loans at June 30, 2017 (December 31, 2016 - 56%). Should interest rates change by 1%, interest expense would change by \$1,074,745 per year.

As at June 30, 2017, the Trust has total mortgage principal maturities on investment properties which mature on or prior to June 30, 2020 of \$179,694,487 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 \$1,796,945 per year.

The Trust has not traded in derivative financial instruments.

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### **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:

	June 30 2017	December 31 2016
<u>Rent receivable overdue:</u>		
0 to 30 days	\$ 122,878	\$ 76,506
31 to 60 days	46,234	55,348
More than 60 days	<u>50,911</u>	<u>171,519</u>
	<u><u>\$ 220,023</u></u>	<u><u>\$ 303,373</u></u>

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Balance, beginning of period	\$ 97,230	\$ 33,071	\$ 109,748	\$ 31,502
Amount charged to bad debt expense relating to impairment of rent receivable	(33,860)	53,227	(20,962)	68,399
Amounts written off as uncollectible	<u>(27,150)</u>	<u>(16,179)</u>	<u>(52,566)</u>	<u>(29,782)</u>
Balance, end of period	<u><u>\$ 36,220</u></u>	<u><u>\$ 70,119</u></u>	<u><u>\$ 36,220</u></u>	<u><u>\$ 70,119</u></u>
Amount charged to bad debts as a percent of rentals from investment properties	-0.69%	1.34%	-0.22%	0.81%

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 June 30, 2017, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$28,885,159 (December 31, 2016 - \$29,312,604) which expires between 2017 and 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 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 15 *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	
	June 30 2017	December 31 2016	June 30 2017	December 31 2016
<b>Financial assets</b>				
Restricted cash	\$ 2,756,241	\$ 2,650,066	\$ 2,313,300	\$ 2,127,195
Cash	925,453	706,768	925,453	706,768
Rent and other receivables	480,595	394,131	480,595	394,131
Deposits	733,470	186,172	733,470	186,172
<b>Financial liabilities</b>				
Mortgages loans	192,237,154	192,674,077	207,999,803	209,179,279
Debentures	24,810,800	24,810,800	4,189,205	5,830,338
Trade and other payables	2,463,641	3,207,534	2,463,641	3,207,534
Deposits from tenants	1,562,186	1,529,110	1,562,186	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:



# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

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

#### **Fair values (continued)**

- 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.
- 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.
- The defeasance assets and the defeased liability have a fair value of nil on a net basis as there was no cash flow impact to the Trust from the defeasance assets or defeased liability.
  - The 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 4.08% and 5.22%.
- 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.

### 16 *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.

Three months ended June 30, 2017:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	3,800,949	391,025	688,619	-	4,880,593
Property operating costs	1,883,781	300,223	222,445	-	2,406,449
Net operating income	1,917,168	90,802	466,174	-	2,474,144
Interest income	3,444	289	679	40,200	44,612
Interest expense	2,311,044	120,871	641,090	640,749	3,713,754
Loss before discontinued operations	(6,881,602)	(147,450)	(912,305)	(958,038)	(8,899,395)
Cash from (used in) operating activities	(293,413)	(24,120)	66,425	(598,881)	(849,989)
Cash from (used in) financing activities	440,272	46,934	(100,153)	598,313	985,366
Cash from (used in) investing activities	(225,574)	(2,271)	2,253	2,948	(222,644)

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### 16 Segmented financial information (continued)

Three months ended June 30, 2016:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	2,838,555	432,116	708,981	-	3,979,652
Property operating costs	1,598,135	249,213	308,156	-	2,155,504
Net operating income	1,240,420	182,903	400,825	-	1,824,148
Interest income	2,435	296	925	36,079	39,735
Interest expense	3,229,908	135,338	665,728	1,733,411	5,764,385
Income (loss) before discontinued operations	18,555,283	44,591	4,168,027	(2,253,438)	20,514,463
Cash from (used in) operating activities	332,094	50,862	11,410	(274,702)	119,664
Cash from (used in) financing activities	344,362	(68,698)	(9,513,931)	367,960	(8,870,307)
Cash from (used in) investing activities	(457,357)	(3,726)	9,614,847	(68,922)	9,084,842

Six Months ended June 30, 2017:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	7,371,036	774,218	1,379,854	-	9,525,108
Property operating costs	3,743,618	604,955	470,278	-	4,818,851
Net operating income	3,627,418	169,263	909,576	-	4,706,257
Interest income	7,846	569	1,356	80,453	90,224
Interest expense	4,590,345	250,821	1,306,443	1,252,399	7,400,008
Loss before discontinued operations	(9,991,486)	(197,519)	(1,457,357)	(1,944,842)	(13,591,204)
Cash used in operating activities	(535,955)	(36,627)	(9,023)	(1,553,135)	(2,134,740)
Cash from (used in) financing activities	1,462,310	54,845	(166,767)	1,546,968	2,897,356
Cash from (used in) investing activities	(533,613)	(11,425)	7,009	(5,902)	(543,931)
Total assets excluding discontinued operations (Note 6) at June 30, 2017	180,717,784	12,680,527	30,759,245	4,548,883	228,706,439

Six Months ended June 30, 2016:

	Investment Properties			Trust	Total
	Fort McMurray	Other	Held for sale and/or sold		
Rental revenue	5,582,872	851,118	1,997,124	-	8,431,114
Property operating costs	3,505,703	529,598	912,308	-	4,947,609
Net operating income	2,077,169	321,520	1,084,816	-	3,483,505
Interest income	4,872	603	1,960	49,553	56,988
Interest expense	6,750,377	269,640	1,511,404	2,889,144	11,420,565
Income (loss) before discontinued operations	12,731,932	49,212	4,045,216	(3,952,126)	12,874,234
Cash from (used in) operating activities	(1,173,439)	43,157	423,489	(898,574)	(1,605,367)
Cash from (used in) financing activities	2,009,310	(23,228)	(9,888,646)	1,028,406	(6,874,158)
Cash from (used in) investing activities	(562,406)	3,543	9,610,032	(30,489)	9,020,680
Total assets excluding discontinued operations (Note 6) at December 31, 2016	188,686,260	12,737,785	31,932,743	4,616,496	237,973,284

# LANESBOROUGH REAL ESTATE INVESTMENT TRUST

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2017

### **17      *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.

### **18      *Subsequent events***

#### **Revolving loan**

Subsequent to June 30, 2017, the Trust received advances of \$1,100,000 and repaid nil on the revolving loan, resulting in a balance of \$28,300,000 as of the date of the Financial Statements.