LANESBOROUGH REIT

2016 ANNUAL REPORT

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Unit Trading Price

	Year Ended December 31, 2016 (Per unit)	Year Ended December 31, 2015 (Per unit)
Opening price	$0.13	$0.47
Closing price	$0.065	$0.13

Lanesborough Real Estate Investment Trust ("LREIT") units are listed on the Toronto Stock Exchange under the symbol "LRT.UN". The Series G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G".

CHIEF EXECUTIVE OFFICER'S MESSAGE
2016 Annual Report

This past year proved to be very challenging for both LREIT and its primary market, Fort McMurray. In May 2016, a devastating wildfire ripped through the City of Fort McMurray, adding to existing challenges facing the community, which have resulted from the prolonged downturn in the Canadian oil sands sector.

Given the strong headwinds that LREIT continues to confront, management has maintained its focus on two primary initiatives: debt restructuring and the divestiture program. In addition, LREIT has been responding to the operational repercussions of the Fort McMurray wildfire, initially focussing on the clean-up and restoration of all of its Fort McMurray properties and, subsequently, on the renovation and conversion of select apartment units into fully furnished suites in order to improve the marketability of LREIT's properties and better meet tenant needs in the post-fire rental market environment.

As evidenced by the discussion of operating results that follows, the entry of homeowners displaced by the wildfire into the rental market and commencement of the post-fire rebuild have resulted in increased economic activity and increased demand for rental accommodations in Fort McMurray. While these factors alone are unlikely to alleviate the cash deficiency facing LREIT, management anticipates that they will, in the short term, serve to mitigate some of the strain caused by the sustained low-level of oil sands development activity.

Operating Results

LREIT completed 2016 with negative funds from operations ("FFO") of $12.5 million, compared to negative FFO of $8.4 million in 2015. The decrease in FFO mainly reflects a decrease in net operating income ("NOI"), partially offset by a decrease in interest expense. NOI decreased primarily as a result of the divestiture activities, as well as the decreased operating performance of the Fort McMurray property portfolio. Consistent with the divestiture and debt restructuring initiatives undertaken during 2016, the decrease in interest expense was primarily due to the decrease in the total mortgage loan debt.

Within the context of the Fort McMurray property portfolio, and as noted above, the entry of homeowners displaced by the wildfire into the rental market and the commencement of the post-fire rebuild during the third quarter of 2016 have resulted in increased economic activity and demand for rental accommodations in the region.

The average occupancy level of the Fort McMurray properties increased to 76% and 72% during the third and fourth quarters of 2016, respectively, compared to 66% and 54% during the third and fourth quarters of 2015. Notwithstanding the improvement in the average occupancy level during the second half of 2016, overall, the average occupancy level of the Fort McMurray properties decreased from 67% to 65% and the average monthly rental rate of the Fort McMurray properties decreased by $419 or 20% during 2016, compared to 2015.

LREIT completed 2016 with a loss and comprehensive loss of $1.7 million, compared to a loss and comprehensive loss of $98.8 million in 2015. The decrease in the loss and comprehensive loss was primarily due to a favourable variance in the fair value adjustments of the investment properties. Specifically, the favourable variance is the result of having experienced significant reductions in the carrying value of the Fort McMurray properties during 2015, due to the impact of the sustained low-level of oil sands development activity, followed by increases in the carrying value of the Fort McMurray properties during 2016, as revenue expectations were adjusted to reflect the improvement in rental market conditions anticipated during the post-wildfire rebuild effort.

Liquidity and Capital Resources

During 2016, cash used in operating activities amounted to $3.3 million and the cash shortfall, after accounting for regular mortgage principal repayments, capital expenditures, and transaction costs, was $10.6 million, compared to cash used in operating activities of $6.5 million and a cash shortfall of $17.9 million in 2015. The cash shortfall was primarily funded by advances under the revolving loan facility from 2668921 Manitoba Ltd., partially offset by the net proceeds from the sales of Beck Court, Willowdale Gardens, and Elgin Lodge.

Restructuring LREIT's mortgage loan debt was a key priority during 2016. As previously reported, during the first quarter of 2016, LREIT defaulted on the debt service requirements of 12 mortgage loans, with an aggregate principal balance of $194.0 million, associated with all 13 properties in the Fort McMurray portfolio. Consequently, management pursued debt restructuring arrangements with the affected lenders and successfully obtained renewal agreements and a forbearance agreement for five mortgage loans in the aggregate principal amount of $105.1 million, inclusive of terms which allow for the partial deferral of interest. As of December 31, 2016, LREIT was current with respect to all debt service payments; however, the lender of five mortgage loans with an aggregate principal balance of $65.1 million, associated with eight of the properties in the Fort McMurray portfolio, maintains that there are servicing fees outstanding which were triggered by the initial mortgage loan defaults and that until such fees are paid the loans will continue to remain in default. As of the date of this report, LREIT continues to meet the debt service obligations of the five affected mortgage loans and the lender has not taken any further actions to enforce the security of the loans.

LREIT continued to make progress with respect to the divestiture program during 2016, completing the sales of Beck Court, Willowdale Gardens, Elgin Lodge, and one condominium unit under the Lakewood Townhomes condominium sales program. The combined net cash proceeds from the sales, after repayment or assumption by the purchaser of the existing mortgage loans, selling costs, and standard closing adjustments amounted to $13.8 million and were used to repay a $5.5 million second mortgage loan, which was secured with a second charge over Willowdale Gardens, and to pay down the revolving loan from 2668921 Manitoba Ltd. by $8.3 million.

Outlook

Effective January 1, 2017, Mr. Gino Romagnoli assumed the position of Chief Executive Officer in the place of Mr. Arni Thorstainson. Mr. Romagnoli has served as a senior officer of LREIT since its inception in 2002. Mr. Thorsteinson will continue to serve LREIT as vice chairman and trustee, providing valuable guidance and direction as LREIT continues to focus on its primary initiatives of debt restructuring, the divestiture program, and the post-fire operational initiatives.

Having already experienced the first signs of improvement in the Fort McMurray rental market, and in view of recent pipeline approvals, it is anticipated that the rental market conditions in Fort McMurray will continue to gradually improve in 2017, resulting in a positive impact on operating results. According to the Government of Alberta, GDP growth is forecasted at 2.4% in 2017, compared to the negative GDP growth experienced during the previous two years. Notwithstanding the anticipated improvements, the extent and duration of any positive impact is subject to various risks and uncertainties and the longer-term prospects for the region will continue to be closely related to oil sands development activity.

GINO ROMAGNOLI, CPA, CGA
Chief Executive Officer
March 13, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("MD&A") of the Lanesborough Real Estate Investment Trust ("LREIT" or the "Trust") should be read in conjunction with the consolidated financial statements ("Financial Statements") of LREIT for the year ended December 31, 2016 and accompanying notes and with reference to the Annual Report for 2016, the quarterly reports for 2016, the audited consolidated financial statements for the years ended December 31, 2016 and 2015, and the Annual Information Form ("AIF") dated March 13, 2017. Throughout this MD&A, it is not our intent to reproduce information that is located in these other reported documents, but rather to highlight some of the key points and refer you to these documents for more detailed information.

Forward-Looking Information

Certain statements contained in this MD&A and in certain documents incorporated by reference herein are "forward-looking statements" that reflect the expectations of management regarding the future growth, results of operations, performance, prospects, and opportunities of LREIT. Readers are cautioned not to place undue reliance on forward-looking information. All statements other than statements of historical fact contained or incorporated by reference herein are forward-looking statements including, without limitation, statements regarding the timing and amount of distributions and the future financial position, business strategy, potential acquisitions or dispositions, plans and objectives of LREIT. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in forward-looking statements including, but not limited to, risks associated with the uncertainty of LREIT's status as, and its ability to continue as, a going concern, concentration of portfolio in one market, dependence on natural resources industries, commodity price risks, current economic conditions, reliance on Shelter Canadian Properties Limited ("Shelter") or its parent company 2668921 Manitoba Ltd. for interim funding, success of the divestiture program, events of default under financing agreements, debt financing, real property ownership, liquidity, interest and financing risk, credit risk, market risk, competition, availability of cash for distributions, insurance risk, tax related risk factors, public market issues, future property acquisitions, availability of suitable investments, general uninsured losses, interest rate fluctuations, Unitholder liability, potential conflicts of interest, multi-unit residential sector risk, environmental risks, supply risk, utility and property tax risk, government regulation, changes in legislation and investment eligibility, rent control risk, the nature of Units, legal rights attaching to the Units, the structural subordination of Units, dilution, relationship with the property manager, reliance on key personnel, risks associated with disclosure controls and procedures on internal control over financial reporting, certain additional risks associated with debentures, including potential default on interest payments and principal repayment under the Series G debentures, subordination of security interests securing the Series G debentures, limited covenant protection in the Series G Trust Indenture, redemption of Series G debentures prior to maturity, and an inability of LREIT to purchase Series G debentures on a change of control, the Alberta Government's royalty framework, substitutions for residential rental units, and litigation risks. Although the forward-looking statements contained or incorporated by reference herein are based upon what management believes to be reasonable assumptions, LREIT cannot assure investors that actual results will be consistent with these forward-looking statements.

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

Purchase Price Information

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

Financial Statements

Throughout this report, the consolidated financial statements as of December 31, 2016 will be referred to as the "Financial Statements"; the consolidated statements of financial position as of December 31, 2016 will be referred to as the "Statement of Financial Position"; the consolidated statements of comprehensive income (loss) for the year ended December 31, 2016 will be referred to as the "Income Statement"; and the consolidated statements of cash flows for the year ended December 31, 2016 will be referred to as the "Statement of Cash Flows".

Operating Segments

The investment properties of LREIT are separated into three operating segments:

- Fort McMurray Properties (twelve properties): Accounting for approximately 76% (December 31, 2015 - Thirteen properties, 73%) of the residential suites in the portfolio of investment properties, the twelve multi-unit residential buildings in the Fort McMurray property portfolio represent the most significant component in LREIT's overall operations.

- Other Investment Properties (three properties): The three other investment properties consist of two multi-unit residential rental properties located in Alberta and one in Manitoba, and account for 16% (December 31, 2015 - 13%) of the residential suites in the portfolio of investment properties.

- Held for Sale (one property) and/or Sold Properties (four properties): The operating results of held for sale and/or sold properties are analysed separately as they have been sold or are expected to be sold within the next twelve months and the properties do not contribute to net operating income past the date of sale. The operating results for held for sale and/or sold properties as disclosed in the analysis of net operating income pertain to the operations of Woodland Park, which is classified as held for sale at December 31, 2016; Beck Court, which was sold on May 1, 2016; Willowdale Gardens, which was sold on May 1, 2016; 156/204 East Lake Blvd., which was sold on April 1, 2015 and Colony Square, which was sold on November 1, 2015. Woodland Park, the one property classified as held for sale, accounts for approximately 8% (December 31, 2015 - two properties classified as held for sale, 14%) of the suites in the portfolio of investment properties.

The operating results for the two seniors' housing complexes, including one which was sold on October 1, 2016, are classified under "Discontinued operations" in the Income Statement of the Trust. The income and expense analyses which are contained throughout this report do not include the two seniors' housing complexes, except where noted.

FINANCIAL SUMMARY

	December 31		
	2016	2015	2014
STATEMENT OF FINANCIAL POSITION			
Total assets	$ 245,402,329	$ 278,524,804	$ 442,773,600
Total long-term financial liabilities (1)	$ 243,501,308	$ 279,529,237	$ 327,980,499
Weighted average interest rate			
- Mortgage loan debt	5.8 %	6.0 %	5.7 %
- Total debt	5.6 %	6.4 %	6.3 %

	Year Ended December 31		
	2016	2015	2014
KEY FINANCIAL PERFORMANCE INDICATORS (2)			
Operating Results			
Rentals from investment properties	$ 18,328,212	$ 30,215,224	$ 38,291,698
Net operating income *	$ 7,814,287	$ 16,151,866	$ 21,775,464
Loss before discontinued operations *	$ (1,264,483)	$ (96,394,897)	$ (20,878,092)
Loss and comprehensive loss	$ (1,730,124)	$ (98,765,643)	$ (22,238,581)
Funds from Operations (FFO) *	$ (12,463,056)	$ (8,426,367)	$ (4,047,931)
Cash Flows			
Cash used in operating activities	$ (3,254,380)	$ (6,492,224)	$ (806,632)
Adjusted Funds from Operations (AFFO) *	$ (13,753,872)	$ (8,728,029)	$ (5,335,938)
Per Unit			
Net operating income *			
- basic	$ 0.369	$ 0.764	$ 1.040
- diluted	$ 0.369	$ 0.764	$ 0.803
Loss before discontinued operations *			
- basic and diluted	$ (0.060)	$ (4.558)	$ (0.997)
Loss and comprehensive loss			
- basic and diluted	$ (0.082)	$ (4.670)	$ (1.062)
Funds from Operations (FFO) *			
- basic and diluted	$ (0.589)	$ (0.398)	$ (0.193)
Cash used in operating activities			
- basic and diluted	$ (0.154)	$ (0.307)	$ (0.039)
Adjusted Funds from Operations (AFFO) *			
- basic and diluted	$ (0.650)	$ (0.413)	$ (0.255)

(1) Long-Term Financial Liabilities

Long-term financial liabilities consist of mortgage loans, debentures, a defeased liability, the revolving loan from 2668921 Manitoba Ltd., an interest rate swap liability and mortgage bonds. The mortgage bonds are included at face value.

(2) Non-IFRS Measurements

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

EXECUTIVE SUMMARY

Overview

LREIT owns a portfolio of 16 multi-unit residential real estate properties, 13 of which are located in Fort McMurray, Alberta, and one seniors' housing complex which is classified under discontinued operations. LREIT's primary objective is to maximize the income producing potential and market value of its real estate portfolio through the execution of strategic acquisition, development, management and divestiture activities.

LREIT's near-term focus has been on the divestiture program, debt restructuring, and post-fire operation initiatives, with the objectives of addressing liquidity concerns and positioning the Fort McMurray properties to satisfy the increased demand from returning residents and the migration of workers taking part in the post-fire rebuilding effort.

2016 Operating Results

Key Financial Indicators

	Year Ended December 31		Favourable (Unfavourable) Variance	
	2016	2015	Amount	%
Rentals from investment properties	$ 18,328,212	$ 30,215,224	$ (11,887,012)	(39)%
Net operating income	$ 7,814,287	$ 16,151,866	$ (8,337,579)	(52)%
Interest expense	$ (19,076,586)	$ (23,272,205)	$ 4,195,619	18 %
Fair value adjustments	$ 11,645,404	$ (87,443,849)	$ 99,089,253	n/a
Loss and comprehensive loss	$ (1,730,124)	$ (98,765,643)	$ 97,035,519	98 %
Funds from operations (FFO)	$ (12,463,056)	$ (8,426,367)	$ (4,036,689)	(48)%

LREIT completed 2016 with negative FFO of $12.5 million, compared to negative FFO of $8.4 million during 2015. On a basic per unit basis, FFO decreased during 2016 by $0.191 to negative $0.589. The decrease in FFO mainly reflects a decrease in net operating income, partially offset by a decrease in interest expense. The decrease in net operating income was principally driven by a decrease in the net operating income of the held for sale and/or sold properties, due to the sale of Colony Square on November 1, 2015 and the sales of Beck Court and Willowdale Gardens on May 1, 2016, and by a decrease in the net operating income of the Fort McMurray property portfolio. The decrease in the net operating income of the Fort McMurray properties is mainly due to the decreased occupancy levels experienced during the first and second quarters of 2016, as well as the decrease in the average rental rates during 2016, compared to 2015.

Notwithstanding the decrease in net operating income experienced during 2016, the third and fourth quarters of 2016 represent a significant improvement in comparison to the preceding quarters of 2016, as well as the third and fourth quarters of 2015. The entry of homeowners displaced by the wildfire into the rental market and the commencement of the post-fire rebuild during the third quarter of 2016 have bolstered economic activity and demand for rental accommodations in the region, moderating the impact of the low-level of oil sands development activity and resulting in a recovery in occupancy levels.

The average occupancy level of the Fort McMurray properties increased from 66% and 54% during the third and fourth quarters of 2015, to 76% and 72% during the third and fourth quarters of 2016, respectively. Notwithstanding the improvement in the average occupancy level during the second half of 2016, the average occupancy level of the Fort McMurray properties decreased from 67% during 2015 to 65% during 2016. In addition, the average monthly rental rate of the Fort McMurray properties decreased by $419 or 20% during 2016, compared to the prior year.

Overall, LREIT completed 2016 with a loss and comprehensive loss of $1.7 million, compared to a loss and comprehensive loss of $98.8 million in the prior year. In addition to the factors discussed above, the decrease in the net loss and comprehensive loss mainly reflects a favourable variance in the fair value adjustments to the investment properties, which is explained in greater detail in the "Analysis of Operating Results - Fair Value Adjustments" section of this report.

Liquidity and Capital Resources

Liquidity refers to the overall ability to generate and have sufficient resources available to fund the ongoing operating, investing, and financing activities of the Trust. LREIT requires working capital for use in the day to day operations of its properties, as well as in order to fund the regular mortgage loan principal payments, transaction costs for debt financing, and capital expenditures.

As of December 31, 2016, the unrestricted cash balance of LREIT was $0.7 million and the working capital deficit was $1.3 million.

Notwithstanding the fact that operating performance during the second half of 2016 improved, as noted above, LREIT continued to require additional sources of cash during 2016 to fund the cash shortfall from operating activities, as well as mortgage loan principal payments, transaction costs for debt financing and capital expenditures. During 2016, cash used in operations amounted to $3.3 million, and the cash shortfall, after accounting for regular mortgage principal repayments, capital expenditures and transaction costs, was $10.6 million, compared to cash used in operations of $6.5 million and a cash shortfall of $17.9 million, respectively, during 2015.

The reduction in the cash shortfall is mainly due to a decrease in cash used in operations, a decrease in regular mortgage loan principal repayments and a decrease in expenditures on transaction costs. The cash shortfall was funded by additional advances under the revolving loan facility from 2668921 Manitoba Ltd. partially offset by the net proceeds from the sale of Beck Court, Willowdale Gardens and Elgin Lodge.

Continuing Operations and Ongoing Initiatives

On the basis of the information presented above, it is evident that there are factors that cause significant doubt as to the ability of the Trust to continue as a going concern, including:

(i) the Trust's concentration of investment properties in Fort McMurray;
(ii) the deterioration of the Fort McMurray rental apartment market over the past several years, resulting from decreased oil sands development activity;
(iii) the successive years of losses and cash deficiencies from operations, in particular from the operations in Fort McMurray;
(iv) the limited availability of mortgage lending in Fort McMurray;
(v) the Trust's limited cash and working capital resources;
(vi) 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,
(vii) the Trust's highly leveraged capital structure.

In an effort to meet ongoing funding obligations and sustain operations, LREIT has continued to pursue debt restructuring arrangements with certain of its lenders and has relied on favourable interim financing arrangements and other support from Shelter and its parent company, 2668921 Manitoba Ltd. Other measures taken in order to address the liquidity challenges facing LREIT include the continuation of the divestiture program, cost reduction, marketing, and other initiatives in order to improve the operating performance of the Trust. The Trust is continuing in its efforts to accommodate the increased demand for rental housing from homeowners displaced by the wildfire and from workers engaged in the Fort McMurray post-fire rebuilding effort.

A summary of LREIT's progress in 2016 with respect to these initiatives is provided below.

Debt Restructuring - Mortgage Loans

During the first quarter of 2016, the Trust defaulted on the debt service requirements of twelve mortgage loans in the aggregate amount of $194.0 million related to all thirteen properties in its Fort McMurray portfolio.

Subsequently the Trust obtained renewal agreements and a forbearance agreement for five mortgage loans in the aggregate principal amount of $105.1 million, inclusive of terms which allow for the partial deferral of interest.

As of December 31, 2016 and the date of this report, the Trust is current with respect to all debt service payments. However, the lender of five mortgage loans on eight properties with an aggregate principal balance of $65.1 million that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain 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.

Debt Restructuring - Debentures & Revolving Loan

On June 22, 2016, the terms of the Series G debentures were amended to extend the maturity date of the debentures to June 30, 2022, to reduce the interest rate for the period commencing June 30, 2016 from 9.5% to 5% and to defer all payments of interest to the amended maturity date.

In conjunction with the approval of the amendments to the Series G debentures, the interest rate on the revolving loan facility from 2668921 Manitoba Ltd. was reduced from 12% to 5% per annum.

On November 14, 2016, the maximum principal balance on the revolving loan facility was increased from $18.0 million to $30.0 million.

Divestitures

During 2016, the Trust completed the sales of Beck Court, Willowdale Gardens and Elgin Lodge under the divestiture program and completed the sale of one condominium unit under the Lakewood Townhomes condominium sales program. The combined net cash proceeds from the sales, after repayment or assumption by the purchaser of the existing mortgage loans, selling costs and standard closing adjustments amounted to $13.8 million and were used to repay a $5.5 million second mortgage loan secured with a second charge over Willowdale Gardens and to pay down the revolving loan from 2668921 Manitoba Ltd. by $8.3 million.

A more detailed description of the divestiture programs and activity is provided in the "Overview of Operations and Investment Strategy - Current Initiatives" and "Analysis of Cash Flows - Investing Activities" sections of this report.

Fort McMurray Post-Wildfire Response

During the second quarter of 2016, LREIT began responding to the operational repercussions of the May 2016 Fort McMurray wildfire. All of the suites and common areas of the properties in Fort McMurray have been professionally cleaned and restored. In addition, renovations continue to be performed at select properties in order to improve their marketability and units are being converted to fully furnished suites in order to better suit the needs of prospective tenants in the post-fire market environment. The entry of homeowners displaced by the wildfire into the rental market and the commencement of the post-fire rebuild have resulted in increased demand for rental accommodations in the region.

Risks and Uncertainties

Notwithstanding the effort and initiatives undertaken by management, the continuation of the Trust's ability to operate as a going concern into the foreseeable future will be contingent upon a combination of events and/or conditions that are subject to material uncertainty and include, but are not limited to:

(i) 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;
(ii) the Trust's ability to renew or refinance debt as it matures;
(iii) the willingness and ability of the Trust's lenders to participate in the restructuring of the Trust's debt to the degree necessary and duration required to allow LREIT to stabilize its operations;
(iv) the timing and extent of a recovery of the Fort McMurray rental market, which is highly dependent on the timing and extent of a recovery in oil sands development activity, and which in the near-term is dependent on the extent of economic activity associated with the post-fire rebuild of Fort McMurray;
(v) the improvement of cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio; and,
(vi) the ability of LREIT to complete additional property sales at prices which exceed the indebtedness related to such properties.

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

OVERVIEW OF OPERATIONS AND INVESTMENT STRATEGY

Brief History and Overview

LREIT is an unincorporated closed-end real estate investment trust which was established on April 23, 2002 under the laws of the Province of Manitoba. LREIT became a publicly traded entity on August 30, 2002. The trust units of LREIT are listed on the Toronto Stock Exchange under the symbol "LRT.UN" and the Series G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G".

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

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

Investment Properties

As of December 31, 2016, the real estate portfolio of LREIT consisted of 15 multi-unit residential investment properties (the "investment properties"), one multi-unit residential property which is classified as held for sale (the "investment properties held for sale") and one seniors' housing complex (the "discontinued operations").

The Financial Statements of LREIT provide segmented results for investment properties, with "Fort McMurray", "Other" and "Held for sale and/or sold" properties representing the segments. Operating results pertaining to general trust operations are disclosed separately in the segmented financial information. Operating results for discontinued operations are disclosed separately on the Income Statement.

Strategy and Operations

The primary objective of LREIT is to maximize the income-producing potential and market value of its real estate portfolio through the implementation of sound financial management practices and operating procedures, responsive management services and proactive leasing strategies.

Current Initiatives

During 2016, the Trust continued to focus on debt restructuring and divestiture initiatives in an effort to address the liquidity issues facing LREIT. In addition, the Trust was engaged in responding to the operational repercussions of the May 2016 Fort McMurray wildfire and has been preparing its properties in order to accommodate the growing demand which is expected to occur throughout the rebuilding effort.

A summary of LREIT's progress with respect to the initiatives is provided below:

Debt Restructuring - Mortgage Loans

During the first quarter of 2016, the Trust defaulted on the debt service requirements of twelve mortgage loans in the aggregate amount of $193,999,155 related to all thirteen properties in its Fort McMurray portfolio.

Subsequently the Trust obtained renewal agreements and a forbearance agreement for five mortgage loans in the aggregate principal amount of $105,109,281, inclusive of terms which allow for the partial deferral of interest.

As of December 31, 2016 and the date of this report, the Trust is current with respect to all debt service payments. However, the lender of five mortgage loans on eight properties with an aggregate principal balance of $65,119,595 that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain 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.

Debt Restructuring - Debentures & Revolving Loan

On June 22, 2016, the terms of the Series G debentures were amended to extend the maturity date of the debentures to June 30, 2022, to reduce the interest rate for the period commencing June 30, 2016 from 9.5% to 5% and to defer all payments of interest to the amended maturity date.

In conjunction with the approval of the amendments to the Series G debentures, the interest rate on the revolving loan facility from 2668921 Manitoba Ltd. was reduced from 12% to 5% per annum.

On November 14, 2016, the maximum principal balance on the revolving loan facility was increased from $18,000,000 to $30,000,000.

Divestiture Program

Rental market conditions quickly deteriorated in Fort McMurray as a result of the rapid decline in oil sands development activity which began during the fourth quarter of 2014. As a result of the downturn in the rental market, and due to LREIT's high concentration of properties in Fort McMurray, LREIT began to incur significant operating cash deficiencies. In response, LREIT instituted a divestiture program which, together with the debt-restructuring initiatives undertaken by management, is part of the overall strategy to address the operating cash deficiencies. The main objective of the program is to improve the working capital position of the Trust to assist it in meeting its ongoing funding obligations and to sustain its operations into the foreseeable future.

Under the terms of the trust indenture governing LREIT's outstanding Series G debentures, the net proceeds from property sales will be applied to prepay the principal amount of the Series G Debentures after the repayment of mortgage loan indebtedness, 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. The repayment of the 2668921 Manitoba Ltd. revolving loan from the net proceeds of the sale of properties, in effect, serves to facilitate the advancing of additional funds under the revolving loan facility, at the discretion of 2668921 Manitoba Ltd., for the payment of LREIT's ongoing funding obligations.

During 2016, the Trust completed the sales of Beck Court, Willowdale Gardens and Elgin Lodge under the divestiture program. The combined net cash proceeds from the sales, after repayment or assumption by the purchaser of the existing mortgage loans, selling costs and standard closing adjustments amounted to $13,802,475 and were used to repay a $5,456,865 second mortgage loan secured with a second charge over Willowdale Gardens and to pay down the revolving loan from 2668921 Manitoba Ltd. by $8,345,610.

Since the beginning of 2015, LREIT has completed the sales of five properties for total gross proceeds of $119,210,000 and net cash proceeds of $44,620,989, after the repayment or assumption by the purchaser of the existing mortgage loans, selling costs and standard closing adjustments.

Lakewood Townhomes Condominium Sales Program

In October 2011, LREIT commenced a condominium sales program for the Lakewood Townhomes. Upon sale of each unit, the first mortgage loan requires a repayment equal to 95% of the sale list price agreed upon with the lender. Additional selling costs, including sale renovation costs, a contribution to the reserve fund of the condominium corporation and closing costs, will be paid by the balance of the net sales proceeds and from working capital. The condominium sales program encompasses services and renovation fees payable to Shelter. Additional information regarding the fees payable to Shelter is provided in the section of this report titled "Related Party Transactions".

During 2016, the Trust completed the sale one condominium unit under the Lakewood Townhomes condominium sales program for gross proceeds of $370,000. The sales proceeds, after the payment of selling costs and standard closing adjustments were insufficient to repay the amount required by the existing mortgage loan with respect to the sale. The deficiency in the repayment of the existing mortgage loan, in the amount of $56,264, was funded by an advance on the revolving loan facility.

As of December 31, 2016, 18 condominium units have been sold at a combined gross selling price of $8,613,100 under the condominium sales program.

Current divestiture activities are focused on the sale of the remaining seniors' housing complex, Chateau St. Michael's, the property classified as held for sale, Woodland Park, and the continuation of the condominium sales program.

A more detailed description of the 2016 divestiture activity is provided in the "Analysis of Cash Flows - Investing Activities" section of this report.

Fort McMurray Post-Wildfire Response

During the second quarter of 2016, LREIT began responding to the operational repercussions of the May 2016 Fort McMurray wildfire. All of the suites and common areas of the Trust's properties in Fort McMurray have been professionally cleaned and restored. In addition, renovations at select properties are being performed in order to improve their marketability and units are being converted into fully furnished suites that better suit the needs of prospective tenants in the post-fire market environment.

Increased economic activity in the Fort McMurray region, which mainly reflects the entry of homeowners displaced by the wildfire into the rental market and the commencement of the post-fire rebuilding activities, has resulted in an increase to the average occupancy level of the portfolio. During the third and fourth quarters of 2016, the average occupancy level of the properties in Fort McMurray was 76% and 72%, respectively, compared to 58% during the second quarter of the year. There is no assurance, however, of the degree to which the increased demand will alleviate the liquidity concerns outlined above.

REAL ESTATE PORTFOLIO

Portfolio Summary - December 31, 2016

As of December 31, 2016, the property portfolio of LREIT consists of 17 rental properties, as follows: 15 properties classified as "Investment properties" on the Statement of Financial Position, including the unsold condominium units at Lakewood Townhomes; one property classified as "Assets held for sale" on the Statement of Financial Position; and one property which is a seniors' housing complex accounted for as "property and equipment" under "discontinued operations" and classified as "Assets held for sale" and "Liabilities held for sale" on the Statement of Financial Position. The entire portfolio of 17 properties has a total purchase price of $319,492,046 and encompasses 1,373 suites.

A list of properties in the LREIT real estate portfolio as at December 31, 2016 is provided below.

Real Estate Portfolio as of December 31, 2016

Property	Location	Purchase Price	Acquisition Date	Number of Suites	Occupancy December 31 2016
INVESTMENT PROPERTIES					
Fort McMurray					
Nelson Ridge Estates	Fort McMurray, AB	$ 40,575,000	April 2005	225	79 %
Gannet Place	Fort McMurray, AB	6,873,700	June 2006	37	78 %
Lunar Apartments	Fort McMurray, AB	4,457,100	June 2006	24	67 %
Parkland Apartments	Fort McMurray, AB	2,230,200	June 2006	12	25 %
Skyview Apartments	Fort McMurray, AB	5,385,800	June 2006	29	59 %
Snowbird Manor	Fort McMurray, AB	6,314,500	June 2006	34	53 %
Whimbrel Terrace	Fort McMurray, AB	6,873,700	June 2006	37	54 %
Laird's Landing	Fort McMurray, AB	51,350,000	August 2006	189	55 %
Lakewood Apartments	Fort McMurray, AB	34,527,719	July 2007	111	83 %
Lakewood Townhomes (1)	Fort McMurray, AB	18,236,327	July 2007	46	84 %
Millennium Village	Fort McMurray, AB	24,220,000	November 2007	72	92 %
Parsons Landing	Fort McMurray, AB	60,733,000	September 2008	160	59 %
		261,777,046		976	
Other					
Highland Tower (2)	Thompson, MB	5,700,000	January 2005	77	68 %
Norglen Terrace	Peace River, AB	2,500,000	October 2004	72	78 %
Westhaven Manor	Edson, AB	4,050,000	May 2007	48	60 %
		12,250,000		197	
Held for sale					
Woodland Park	Fort McMurray, AB	37,865,000	March 2007	107	78 %
Total - Investment properties		**311,892,046**	Total suites	**1,280**	
DISCONTINUED OPERATIONS (SENIORS' HOUSING COMPLEX) (3)					
Chateau St. Michael's	Moose Jaw, SK	**7,600,000**	June 2006	**93**	67 %
Total real estate portfolio		**$ 319,492,046**		**1,373**	

Notes to the Property Portfolio:

(1) Lakewood Townhomes is comprised of 64 condominium units. The number of suites as of December 31, 2016 has been reduced to 46 to account for the sale of 18 condominium units. One unit is held as available for sale and is not included in the occupancy statistic. The purchase price reflects the 46 condominium units that have not been sold.

(2) Includes the cost of major renovations and asset additions.

(3) The seniors' housing complex represents the remaining property of a distinct line of business which the Trust intends to dispose of under a coordinated plan, and is categorized as "discontinued operations".

Recent Changes in the Property Portfolio

During 2016, the Trust completed the sales of Beck Court, Willowdale Gardens and Elgin Lodge under the divestiture program and sold one condominium unit under the Lakewood Townhomes condominium sales program. The combined gross selling price of the properties was $46,870,000.

A more detailed description of the divestiture programs and activity is provided in the "Overview of Operations and Investment Strategy - Current Initiatives" and "Analysis of Cash Flows - Investing Activities" sections of this report.

During the first quarter of 2016, the Trust reclassified the property known as Woodland Park to "Assets held for sale" on the Statement of Financial Position. Other properties have been targeted for sale and will be classified as held for sale, in accordance with IFRS, when a sale is determined to be highly probable.

ANALYSIS OF OPERATING RESULTS

Analysis of Income (Loss)

	Year Ended December 31		Increase (Decrease) in Income	
	2016	2015	Amount	%
Rentals from investment properties	$ 18,328,212	$ 30,215,224	$ (11,887,012)	(39)%
Property operating costs	10,513,925	14,063,358	3,549,433	25 %
Net operating income	7,814,287	16,151,866	(8,337,579)	(52)%
Interest income	149,576	86,998	62,578	72 %
Interest expense	(19,076,586)	(23,272,205)	4,195,619	18 %
Trust expense	(1,883,331)	(1,816,996)	(66,335)	(4)%
Loss before the following	(12,996,054)	(8,850,337)	(4,145,717)	(47)%
Gain (loss) on sale of investment property	86,167	(100,711)	186,878	n/a
Fair value adjustments - Investment properties	11,645,404	(87,443,849)	99,089,253	n/a
Loss before discontinued operations	(1,264,483)	(96,394,897)	95,130,414	99 %
Loss from discontinued operations	(465,641)	(2,370,746)	1,905,105	80 %
Loss and comprehensive loss	$ (1,730,124)	$ (98,765,643)	$ 97,035,519	98 %

Analysis of Loss per Unit

	Year Ended December 31		Change	
	2016	2015		
Loss before discontinued operations - basic and diluted	$ (0.060)	$ (4.558)	$ 4.498	99 %
Loss from discontinued operations - basic and diluted	(0.022)	(0.112)	0.090	80 %
Loss and comprehensive loss - basic and diluted	$ (0.082)	$ (4.670)	$ 4.588	98 %

Overall Results

LREIT completed 2016 with a loss and comprehensive loss of $1,730,124, compared to a loss and comprehensive loss of $98,765,643 during 2015. The decrease in the loss mainly reflects a favourable variance in the fair value adjustments of the investment properties, as well as a reduction in interest expense, partially offset by a decrease in the net operating income.

The favourable fair value adjustments variance mainly reflects the net effect of having experienced significant reductions in the carrying value of the Fort McMurray properties during 2015 and a subsequent increase in the carrying value of the Fort McMurray properties during 2016. As previously reported, the carrying value of the Fort McMurray properties was reduced in 2015 to reflect an anticipated decline in operating results and the increased uncertainty as to the extent and/or timing of a recovery in the Fort McMurray rental market, resulting from the prolonged low-level of oil sands development activity. During the second quarter of 2016, the carrying value of the Fort McMurray properties increased as revenue expectations were revised to account for the anticipated improvement in rental market conditions associated with the post-wildfire rebuild and the migration of displaced homeowners into the rental market.

The decrease in interest expense is mainly due to a reduction in mortgage loan debt as a result of the sale of Colony Square in November, 2015 and the sales of Beck Court and Willowdale Gardens in May, 2016, as well as lump-sum payments made on mortgage loans during the third and fourth quarters of 2015 and the full repayment of two second mortgage loans during 2016. Also contributing to the decrease in interest expense were interest rate reductions for both the revolving loan from 2668921 Manitoba Ltd. and the Series G debentures.

The decrease in net operating income mainly reflects the sale of Colony Square in November, 2015 and the sales of Beck Court and Willowdale Gardens in May, 2016, as well as a decrease in the net operating income of the Fort McMurray properties.

The decline in the net operating income of the Fort McMurray portfolio is primarily the result of the sustained low-level of oil sands development activity which continues to exert downward pressure on the general economic and rental market conditions in Fort McMurray. The entry of homeowners displaced by the wildfire into the rental market and the commencement of the post-fire rebuild are factors that are currently moderating the downward pressure, as evidenced by the increase in the average occupancy level from 58% during the second quarter of 2016 to 76% during the third quarter of 2016 and to 72% during the fourth quarter of 2016. The extent and duration of the impact of these moderating factors on future operating results is uncertain and the long-term prospects of the Fort McMurray rental market remain dependent on the level of future oil-sands development activity.

The overall results discussed above are described in greater detail throughout this report.

Funds from Operations (FFO)

LREIT considers "Funds from Operations" ("FFO") to be a meaningful supplemental measure of operating performance. FFO is a non-IFRS financial metric widely used by the real estate industry and is considered by many analysts to provide a reasonable indication of the past and recurring operating performance of a real estate property portfolio. Since FFO is a non-IFRS financial measurement it should not be construed as an alternative to net income or cash flow from operating activities, as determined in accordance with IFRS.

LREIT completed 2016 with negative FFO of $12,463,056, compared to negative FFO of $8,426,367 during 2015, representing an unfavourable variance of $4,036,689. On a basic per unit basis, FFO decreased by $0.191, from negative $0.398 during 2015 to negative $0.589 during 2016.

The unfavourable variance in FFO mainly reflects a decrease in net operating income, partially offset by a decrease in interest expense, as disclosed in the preceding, "Overall Results", section and described in further detail in the following sections of this report.

A reconciliation between FFO and the closest IFRS comparable measure, loss and comprehensive loss, is provided in the following chart.

Funds from Operations *

	Year Ended December 31	
	2016	2015
Loss and comprehensive loss	$ (1,730,124)	$ (98,765,643)
Add (deduct):		
Loss (gain) on sale - Investment properties	(86,167)	100,711
Loss (gain) on sale - Property and equipment	(53,260)	-
Fair value adjustment - Property and equipment	1,051,899	2,794,716
Fair value adjustment - Investment properties	(11,645,404)	87,443,849
Funds from operations (FFO) *	$ (12,463,056)	$ (8,426,367)
FFO per unit *		
- basic and diluted	$ (0.589)	$ (0.398)

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

Segmented Results

The investment properties of LREIT are separated into three operating segments, as summarized below.

Fort McMurray Properties (twelve properties)

Accounting for approximately 76% of the residential suites in the portfolio of investment properties (December 31, 2015 - Thirteen properties, 73%), the twelve multi-unit residential rental properties in the Fort McMurray property portfolio represent the most significant component in LREIT's overall operations.

The rental revenue, operating costs and interest expense which are attributable to units sold under the condominium sales program at Lakewood Townhomes are also included in this operating segment.

Other Investment Properties (three properties)

The three other investment properties consist of two multi-unit residential rental properties located in Alberta and one in Manitoba, and account for 16% (December 31, 2015 - 13%) of the residential suites in the portfolio of investment properties.

Held for Sale (one property) and/or Sold Properties (four properties)

The operating results of held for sale and/or sold properties are analysed separately as they have been or are expected to be sold within the next twelve months and the properties do not contribute to net operating income past the date of sale. The operating results for held for sale and/or sold properties as disclosed in the analysis of net operating income pertain to the operations of Woodland Park; Beck Court, which was sold on May 1, 2016; Willowdale Gardens, which was sold on May 1, 2016; 156/204 East Lake Blvd., which was sold on April 1, 2015 and Colony Square, which was sold on November 1, 2015. Woodland Park, the one property classified as held for sale, accounts for approximately 8% of the suites in the portfolio of investment properties (December 31, 2015 - two held for sale properties, 14%).

Rental Revenues

The rental revenue of LREIT during 2016 and 2015 was primarily derived from the leasing of residential units and commercial space, prior to the divestiture of the remaining commercial space upon the sale of Colony Square on November 1, 2015. Rental revenue includes revenue from all investment properties, including investment properties sold during the year prior to their sale.

Analysis of Rental Revenue

	Year Ended December 31					
			Increase (Decrease)		% of Total	
	2016	2015	Amount	%	2016	2015
Fort McMurray properties	$ 13,262,742	$ 17,052,331	$ (3,789,589)	(22)%	72 %	56 %
Other investment properties	1,631,872	1,935,784	(303,912)	(16)%	9 %	6 %
Sub-total	14,894,614	18,988,115	(4,093,501)	(22)%	81 %	63 %
Held for sale and/or sold properties (1)	3,433,598	11,227,109	(7,793,511)	(69)%	19 %	37 %
Total	$ 18,328,212	$ 30,215,224	$(11,887,012)	(39)%	100 %	100 %

Occupancy Level, by Quarter (2)

	2016				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray properties	52 %	58 %	76 %	72 %	65 %
Other investment properties	72 %	74 %	69 %	69 %	71 %
Total	54 %	60 %	75 %	72 %	65 %
Held for sale and/or sold properties (3)	75 %	64 %	86 %	82 %	75 %

	2015				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray properties	76 %	71 %	66 %	54 %	67 %
Other investment properties	85 %	86 %	83 %	79 %	83 %
Total	77 %	73 %	68 %	56 %	69 %
Held for sale and/or sold properties (3)	89 %	88 %	87 %	81 %	87 %

Average Monthly Rents, by Quarter

	2016				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray properties	$1,699	$1,599	$1,700	$1,669	$1,667
Other investment properties	$969	$960	$945	$919	$948
Total	$1,576	$1,491	$1,573	$1,543	$1,546
Held for sale and/or sold properties (3)	$1,783	$2,036	$2,546	$2,581	$2,088

	2015				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray properties	$2,158	$2,127	$2,079	$1,980	$2,086
Other investment properties	$949	$967	$973	$971	$965
Total	$1,954	$1,931	$1,892	$1,810	$1,897
Held for sale and/or sold properties (3)	$1,239	$1,220	$1,223	$1,219	$1,224

(1) Includes revenue from Woodland Park, as well as Beck Court, Willowdale Gardens, Colony Square and 156/204 East Lake Blvd. prior to their respective sales dates of May 1, 2016, May 1, 2016, November 1, 2015 and April 1, 2015.
(2) The occupancy level represents the portion of potential revenue that was achieved.
(3) Includes Woodland Park, as well as Beck Court, Willowdale Gardens, and the residential portion of Colony Square prior to their respective sales dates of May 1, 2016, May 1, 2016, and November 1, 2015.

During 2016, total revenue from LREIT's investment properties, excluding held for sale and/or sold properties, decreased by $4,093,501 or 22%, as compared to the prior year. The decrease in revenue is almost entirely due to the unfavourable variance in revenue results for the Fort McMurray portfolio.

The revenue results of the Fort McMurray property portfolio continue to reflect challenging rental market conditions due to the depressed level of oil sands development activity in the region, the impact of which was tempered during the third and fourth quarters of 2016 by the entry of homeowners displaced by the wildfire into the rental market and the migration of workers involved in the rebuilding effort. As a result, the average occupancy level for the Fort McMurray portfolio increased from 66% during the third quarter of 2015 to 76% during the third quarter of 2016 and increased from 54% during the fourth quarter of 2015 to 72% during the fourth quarter of 2016. Notwithstanding, the average occupancy level for the Fort McMurray portfolio decreased from 67% during 2015 to 65% during 2016, and the rental rates of the Fort McMurray properties continued to remain at reduced levels compared to the prior year. In comparison to the prior year, the average monthly rental rate decreased by $419 per suite or 20% during 2016. The reduced rental rate level, together with the uncertainty with respect to the extent and/or duration of the post-fire rental market recovery, are key factors that cast significant doubt as to the ability of the Trust to sustain operations into the foreseeable future. Measures being taken by management in order to address the liquidity challenges facing LREIT and improve operating performance are discussed in the "Liquidity and Capital Resources" section of this report.

After accounting for the decrease in revenue from held for sale and/or sold properties of $7,793,511 during 2016, the total revenue of LREIT decreased by $11,887,012 or 39% during 2016, compared to the prior year. The decrease in revenue from held for sale and/or sold properties for 2016 was primarily due to the sale of Colony Square on November 1, 2015 and the sales of Beck Court and Willowdale Gardens on May 1, 2016, as well as a decrease in the revenue of Woodland Park, the Fort McMurray property which is classified as held-for-sale.

Property Operating Costs

Analysis of Property Operating Costs

	Year Ended December 31			
	2016	2015	Increase (Decrease)	%
Fort McMurray properties	$ 8,085,890	$ 8,090,681	$ (4,791)	- %
Other investment properties	1,067,768	1,119,567	(51,799)	(5)%
Sub-total	9,153,658	9,210,248	(56,590)	(1)%
Held for sale and/or sold properties	1,360,267	4,853,110	(3,492,843)	(72)%
Total	$ 10,513,925	$14,063,358	$ (3,549,433)	(25)%

During 2016, property operating costs decreased by $3,549,433 or 25%, as compared to the prior year. The decreases mainly reflect a decrease in the property operating costs of held for sale/or sold properties, primarily due to the sale of Colony Square on November 1, 2015 and the sales of Beck Court and Willowdale Gardens on May 1, 2016.

Excluding the Held for sale and/or sold properties, property operating costs decreased by $56,590 or 1% during 2016, compared to the prior year. The modest decrease is mainly comprised of decreases in property taxes, utilities, and management fees, largely offset by an increase in maintenance costs primarily reflecting the cost associated with preparing suites in Fort McMurray to accommodate the post-fire increase in demand for accommodation.

Net Operating Income and Operating Margin

Analysis of Net Operating Income

	Net Operating Income						Operating Margin *	
	Year Ended December 31		Increase (Decrease)		Percent of Total			
	2016	2015	Amount	%	2016	2015	2016	2015
Fort McMurray properties	$ 5,176,852	$ 8,961,650	$ (3,784,798)	(42)%	66 %	55 %	39 %	53 %
Other investment properties	564,104	816,217	(252,113)	(31)%	7 %	5 %	35 %	42 %
Sub-total	5,740,956	9,777,867	(4,036,911)	(41)%	73 %	60 %	39 %	51 %
Held for sale and/or sold properties	2,073,331	6,373,999	(4,300,668)	(67)%	27 %	40 %	60 %	57 %
Total	$ 7,814,287	$ 16,151,866	$ (8,337,579)	(52)%	100 %	100 %	43 %	53 %

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

During 2016, the net operating income of the investment properties portfolio, excluding held for sale and/or sold properties, decreased by $4,036,911 or 41%, compared to the prior year. The operating margin, excluding held for sale and/or sold properties, decreased from 51% during 2015 to 39% during 2016. The decrease in net operating income and operating margin, excluding held for sale and/or sold properties, is primarily due to the decreased revenue results of the Fort McMurray property portfolio, as disclosed in the Rental Revenues section of this report.

After including held for sale and/or sold properties, the total net operating income of LREIT during 2016, decreased by $8,337,579 or 52%, compared to the prior year. The decrease in net operating income from held for sale and/or sold properties is primarily due to the sale of Colony Square on November 1, 2015 and the sales of Beck Court and Willowdale Gardens on May 1, 2016. The decrease in net operating income from held for sale and/or sold properties was also impacted by a decrease in the revenue of Woodland Park, the Fort McMurray property which is classified as held-for-sale.

Interest Expense

A breakdown of total interest expense, including a summary of the cash and non-cash components of interest expense is included in the table below.

Analysis of Interest Expense

	Year Ended December 31			
	2016	2015	Increase (Decrease)	Increase (Decrease) %
Investment Properties				
Mortgage Loans	$ 15,217,883	$ 18,485,845	$ (3,267,962)	(18)%
Mortgage Bonds	-	490,715	(490,715)	(100)%
Debentures	2,484,580	2,587,218	(102,638)	(4)%
Revolving Loan	1,374,123	1,708,427	(334,304)	(20)%
	19,076,586	23,272,205	(4,195,619)	(18)%
Discontinued Operations				
Mortgage Loans	814,652	1,009,618	(194,966)	(19)%
Total - interest expense	$ 19,891,238	$ 24,281,823	$ (4,390,585)	(18)%

Cash and Non-cash Component

	Year Ended December 31			
	2016	2015	Increase (Decrease)	Increase (Decrease) %
Total cash component	$ 15,798,135	$ 20,873,800	$ (5,075,665)	(24)%
Non-cash component				
Accretion of mortgage bonds	-	213,774	(213,774)	(100)%
Amortization of transaction costs	4,093,103	3,034,954	1,058,149	35 %
Change in fair value of interest rate swaps	-	159,295	(159,295)	(100)%
Total non-cash component	4,093,103	3,408,023	685,080	20 %
Total - interest expense	$ 19,891,238	$ 24,281,823	$ (4,390,585)	(18)%

During 2016, total interest expense decreased by $4,390,585 or 18%, compared to the prior year. The decrease reflects a decrease in mortgage loan interest of $3,267,962, a decrease in mortgage bond interest of $490,715, a decrease in revolving loan interest of $334,304, a decrease in interest expense related to discontinued operations of $194,966, and a decrease in debenture interest of $102,638.

The decrease in mortgage loan interest is primarily due to a decrease in the total mortgage debt during the year which is explained in greater detail in the "Long-term debt" section of this report. Also contributing to the decrease in mortgage loan interest are lump-sum payments made concurrently with the refinancing of three mortgage loans in 2015. The decrease in mortgage bond interest is due to the redemption of the remaining $6,000,000 mortgage bonds during the first quarter of 2015. The decrease in revolving loan interest mainly reflects the reduction of the interest rate from 12% to 5%, effective July 1, 2016, partially offset by an increase in the average outstanding principal balance. The decrease in interest expense related to discontinued operations is due to the sale of Elgin Lodge on October 1, 2016. The decrease in debentures interest mainly reflects a $558,243 decrease due to the reduction in the Series G debenture interest rate from 9.5% to 5%, effective June 30, 2016, in accordance with the amended terms of the Series G debentures, partially offset by the acceleration of amortization of transaction costs of $445,605 as a result of the amendment.

Cash vs. Non-Cash Component of Interest

The total cash component of interest expense decreased by $5,075,665 during 2016, compared to the prior year, primarily driven by the same factors discussed in the preceding paragraphs, with the exception of factors related to the amortization of transaction costs.

The total non-cash component of interest expense increased by $685,080 during 2016, compared to 2015. The increase in the non-cash component of interest expense mainly reflects an increase in the amortization of transaction costs related to forbearance and servicing fees, as well as the accelerated amortization of transaction costs as a result of amending the Series G debenture terms and the sale of properties during 2016. The increase in the non-cash component of interest expense was partially offset by higher transaction costs in 2015 with respect to renewals, a decrease in accretion of mortgage bonds and a decrease in fair value of interest rate swaps.

Trust Expense

Included within trust expense are service fees, professional fees, unit-based compensation, gains/losses on debenture and warrant repurchases and other administrative costs not directly attributable to the investment properties.

During 2016, trust expense increased by $66,335 or 4%, compared to 2015. The increase is mainly due to costs incurred in obtaining the Series G debenture extension in 2016 and the one time recovery of financing fees in the first quarter of 2015, largely offset by a decrease in service fees due to the reduction in the number of properties being managed as a result of divestitures.

Fair Value Adjustments

Investment Properties

During 2016, LREIT recorded a gain related to fair value adjustments on its investment properties and investment properties held for sale of $11,645,404, compared to a loss related to fair value adjustments of $87,443,849 during the prior year, representing a variance of $99,089,253.

The losses from fair value adjustments during 2015 reflect the deterioration in operating result expectations that occured throughout the year combined with increased uncertainties as to the timing and extent of a recovery of the Fort McMurray rental market.

During the second quarter of 2016, a gain related to fair value adjustments of $24,952,489 was recorded as revenue expectations for the Fort McMurray portfolio were increased to reflect the impact of the improved rental market conditions resulting from the economic activity associated with the aftermath of the May 2016 Fort McMurray wildfire.

The gain related to fair value adjustments recognized during the second quarter of 2016 was partially offset by losses related to fair value adjustments of $3,104,229, $8,861,510 and $1,341,346 in the first, third and fourth quarters of 2016, respectively, reflecting the increased uncertainty of a recovery in the Fort McMurray rental market associated with the prolonged nature of the economic downturn in the region.

After accounting for fair value adjustments, capital expenditures, and investment properties transferred to held for sale and/or sold properties, the carrying value of investment properties decreased by $18,335,827 while the carrying value of investment properties held for sale decreased by $616,938 during 2016.

Discontinued Operations

Income from discontinued operations includes the net operating income, interest expense and fair value adjustment for the seniors' housing complexes.

Analysis of Income from Discontinued Operations

	Year Ended December 31 2016	Year Ended December 31 2015	Increase (Decrease) in income
Rental income	$ 4,488,348	$ 5,362,196	$ (873,848)
Property operating costs	3,140,698	3,928,608	787,910
Net operating income	1,347,650	1,433,588	(85,938)
Interest expense	(814,652)	(1,009,618)	194,966
Fair value adjustment	(1,051,899)	(2,794,716)	1,742,817
Profit on sale	53,260	-	53,260
Loss from discontinued operations	$ (465,641)	$ (2,370,746)	$ 1,905,105

During 2016, the loss from discontinued operations decreased by $1,905,105, primarily due to the relative change in fair value adjustments. The negative fair value adjustments associated with discontinued operations in 2015 and 2016 primarily pertain to reductions in the carrying value of Elgin Lodge, which was sold for gross proceeds of $14,500,000 on October 1, 2016.

SUMMARY OF QUARTERLY RESULTS

The summary of quarterly results is intended to provide readers with an overview of key trends and other factors affecting variations in the quarterly results of LREIT.

Quarterly Analysis

	2016 Q4	2016 Q3	2016 Q2	2016 Q1
Rentals from investment properties	$ 4,800,490	$ 5,096,608	$ 3,979,652	$ 4,451,462
Net operating income	$ 1,723,989	$ 2,606,793	$ 1,824,148	$ 1,659,357
Income (loss) for the period before discontinued operations	$ (3,523,752)	$(10,614,965)	$ 20,514,463	$ (7,640,229)
Income (loss) and comprehensive income (loss)	$ (3,482,970)	$(11,136,578)	$ 20,488,721	$ (7,599,297)
Funds from Operations (FFO)	$ (2,260,065)	$ (1,579,111)	$ (4,343,306)	$ (4,280,574)
PER UNIT				
Net operating income - basic and diluted	$ 0.082	$ 0.123	$ 0.086	$ 0.078
Income (loss) for the period before discontinued operations - basic and diluted	$ (0.167)	$ (0.502)	$ 0.970	$ (0.361)
Income (loss) and comprehensive income (loss) - basic and diluted	$ (0.165)	$ (0.527)	$ 0.969	$ (0.359)
Funds from Operations (FFO) - basic and diluted	$ (0.107)	$ (0.075)	$ (0.205)	$ (0.202)

Quarterly Analysis

	2015			
	Q4	Q3	Q2	Q1
Rentals from investment properties	$ 5,957,332	$ 7,568,402	$ 7,957,771	$ 8,731,719
Net operating income	$ 2,575,846	$ 4,266,094	$ 4,556,944	$ 4,752,982
Loss for the period before discontinued operations	$(30,150,728)	$(27,333,719)	$(34,990,639)	$ (3,919,811)
Loss and comprehensive loss	$(32,856,373)	$(27,276,615)	$(34,820,609)	$ (3,812,046)
Funds from Operations (FFO)	$ (3,042,062)	$ (1,904,147)	$ (1,564,934)	$ (1,915,224)
PER UNIT				
Net operating income - basic and diluted	$ 0.122	$ 0.202	$ 0.215	$ 0.225
Loss for the period before discontinued operations - basic and diluted	$ (1.426)	$ (1.292)	$ (1.654)	$ (0.185)
Loss and comprehensive loss - basic and diluted	$ (1.554)	$ (1.290)	$ (1.646)	$ (0.180)
Funds from Operations (FFO) - basic and diluted	$ (0.144)	$ (0.090)	$ (0.074)	$ (0.091)

Rental Revenue and Net Operating Income

The decline in oil prices experienced during the fourth quarter of 2014 and the low-level oil prices which continued throughout 2015, 2016, and into 2017 have resulted in a decreased level of oil sands development activity in Fort McMurray, which in turn has exerted downward pressure on the general economic and rental market conditions of the region. The economic downturn in the region continues to negatively impact the quarterly operating results of LREIT by means of increased vacancies and reduced rental rates.

During the third and fourth quarters of 2016, however, the downward pressure caused by the reduced oil sands development activity was tempered by an increase in economic activity which resulted from the return of homeowners displaced by the wildfire and the migration of workers participating in the Fort McMurray rebuilding effort.

During the third and fourth quarters of 2016, the average occupancy level of the Trust's Fort McMurray properties increased to 76% and 72%, respectively, compared to 58% in the second quarter of 2016.

It is anticipated that the post-fire rental market conditions in Fort McMurray will continue to have a positive impact on operating results in 2017; however, the extent and duration of the impact remains uncertain.

The Fort McMurray rental market is also affected by seasonal variations in demand, with stronger levels of demand typically being experienced in the second and third quarters of the year.

Income (loss) before Discontinued Operations

The two main factors that can cause quarterly variations in net income/loss before discontinued operations, in addition to variations in net operating income, are changes in the fair value of investment properties and changes in interest expense.

Gains from fair value adjustments were most pronounced during the second quarter of 2016 and amounted to $24,952,489, mainly reflecting an increase in the carrying value of the Fort McMurray properties of $24,957,742. The fair value gain was triggered by improved revenue expectations for the Fort McMurray portfolio due to the improved rental market conditions resulting from the economic activity associated with the aftermath of the May 2016 Fort McMurray wildfire.

Losses from fair value adjustments were most pronounced in the second, third and fourth quarters of 2015 and amounted to $33,054,460, $25,372,468 and $27,120,099, respectively, as revenue and occupancy expectations from the Fort McMurray portfolio were continuously lowered to reflect reductions in oil sands development activity and increasing levels of uncertainty with respect to the timing and extent of the recovery of the Fort McMurray economy.

Financing activities such as the acquisition, discharge, paydown and refinancing of the mortgage loan debt of investment properties, as well as changes in the balance of the revolving loan and mortgage bonds, affect quarterly variations in interest expense.

Loss and Comprehensive Loss

With the exception of fair value adjustments, the operations of the seniors' housing complexes of LREIT, as reflected in income from discontinued operations, do not contribute significantly to variations in the quarterly financial results. Losses from fair value adjustments with respect to the seniors' housing complexes were most pronounced in the third quarter of 2016 and the fourth quarter of 2015, in the amounts of $695,957 and $2,794,716, respectively.

ANALYSIS OF CASH FLOWS

Operating Activities

Net cash flow from operating activities primarily reflects the cash component of net operating income, the cash component of trust expense, the net increase or decrease in working capital items (disclosed as "working capital adjustments"), and interest paid/interest received for both investment properties and the seniors' housing complexes classified as discontinued operations.

Cash from Operating Activities

	Year Ended December 31		Increase
	2016	2015	(Decrease) in Cash
Net operating income			
Investment properties	$ 7,814,287	$ 16,151,866	$ (8,337,579)
Discontinued operations	1,347,650	1,433,588	(85,938)
Total net operating income	9,161,937	17,585,454	(8,423,517)
Accrued rent receivable	60,930	324,258	(263,328)
Net operating income - cash basis	9,222,867	17,909,712	(8,686,845)
Trust expense	(1,883,331)	(1,816,996)	(66,335)
Gain on debenture repurchases	-	(11,654)	11,654
Trust expense - cash basis	(1,883,331)	(1,828,650)	(54,681)
Interest expense - cash basis			
Investment properties	(10,493,079)	(20,282,117)	9,789,038
Discontinued operations	(808,291)	(932,833)	124,542
Total interest expense - cash basis	(11,301,370)	(21,214,950)	9,913,580
Interest income - cash basis	135,593	90,089	45,504
Cash used in operating activities, before working capital adjustments	(3,826,241)	(5,043,799)	1,217,558
Working capital adjustments, net	571,861	(1,448,425)	2,020,286
Cash used in operating activities	$ (3,254,380)	$ (6,492,224)	$ 3,237,844

During 2016, the net cash used in operating activities, before working capital adjustments, decreased by $1,217,558, compared to 2015. The favourable variance mainly reflects a decrease in interest paid of $9,913,580, partially offset by a decrease in the cash component of net operating income of $8,686,845.

After providing for working capital adjustments, the net cash used in operating activities decreased by $3,237,844 during 2016, compared to 2015.

The decrease in the cash component of net operating income for 2016, compared to the prior year, is mainly due to the same factors discussed in the "Net Operating Income and Operating Margin" section of this report, namely the overall decline in the occupancy and rental rates experienced by the Fort McMurray Portfolio and the effect of properties sold.

The decrease in interest paid is mainly due to the same factors that affected the decrease in interest expense, as previously discussed. The decrease in interest paid also reflects the deferral of interest payments in accordance with mortgage loan renewal and forbearance agreements. In addition, the decrease was impacted by the amended terms of the Series G debentures, which incorporates the deferral of interest payments from June 30, 2016 to the maturity of the debentures on June 30, 2022.

These factors, in addition to the exclusion from interest paid of other non-cash items such as regular monthly interest accruals, amortization of transaction costs, accretion of mortgage bonds and change in fair value of interest rate swaps, account for the difference between interest expense of $19,076,586 for 2016, as reported on the Statements of Comprehensive Income and interest paid of $11,301,370 for 2016, as reported on the Statements of Cash Flow.

Financing Activities

As disclosed in the Statement of Cash Flows, the financing activities of LREIT resulted in a net cash outflow of $11,353,115 during 2016. The net cash outflow mainly reflects the prepayment of mortgage loans, the repayment of mortgage loans on refinancing, the repayment of long-term debt and the repayment of the defeased liability upon maturity, partially offset by the net proceeds of the revolving loan facility.

Prepayment of Mortgage Loans

During the first quarter of 2016, an interest-only second mortgage loan, secured by assets of 2668921 Manitoba Ltd., in the amount of $7,500,000 was fully repaid. The repayment was funded by advances from the revolving loan facility.

During the second quarter of 2016, an interest-only second mortgage loan in the amount of $5,456,865 was fully repaid. The repayment was funded by the net proceeds from the sale of Willowdale Gardens.

Repayment of Mortgage Loans on Refinancing

During the fourth quarter of 2016, LREIT made a lump-sum payment of $5,500,000 required by the terms of a first mortgage loan renewal in the first quarter of 2016. The lump-sum payment along with the payment of outstanding debt service obligations during the fourth quarter of 2016 led to the withdrawal of a previously issued demand notice by the lender of three mortgage loans on three Fort McMurray properties with an aggregate principal amount of $74,946,302.

Also during the fourth quarter of 2016, a $300,000 lump-sum payment was made in accordance with the terms of the renewal of the first mortgage loan on the remaining seniors' housing complex.

Repayment of Long-term Debt

During 2016, the regular repayment of mortgage loan and defeased mortgage loan principal for both investment properties and discontinued operations amounted to $4,598,670, compared to $7,221,562 for 2015.

The decrease is mainly due to the fact that regular principal repayments were comparatively low during 2016, as two mortgage loans with an aggregate principal amount of $42,663,266 were renewed in the first quarter of 2016 with interest-only terms and no principal payments were required to be made under the terms of the forbearance agreement obtained in the first quarter of 2016 on a mortgage loan in the aggregate principal amount of $25,170,364. Also contributing to the decrease in regular principal repayments were the full repayment of mortgage loans related to the sales of Colony Square, Beck Court and Willowdale Gardens.

Revolving Loan Facility

During 2016, net proceeds from the revolving loan amounted to $15,200,000 and served as a funding source for the mortgage loan prepayments, the cash outflow from operating activities, mortgage loan principal payments, transaction costs, and capital expenditures.

The revolving loan is for a three year term, maturing June 30, 2018, with a maximum principal balance of $30,000,000 and an interest rate of 5%. Advances on the revolving loan are made at the discretion of 2668921 Manitoba Ltd. and the revolving loan is payable on demand.

Investing Activities

As disclosed in the Statement of Cash Flows, the investing activities of LREIT resulted in a net cash inflow of $14,436,075 during 2016. The net cash inflow mainly reflects proceeds from sale of properties and a decrease in defeasance assets, partially offset by capital expenditures on investment properties, investment properties held for sale, and property and equipment.

Divestitures

On May 1, 2016, LREIT sold Beck Court for gross proceeds of $23,000,000. The Trust provided vendor take back financing to the purchaser in the amount of $4,000,000, bearing interest at 4%, with monthly interest only payments and maturing on May 1, 2022. The net cash proceeds of approximately $3,400,000, after the assumption of the mortgage loan by the purchaser, the vendor take back financing, selling costs, and standard closing adjustments, were used to reduce the revolving loan balance. The sale of Beck Court resulted in a capital gain for tax purposes of approximately $6,800,000.

On May 1, 2016, LREIT sold Willowdale Gardens for gross proceeds of $9,000,000. The net cash proceeds of approximately $5,945,000, after the repayment of the existing mortgage loan, selling costs, and standard closing adjustments, were used to pay a $5,449,594 second mortgage loan in full with a second secured charge over the property, in exchange for discharge of the security. The remaining proceeds were used to reduce the revolving loan balance. The sale of Willowdale Gardens resulted in a capital gain for tax purposes of approximately $4,300,000.

On October 1, 2016, LREIT sold Elgin Lodge for gross proceeds of $14,500,000. The net cash proceeds of approximately $4,382,000, after closing costs and adjustments and the repayment of the existing mortgage loan, were used to reduce the outstanding balance of the revolving loan. The sale of Elgin Lodge resulted in a capital loss for tax purposes of approximately $5,200,000.

On December 13, 2016, LREIT sold one condominium unit under the Lakewood Townhomes condominium sales program for gross proceeds of $370,000. The sales proceeds, after the payment of selling costs and standard closing adjustments were insufficient to repay the amount required by the existing mortgage loan with respect to the sale. The deficiency in the repayment of the existing mortgage loan, in the amount of $56,264, was funded by an advance on the revolving loan facility.

A more detailed description of the divestiture programs is provided in the "Overview of Operations and Investment Strategy - Current Initiatives" section of this report.

A more detailed description of the tax implications from the divestitures is provided in the "Taxation" section of the MD&A.

Capital Expenditures

LREIT has a continuous capital improvement program with respect to its properties. The primary objectives of the program are to extend the useful life of the properties, increase the future productive capacity of the properties, and improve the quality of tenants' physical surroundings. LREIT distinguishes between sustaining and value-added capital expenditures. In general, sustaining capital expenditures reflect the cost of capital expenditures that are required in order to maintain the existing productive capacity of the properties. Value-added capital expenditures tend to be more discretionary in nature and primarily reflect the cost of major renovation and/or expansion projects that are aimed at increasing the future productive capacity of the properties. Given LREIT's working capital and liquidity position, the current focus of its capital improvement program is on sustaining capital expenditures and minimizing discretionary expenditures. Notwithstanding the focus on sustaining capital expenditures, certain value-added expenditures were incurred during the third quarter of 2016 as renovations at select properties and the conversion of units to furnished suites were completed in order to more aptly meet the needs of prospective tenants in the post-fire market environment.

During 2016, capital expenditures on investment properties, including investment properties held for sale and capital expenditures on property and equipment related to the two remaining seniors' homes, amounted to $2,092,516, compared to $998,989 during 2015.

Management's estimate of sustaining vs. value-added capital expenditures is provided in the table below.

	Year Ended December 31	
	2016	2015
Sustaining Capital Expenditures		
- Investment properties	$ 868,345	$ 697,896
- Investment properties held for sale	29,868	171,356
- Property and equipment	453,533	129,737
Value-added capital expenditures		
- Investment properties	740,770	-
	$ 2,092,516	$ 998,989

Adjusted Funds from Operations (AFFO)

LREIT considers "Adjusted Funds from Operations" ("AFFO") to be a meaningful additional measure of operating performance. AFFO is a non-IFRS financial measure widely used by the real estate industry. However, AFFO should not be construed as an alternative to net income or cash flow from operating activities determined in accordance with IFRS.

AFFO estimates the sustainable cash distribution capacity and cash flows of a real estate investment trust. AFFO is calculated by adjusting FFO for sustaining capital expenditures as well as certain other non-cash items.

A reconciliation between FFO and AFFO is provided in the chart below.

Adjusted Funds from Operations *

	Year Ended December 31	
	2016	2015
Funds from operations (FFO)	$ (12,463,056)	$ (8,426,367)
Add (deduct):		
Straight-line rent adjustment	60,930	324,258
Accretion of debt component of mortgage bonds	-	213,774
Change in fair value of interest rate swaps	-	159,295
Sustaining capital expenditures on investment properties **	(868,345)	(697,896)
Sustaining capital expenditures on investment properties held for sale **	(29,868)	(171,356)
Sustaining capital expenditures on property and equipment **	(453,533)	(129,737)
Adjusted funds from operations (AFFO) *	$ (13,753,872)	$ (8,728,029)
AFFO per unit *		
- basic and diluted	$ (0.650)	$ (0.413)

* AFFO does not have any standardized meaning prescribed by IFRS and, therefore, the method that is used by LREIT for calculating AFFO may not be comparable to similar measures presented by other issuers. The most directly comparable IFRS measurement of AFFO is the "net cash flow from operating activities", as disclosed in the Statement of Cash Flows in the Financial Statements.

** The capital expenditures referred to in the table above are expenditures that by standard accounting definitions are accounted for as capital in accordance with IFRS and are expected to have a useful life beyond one year but are considered sustaining capital expenditures as they are not part of a major renovation or expansion project aimed at increasing future productive capacity.

As disclosed in the preceding chart, LREIT completed 2016 with an AFFO deficiency of $13,753,872, compared to AFFO deficiency of $8,728,029 during 2015. On a basic per unit basis, the AFFO deficiency increased by $0.237 per unit during 2016, compared to 2015.

A reconciliation between cash provided by operating activities and AFFO is provided in the chart below.

Reconciliation Between Cash Provided by (Used in) Operating Activities and Adjusted Funds from Operations

	Year Ended December 31	
	2016	2015
Cash used in operating activities	$ (3,254,380)	$ (6,492,224)
Add (deduct):		
Working capital adjustments	(571,861)	1,448,425
Gain on debenture repurchases	-	11,654
Amortization of transaction costs	(4,093,103)	(3,034,954)
Differences in interest accruals	(4,482,782)	338,059
Sustaining capital expenditures on investment properties **	(868,345)	(697,896)
Sustaining capital expenditures on investment properties held for sale **	(29,868)	(171,356)
Sustaining capital expenditures on property and equipment **	(453,533)	(129,737)
Adjusted funds from operations (AFFO) *	$ (13,753,872)	$ (8,728,029)

* AFFO does not have any standardized meaning prescribed by IFRS and, therefore, the method that is used by LREIT for calculating AFFO may not be comparable to similar measures presented by other issuers. The most directly comparable IFRS measurement of AFFO is the "net cash flow from operating activities", as disclosed in the Statement of Cash Flows in the Financial Statements.

** The capital expenditures referred to in the table above are expenditures that by standard accounting definitions are accounted for as capital in accordance with IFRS and are expected to have a useful life beyond one year but are considered sustaining capital expenditures as they are not part of a major renovation or expansion project aimed at increasing future productive capacity.

Distributions

Regular cash distributions are suspended given the debt reduction priorities and financial position of LREIT.

For information regarding the "Special Distribution" of trust units made on December 31, 2015, please refer to the "Taxation" section of this report.

LIQUIDITY AND CAPITAL RESOURCES

General

Liquidity refers to the overall ability to generate and have sufficient funds available to fund the ongoing operating, investing, and financing activities of the Trust.

The depressed rental market conditions in Fort McMurray, as described in the preceding sections of this report, have affected operating cash flow to the extent that LREIT requires ongoing additional sources of cash to fund the cash outflow from operating activities, in addition to the regular mortgage loan principal payments, transaction costs for debt financing and capital expenditures. LREIT will also require additional capital in order to fund the repayment of mortgage loans upon maturity or refinancing to the extent that there is a deficit between the repayment amount and the amount of new mortgage loan proceeds.

	December 31 2016	December 31 2015
Unrestricted cash	$ 706,768	$ 407,513
Amount available on revolving loan *	7,700,000	10,900,000
Total available liquidity	$ 8,406,768	$ 11,307,513

* As of the date of this report, there is $5,100,000 available under the revolving loan facility.

Working Capital

LREIT requires working capital for use in the day-to-day operations of its properties. Working capital is a commonly used financial measurement of an entity's liquidity and ability to fund its short term operating obligations. It is generally derived by deducting current liabilities from current assets. Working capital is a non-IFRS measurement and the method which is used by LREIT for calculating working capital may differ from the method which is used by other issuers.

As of December 31, 2016, the working capital deficit was $1,333,161, representing a decrease of $1,449,116, compared to the previous working capital balance as at December 31, 2015. Working capital excludes the current portion of long-term debt, as a result, the revolving loan balance of $22,300,000 (December 31, 2015 - $7,100,000) is also excluded. Working capital also excludes "held for sale" assets and liabilities that are of a long-term nature and includes the tenant security deposit liability, net of the security deposit balance in restricted cash.

The decrease in the working capital balance mainly reflects a $1,471,933 increase in trade and other payables and a $257,412 decrease in deposits and prepaid, partially offset by a $299,255 increase in cash.

Debt Service

Debt Service Coverage

The ratio of net operating income to mortgage loan debt service costs is one of the measures used to assess the overall financial position of the Trust. During 2016, the mortgage loan debt service coverage ratio, inclusive of debt service concessions granted under mortgage renewal and forbearance agreements, and excluding mortgage prepayments, was 0.51, compared to 0.76 during 2015.

Interest Coverage Ratio

The ratio of net operating income to the cash component of interest on mortgage loans assesses LREIT's ability to pay mortgage loan interest out of net operating income, including discontinued operations.

During 2016, the interest coverage ratio decreased to 0.73, compared to 1.05 during 2015. After including the cash component of interest on the revolving loan facility, mortgage bonds and debentures, the interest coverage ratio decreased to 0.58 during 2016, compared to 0.84 during 2015.

The decreases in the debt service coverage ratio and interest coverage ratio during 2016, compared to 2015, are mainly due to a decrease in net operating income, partially offset by a decrease in debt service costs.

As indicated by the Debt Service Coverage and Interest Coverage Ratios, operating performance has decreased to the extent that net operating income is insufficient to fund the debt service or interest payment obligations of the Trust.

Summary of Total Debt Obligations by Year

A summary of the debt obligations of LREIT for 2017 and for the next five years and beyond is provided in the following chart, which reflects the upcoming mortgage payments in accordance with the payment terms specified by the applicable mortgage loan and/or forbearance agreement, where applicable.

Summary of Contractual Obligations - Long-term Debt

Payments Due by Period	Total	2017	2018/2019	2020/2021	2022 and beyond
Mortgage loans					
Investment properties (1)	$ 192,674,077	$ 59,382,322	$ 121,355,769	$ 535,385	$ 11,400,601
Discontinued operations	3,716,431	3,716,431	-	-	-
Total mortgage loans	196,390,508	63,098,753	121,355,769	535,385	11,400,601
Revolving loan	22,300,000	-	22,300,000	-	-
Debentures	24,810,800	-	-	-	24,810,800
Total	$ 243,501,308	$ 63,098,753	$ 143,655,769	$ 535,385	$ 36,211,401

(1) A forbearance agreement and four loan agreements have been negotiated with the lenders for five mortgage loans affecting 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 February 28, 2018. Over the period from December 31, 2016 to maturity, $2,612,064 of accrued interest will be incurred and added to the outstanding mortgage principal.

The amount due during 2017 for mortgage loans on investment properties of $59,382,322 consists of six mortgage loans, with maturity dates in 2017, in the aggregate principal amount of $56,900,974, and regular principal payments of $2,481,348 for other mortgage loans.

All mortgages which have matured prior to the date of this report have been repaid, renewed or refinanced, except for one mortgage loan in forbearance with a balance of $25,170,364 and one mortgage loan with a balance of $3,212,873 that are currently overholding past their maturity dates of February 28, 2017 and March 1, 2017, respectively.

An analysis of mortgage loans is provided in the "Mortgage Loans" section of the MD&A.

Loan Defaults

As of December 31, 2016, the Trust is current with respect to all debt service payments. However, the lender of five mortgage loans on eight properties with an aggregate principal balance of $65,119,595 that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain in default. As a result of the lender's position, the financial statements as at December 31, 2016 reflect such mortgage loans 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 on the mortgage loans in default as of the date of this report, the Trust would be unable to satisfy these obligations with its current resources.

The following chart reflects the estimated maximum service fee charges related to the above noted mortgages:

Summary of maximum service fees payable

	As at December 31, 2016	
Property	Aggregate principal balance	Estimate of maximum service fees payable (1)
Nelson Ridge Estates	$ 28,968,701	$ 394,448
Lakewood Apartments	16,949,047	230,571
Gannet Place / Parkland Apartments	5,669,117	77,144
Lunar Apartments / Whimbrel Terrace	6,949,239	94,563
Snowbird Manor / Skyview Apartments	6,583,491	89,586
	$ 65,119,595	$ 886,312

(1) The Financial Statements as of December 31, 2016 include the accrual of the estimated maximum service fees in Trade and other payables on the Statement of Financial Position.

Events of default allow LREIT's lenders to accelerate payment of the mortgage loans and/or enforce their security in accordance with the underlying financing agreements.

If the five mortgage loans with an aggregate principal balance of $65,119,595 which are classified as being in default for financial statement purposes as of the date of this report were to be called by the lenders in 2017 and the "Summary of Contractual Obligations - Long-term Debt" chart above was adjusted to reflect the repayments, the total long-term debt due in 2017 would increase to $109,596,228, the total long-term debt due in 2018/2019 would decrease to $97,158,294, and the total long-term debt due in 2020 and beyond would remain the same.

Debentures

On June 22, 2016, the terms of the Series G debentures were amended to extend the maturity date of the debentures to June 30, 2022, to reduce the interest rate for the period commencing June 30, 2016 from 9.5% to 5.0% and to defer all payments of interest to the amended maturity date. As of December 31, 2016, the total face value of the 5.0% Series G debentures is $24,810,800 and the cummulative accrued interest is $1,798,783.

The terms of the debentures provide for the net proceeds from property sales to be applied to prepay the principal amount of the Series G debentures after the repayment of mortgage loan indebtedness, 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. The extent of future repayments on the Series G debentures, if any, is dependent on the extent and proceeds of property sales, the amount of mortgage loan indebtedness related to the properties sold and the balance of amounts owing to Shelter and/or its parent company 2668921 Manitoba Ltd.

Reserves and Escrows Required by Mortgage Loan Agreements

In accordance with mortgage loan agreements, cash deposits are provided to certain lenders to be held in escrow to fund future capital expenditures and property tax payments. During 2016, cash deposits of $1,131,270 were added to mortgage escrow reserves and cash funds in the amount of $1,718,868 were released from escrow following: application to outstanding debt service requirements, repayment or assignment of the underlying mortgage loan upon sale of the property, and payment of property taxes. As of December 31, 2016, cash deposits in escrow required by mortgage loan agreements amounted to $1,180,015.

Capital Resources

The revolving loan facility from 2668921 Manitoba Ltd. and interest free advances from Shelter represent the primary funding sources for any cash shortfall from the operating, investing and financing activities of LREIT. The net proceeds from property sales must be applied to prepay the principal amount of the Series G Debentures after the repayment of mortgage loan indebtedness, 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. The repayments to Shelter or 2668921 Manitoba Ltd. under the revolving loan from the net proceeds of the sale of properties, in effect, serves to facilitate the advancing of additional funds under the revolving loan facility, at the discretion of 2668921 Manitoba Ltd., for the payment of LREIT's ongoing funding obligations.

Revolving Loan Facility from 2668921 Manitoba Ltd.

LREIT utilizes advances made by 2668921 Manitoba Ltd., the parent company of Shelter, under a revolving loan facility. The revolving loan is a demand loan; accordingly, 2668921 Manitoba Ltd. can request repayment of the loan at any time.

Effective July 1, 2015, the revolving loan facility was renewed for a three-year term at an interest rate of 12% with a maximum balance of $18,000,000. As discussed in the preceding sections of this report, the interest rate on the revolving loan facility from 2668921 Manitoba Ltd. was reduced from 12% to 5% per annum, effective July 1, 2016, in conjunction with the approval of the amendments to the Series G debentures. On November 14, 2016, the maximum principal balance on the revolving loan facility was increased to $30,000,000. As of the date of this report, there is $5,100,000 available under the revolving loan facility.

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

Proceeds from the Sale of Select Properties

During 2016, the Trust completed the sales of Beck Court, Willowdale Gardens and Elgin Lodge under the divestiture program and completed the sale of one condominium unit under the Lakewood Townhomes condominium sales program. The combined net cash proceeds from the sales, after repayment or assumption by the purchaser of the existing mortgage loans, selling costs and standard closing adjustments amounted to $13,746,211 and were used to repay a $5,456,865 second mortgage loan secured with a second charge over Willowdale Gardens and to pay down the revolving loan from 2668921 Manitoba Ltd. by $8,345,610.

Current divestiture activities focus on the sale of the remaining seniors' housing complex, the property classified as held for sale, the Lakewood Townhomes Condominium Sales Program and other properties with consideration of the overall debt reduction requirements of the Trust. The timing and terms of property sales is uncertain.

A more detailed description of the divestiture programs and activity is provided in the "Overview of Operations and Investment Strategy - Current Initiatives" and "Analysis of Cash Flows - Investing Activities" sections of this report.

Upward Refinancing of Mortgage Loans

Upward refinancing of mortgage loan debt was not a source of funds for LREIT during 2016. The opportunity to complete future upward refinancings is limited by the extent to which the existing property portfolio is leveraged, the maximum 75% mortgage loan debt to appraised value restriction pursuant to the terms of the Declaration of Trust, and market lending conditions. The upward refinancing of mortgage loans is not expected to be a viable source of funds until market and lending conditions in Fort McMurray improve.

Equity Offerings

LREIT may pursue equity offerings in the future as a source of investment capital. LREIT may also issue trust units to vendors as consideration for real property acquisitions.

Outlook and Continuing Operations

After accounting for the cash outflow from operating activities, regular payments of debt, transaction costs for debt financing, and capital improvements, LREIT completed 2016 with a cash shortfall of $10,643,857, compared to a cash shortfall of $17,918,983 during 2015. LREIT is expected to incur an additional cash shortfall during 2017.

In an effort to meet its ongoing funding obligations and sustain operations, LREIT has continued to pursue debt restructuring arrangements with its lenders and has relied on favourable interim financing arrangements and other support from Shelter and its parent company, 2668921 Manitoba Ltd. Other measures taken in order to address the liquidity challenges facing LREIT include the continuation of the divestiture program, cost reduction, marketing and other initiatives in order to improve the operating performance of the Trust. The Trust is continuing in its efforts to accommodate the increased demand for rental housing from homeowners displaced by the wildfire and from workers engaged in the Fort McMurray post-fire rebuilding effort.

Continuation of operations into the foreseeable future will be contingent upon a combination of events and/or conditions that are subject to material uncertainty and include, but are not limited to:

(i) 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;
(ii) the willingness and ability of the Trust's lenders to participate in a restructuring of the Trust's debt to the degree necessary and duration required to allow LREIT to stabilize its operations;
(iii) the Trust's ability to renew or refinance debt as it matures;
(iv) the timing and extent of a recovery of the Fort McMurray rental market, which is highly dependent on the timing and extent of a recovery in oil sands development activity, and which in the near-term is dependent on the extent of economic activity associated with the post-fire rebuild of Fort McMurray;
(v) the improvement of cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio; and,
(vi) the ability of LREIT to complete additional property sales at prices which exceed the indebtedness related to such properties.

CAPITAL STRUCTURE

The purchase price of the LREIT properties was primarily funded from the proceeds of mortgage loans with the remaining balance funded from other investment capital. The investment capital of LREIT has been primarily raised through the completion of trust unit and debenture offerings as well as public offerings of investment units, comprised of second mortgage bonds and trust unit purchase warrants.

LREIT utilizes the refinancing of mortgage loan debt, second mortgage loans and bridge financing as sources of capital. In addition, as an interim source of funds, LREIT has obtained advances under a revolving loan facility from 2668921 Manitoba Ltd. and other periodic credit support from Shelter, as required.

Capital Structure

	December 31, 2016		December 31, 2015	
	Amount	%	Amount	%
Long-term debt	$ 110,597,313	46.7 %	$ 122,080,890	46.9 %
Current portion of long-term debt	130,720,198	55.2 %	141,300,008	54.2 %
Deficit	(4,605,143)	(1.9)%	(2,875,019)	(1.1)%
Total capitalization	$ 236,712,368	100.0 %	$ 260,505,879	100.0 %

Long-term Debt

The long-term debt of LREIT includes mortgage loans, debenture debt, a revolving loan, and accrued interest payable, less unamortized transaction costs. On the Statement of Financial Position, the long-term debt of investment properties, including investment properties held for sale, is separated into current and non-current portions, while the long-term debt for the seniors' housing complex in discontinued operations is classified under "Liabilities held for sale". The long-term debt for the seniors' housing complex consists solely of mortgage loan debt, less unamortized transaction costs.

Pursuant to the terms of the Declaration of Trust, LREIT is not permitted to incur mortgage 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.

Summary of Long-term Debt

	December 31 2016	December 31 2015	Increase (Decrease)
Long-term debt - Investment properties			
Secured long-term debt			
Mortgage loans	$ 192,674,077	$ 230,897,904	$ (38,223,827)
Debentures	24,810,800	24,810,800	-
Defeased liability	-	2,520,859	(2,520,859)
Revolving loan from 2668921 Manitoba Ltd.	22,300,000	7,100,000	15,200,000
Total secured long-term debt	239,784,877	265,329,563	(25,544,686)
Accrued interest payable	2,610,724	1,139,300	1,471,424
Unamortized transaction costs	(1,078,090)	(3,087,965)	2,009,875
Total long-term debt - Investment properties	241,317,511	263,380,898	(22,063,387)
Long-term debt - Discontinued operations			
Mortgage loans	3,716,431	14,199,674	(10,483,243)
Unamortized transaction costs	(4,125)	(2,750)	(1,375)
Total long-term debt - Discontinued operations	3,712,306	14,196,924	(10,484,618)
Total long-term debt	$ 245,029,817	$ 277,577,822	$ (32,548,005)

As disclosed in the preceding chart, the total long-term debt of LREIT as of December 31, 2016 decreased by $32,548,005 or 12%, compared to the balance as of December 31, 2015. The decrease is comprised of a $25,544,686 decrease in the secured long-term debt of investment properties and a $10,484,618 decrease in the long-term debt of discontinued operations, partially offset by increases in accrued interest payable and a decrease in unamortized transaction costs of $1,471,424 and $2,009,875, respectively. The decrease in secured long-term debt of investment properties mainly reflects a decrease in the balance of mortgage loans of $38,223,827 and the repayment of defeased liability of $2,520,859, partially offset by a $15,200,000 increase in the balance of the revolving loan from 2668921 Manitoba Ltd. The change in the balance of the mortgage loans mainly reflects the elimination of mortgage loans from the sale of properties in 2016, inclusive of the prepayment of a $5,456,865 second mortgage loan secured by a second charge over Willowdale Gardens, a $5,500,000 principal paydown of Laird's Landing's first mortgage loan, as well as the prepayment of a $7,500,000 interest-only second mortgage loan in the Fort McMurray property portfolio. The increase in the balance of the revolving loan from 2668921 Manitoba Ltd. is described in the "Analysis of Cash Flows - Financing Activities" section of this report. The decrease in the long-term debt of discontinued operations is mainly due to the sale of Elgin Lodge on October 1, 2016.

The increase in accrued interest payable mainly reflects the amended terms of the Series G debentures, which defers the payment of interest until the extended maturity date of June 30, 2022.

The decrease in the balance of unamortized transaction costs mainly reflects the accelerated amortization of transaction costs as a result of the early renewals of four mortgage loans during the first quarter of 2016 and the sale of two properties during the second quarter of 2016, as well as the immediate amortization of transaction costs as a result of the amendments to the Series G debenture terms during the second quarter of 2016.

Mortgage Loans

Change in Total Mortgage Loan Debt

As of December 31, 2016, the total mortgage loan debt of LREIT decreased by $48,707,070 compared to the amount payable as of December 31, 2015. As disclosed in the chart below, the decrease primarily reflects reductions in the balance of mortgage loans on sale of properties, the prepayment of two mortgage loans, the repayment of mortgage loans on refinancing for two mortgage loans and regular repayments of principal on mortgage loans, partially offset by interest and forbearance fees capitalized to mortgage loan principal in accordance with mortgage renewal and forbearance agreements.

	Year Ended December 31, 2016		
	Total	Investment Properties	Seniors' Housing Complexes
Regular repayment of principal on mortgage loans	$ (4,565,516)	$ (4,382,273)	$ (183,243)
Repayment of mortgage loans on refinancing	(5,800,000)	(5,500,000)	(300,000)
Prepayment of mortgage loans	(12,956,865)	(12,956,865)	-
Interest capitalized, net of repayment	3,574,828	3,574,828	-
Reduction of mortgage loans on sale of properties	(28,959,517)	(18,959,517)	(10,000,000)
Increase (decrease) in mortgage loans	(48,707,070)	(38,223,827)	(10,483,243)
Total mortgage loans - December 31, 2015	245,097,578	230,897,904	14,199,674
Total mortgage loans - December 31, 2016	$ 196,390,508	$ 192,674,077	$ 3,716,431

Summary of Mortgage Loans Payable

Year of Maturity (Note 1)	Weighted Average Interest Rate (Note 2)	Amount December 31, 2016	Percentage of Total
Investment Properties			
Fixed rate			
2017	6.9 %	$ 24,637,502	12.5 %
2018	5.0 %	19,201,847	9.8 %
2019	5.0 %	28,968,701	14.8 %
2025	4.4 %	12,656,253	6.4 %
	5.5 %	85,464,303	43.5 %
Demand/variable rate	6.1 %	107,209,774	54.6 %
Principal amount	5.8 %	192,674,077	98.1 %
Discontinued Operations			
Demand/variable rate	4.8 %	3,716,431	1.9 %
Total	5.8 %	$ 196,390,508	100.0 %

(1) The year of maturity is based on the contractual loan obligation and does not reflect the IFRS Financial Statement disclosure requirement to disclose fixed term loans which are secured by a demand promissory note and loans in breach of a covenant and/or default as a current liability.

(2) As of December 31, 2016, the weighted average interest rate of the mortgage loan debt for investment properties, discontinued operations and total mortgage loan debt is 5.8%, 4.8% and 5.8%, respectively, compared to 5.9%, 6.5% and 6.0% at December 31, 2015.

Mortgage Loan Debt Summary

	2016			
	Q 4	Q 3	Q 2	Q 1
Weighted average interest rate				
Investment properties				
Fixed rate mortgage loans	5.5%	5.5%	5.4%	5.2%
Variable rate mortgage loans	6.1%	6.1%	6.1%	6.1%
Investment properties and discontinued operations				
Mortgage loans, mortgage bonds, debentures, defeased liability and revolving loan	5.6%	5.7%	6.5%	6.4%
Ratio of mortgage loans compared to carrying value of income-producing properties and discontinued operations *	83%	85%	82%	88%
Ratio of mortgage loans, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	93%	94%	91%	97%

	2015			
	Q 4	Q 3	Q 2	Q 1
Weighted average interest rate				
Investment properties				
Fixed rate mortgage loans	4.8%	4.6%	4.6%	4.7%
Variable rate mortgage loans	7.3%	7.3%	7.6%	7.5%
Investment properties and discontinued operations				
Mortgage loans, mortgage bonds, debentures, defeased liability and revolving loan	6.4%	6.3%	6.3%	6.3%
Ratio of mortgage loans compared to carrying value of income-producing properties and discontinued operations *	91%	79%	75%	70%
Ratio of mortgage loans, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	100%	85%	82%	75%

* Excludes the revolving loan and advances from Shelter.

Mortgage Bonds

During the first quarter of 2015, LREIT repaid all outstanding mortgage bonds. The face value of the repaid mortgage bonds was $6,000,000.

Debentures

As of December 31, 2016, LREIT has 5% Series G debentures outstanding with a face value of $24,810,800, due June 30, 2022. Interest is payable on June 30, 2022 and is to be accrued on a non-compounded basis. As of December 31, 2016, $1,798,783 of interest was accrued.

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 such property sales; 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.

Equity - Trust Units

Units Outstanding

Authorized	unlimited
Issued as of,	
- December 31, 2015	20,252,386
- December 31, 2016	20,557,320
- March 13, 2017	20,557,320

As of December 31, 2016, LREIT had 20,557,320 units outstanding. The increase in the number of units outstanding as compared to December 31, 2015 was the result of the redemption of 304,934 deferred units during the second quarter of 2016.

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

RELATED PARTY TRANSACTIONS

Shelter

Asset and Property Management

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

Shelter currently receives a service fee equal to 0.3% of the gross book value of the total assets of the Trust. The gross book value of the total assets is defined as the total assets, as disclosed on the most recently issued Financial Statements, excluding cash, valuation adjustments and defeasance assets. The Services Agreement provides for payment of the fee to occur on a monthly basis, on the last day of each month. The Services Agreement expires December 31, 2024.

Shelter is also the Property Manager for LREIT, pursuant to a Property Management Agreement. Shelter has a direct involvement in the management of all of the investment properties in the portfolio of LREIT and acts as the Property Manager for all of the properties, except for the seniors' housing complexes, where LREIT has retained third party managers to provide on-site management services due to the nature of the operations. In accordance with the terms of the Property Management Agreement, Shelter receives a property management fee equal to 4% of gross receipts and compensation for reimbursable expenses from the investment properties where it acts as Property Manager. In regard to commercial properties, Shelter is also entitled to leasing commissions on new leases of 3% to 5% of base rental payments, leasing commissions on renewal of 1.5% to 2.5% of base rental payments and to tenant improvement and renovation fees equal to 5% of the total cost of improvements and/or renovations. The Property Management Agreement expires December 31, 2024.

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

During 2016, fees payable to Shelter for investment properties included fees payable under the Property Management Agreement and the Service Agreement of $757,104 and $990,458, respectively, compared to $1,187,470 and $1,263,673, respectively, during 2015.

Services fee and renovation fee for Lakewood Townhomes condominium sales program

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

LREIT incurred service fees payable to Shelter of $19,425 for the year ended December 31, 2016 (2015 - nil) in regard to the condominium sales program.

The terms of the condominium sales program, including the service fee and renovation fee, were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the service fee and renovation fee.

Loans

Revolving Loan

LREIT receives advances under a revolving loan facility from 2668921 Manitoba Ltd., the parent company of Shelter. As of December 31, 2016, the revolving loan facility was secured by mortgage charges against the title of the remaining seniors' housing complex and the assignment of a vendor take-back mortgage.

A summary of the terms for the revolving loan facility from October 1, 2014 is provided in the following chart.

Revolving Loan Term				Maximum	Maximum Loan
From	**To**	**Renewal Fees**	**Interest Rate**	**Interest Charge**	**Commitment**
October 1, 2014	June 30, 2015	$ 25,000	12.00%	$ 1,375,000	$ 15,000,000
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.

Effective July 1, 2015, the revolving loan facility from 2668921 Manitoba Ltd. was renewed and increased to a maximum of $18,000,000 at an interest rate of 12% to June 30, 2018, subject to a maximum interest payment of $6,480,000 for the three-year term from July 1, 2015 to June 30, 2018, plus the renewal fee. The renewal encompassed the payment of a $25,000 extension fee.

Advances on the revolving loan are made at the discretion of 2668921 Manitoba Ltd. and the revolving loan is payable on demand.

During 2016, interest on the loan facility amounted to $1,374,123, compared to $1,689,898 during 2015.

During 2016, the Trust received advances of $24,650,000 and repaid $9,450,000 on the revolving loan, resulting in a balance of $22,300,000 at December 31, 2016. Subsequent to December 31, 2016, the Trust received advances of $2,600,000 and repaid nil on the revolving loan, resulting in a balance of $24,900,000 as of the date of this report.

Approval

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

Nelson Ridge Second Mortgage Loan

On March 31, 2016, 2668921 Manitoba Ltd. purchased the Nelson Ridge second mortgage loan in the amount of $4,571,609, inclusive of accrued interest, with an interest rate of 11.75% and maturity date of November 1, 2016.

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. Interest is capitalized monthly.

OPERATING RISKS AND UNCERTAINTIES

An investment in units of LREIT encompasses the risks which are inherent in the ownership and operation of a portfolio of residential and commercial properties, as well as the normal risks which are associated with an investment in a real estate investment trust. In addition to the forward-looking statements provided throughout this MD&A, a summary of key risks is provided below; however, readers should also carefully consider the risks relating to LREIT as disclosed in the Annual Information Form (AIF) which is available at www.sedar.com.

The key risks include the following:

Continuing Operations / Liquidity Risks

Material uncertainties exist as to LREIT's ability to remain a going concern due to various factors, including the Trust's concentration of investment properties in Fort McMurray; the deterioration of the Fort McMurray rental apartment market over the past several years and, in particular, the significant deterioration that occurred as a result of the decline in oil prices that began in 2014; 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.

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, is continuing its divestiture program and cost reduction measures, marketing initiatives and other efforts to improve operating results. In addition, the Trust is working diligently to accommodate the increase in demand for rental housing from displaced residents who lost their homes in the wildfire and workers engaged in the Fort McMurray rebuilding effort.

Continuation of 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 to 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 is highly dependent on the timing and extent of a recovery in oil sands development activity, and which in the near-term is dependent on the extent of economic activity associated with the post-fire rebuild of Fort McMurray; 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.

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.

Concentration of the Portfolio of LREIT in One Market

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

At December 31, 2016, there were 17 properties in the real estate portfolio of LREIT, 13 of which were located in Fort McMurray, Alberta. The 13 properties in Fort McMurray comprise a total of 1,083 suites, or 85% of the total suites in the investment property portfolio. The 13 properties have an aggregate carrying value of $217,281,874, which represents approximately 95% of the total aggregate carrying value of the investment property portfolio as at December 31, 2016.

The Fort McMurray properties, excluding one property classified as investment property held for sale, accounted for 72% of investment property revenue and 66% of net operating income during 2016.

Financing

General

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

The decline in oil prices has resulted in a tightening of mortgage lending conditions for properties located in Fort McMurray.

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

Loan Defaults

Failure to comply with debt service obligations and debt covenants are considered to be events of default that allow LREIT's lenders to accelerate payment of the mortgage loans and/or enforce their security in accordance with the underlying financing agreements.

As of December 31, 2016, the Trust is current with respect to all debt service payments. However, the lender of five mortgage loans on eight properties with an aggregate principal balance of $65,119,595 that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain in default. As a result of the lender's position, the financial statements as at December 31, 2016 reflect such mortgage loans 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.

Additional details regarding the mortgage loans in default and the actions taken by management to remedy the situation are discussed in the "Liquidity and Capital Resources" section of this report.

Notwithstanding the progress made with respect to LREIT's debt restructuring initiatives, there is a risk that certain lenders may be unwilling to participate in the restructuring of the Trust's debt to the degree or for the duration necessary to sustain operations. In such an event, the lender(s) could take action against LREIT and the indebted properties, such as calling for the acceleration of payments on the mortgage loans and/or enforcing their security in accordance with the underlying financing agreements.

Revolving Loan Facility From 2668921 Manitoba Ltd.

The financial capacity of LREIT to continue operations is partially dependent on the ongoing renewal of the revolving loan facility from 2668921 Manitoba Ltd. which is subject to ongoing regulatory approval and the willingness/ability of 2668921 Manitoba Ltd. to advance funds, as required. The revolving loan is a demand loan and as such 2668921 Manitoba Ltd. can request repayment of the loan at any time. The periodic deferral of interest payments on the revolving loan by LREIT may be necessary depending on the cash requirements of the Trust.

Credit Support from Shelter

Shelter has provided LREIT with interim funding on a periodic basis. The interim funding has been provided in the form of interest-free advances and deferred service and property management fees.

The continuation of interim funding from Shelter may be necessary to ensure the ongoing operations of LREIT pending the generation of cash inflows from other sources and the cash requirements of the Trust.

Divestiture Program

Detailed information with respect to the Divestiture Program is provided in the "Analysis of Cash Flows - Investing Activities" and the "Overview of Operations and Investment Strategy" sections of this report.

Current divestiture activities focus on the sale of the remaining seniors' housing complex, the property classified as held for sale, the Lakewood Townhomes Condominium Sales Program and other properties with consideration of the overall debt reduction requirements of the Trust.

There can be no assurance that LREIT will complete divestitures under the time frame or to the extent which is necessary to sustain operations for the foreseeable future.

Insurance Risk

LREIT takes steps to ensure that it has a level of property, comprehensive general liability, business interruption and other insurance coverage that is prudent for its business operations. These steps include consultations with insurance industry experts. However, there can be no guarantee that LREIT will be fully covered in regard to any specific loss it might incur.

In May 2016, a wildfire developed in Fort McMurray, Alberta which resulted in the evacuation of the entire city of Fort McMurray. LREIT owns thirteen residential properties in Fort McMurray, comprising a total of 1,083 suites or 85% of its total suites in the investment property portfolio. None of LREIT's properties incurred structural damage as a result of the wildfire; however, all of the Fort McMurray properties sustained smoke damage to varying degrees. It is anticipated that the insurance coverage of LREIT will be sufficient to cover all restoration costs and the rental loss incurred as a result of the wildfire; however, there remains a risk that proceeds of insurance, or timing of receipt thereof, may be inadequate to fully compensate LREIT for all of the losses associated with the wildfire.

Credit Risk

Credit risk for LREIT arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The maximum exposure to this credit risk is equal to the carrying value of the amounts receivable. LREIT strives to mitigate this risk of credit loss by reviewing tenants' covenants, by obtaining security deposits whenever permitted by legislation and by limiting its exposure to any one tenant. The failure of LREIT's tenants to pay LREIT amounts owing on a timely basis or at all would have an adverse effect on LREIT's financial condition.

In addition, credit risk arises for LREIT from the fact that LREIT continues to guarantee certain debt assumed by purchasers in connection with past dispositions of properties by LREIT. LREIT will remain liable until such debts are extinguished or the lenders agree to release LREIT's covenants. At December 31, 2016, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to this credit risk, is $29,312,604 (December 31, 2015 - $45,382,027) which expires between 2017 and 2022 (December 31, 2015 - expires between 2016 and 2022). There have been no defaults by the primary obligors for debts on which LREIT has provided its guarantees.

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

CRITICAL ACCOUNTING ESTIMATES

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

Financial Statement items which encompass estimates include the following:

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

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

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

- the determination of the amount of temporary differences, the timing of reversal and the tax rate to be used in calculating deferred income tax assets and liabilities are based on estimates; and

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

CHANGES TO SIGNIFICANT ACCOUNTING POLICIES

The Financial Statements are based on IFRS standards issued and effective as of the date of this report.

Future Changes In Accounting Policies

The following new or amended standards have been issued by the International Accounting Standards Board. The new standards are not expected to have an impact on shareholders' equity or net income, but may have a presentation impact on the financial statements.

- 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.

- IFRS 15 - Revenue form 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 form 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.

- IFRS 16 - Leases replaces IAS 17 - Leases and requires lessees to accout 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 period beginning on or after January 1, 2019, with earlier adoption permitted. LREIT's leasing activity is primarily comprised of leasing at Investment Properties whereby residential units are leased 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.

Adoption of Accounting Standards

Amendments to IAS 1 - Presentation of Financial Statements ("IAS 1"): Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify: the materiality requirements in IAS 1; that specific line items in the statement(s) of profit or loss and other comprehensive income ("OCI") and the statement of financial position may be disaggregated; that entities have flexibility as to the order in which they present the notes to the financial statements; and that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after January 1, 2016, with early adoption permitted.

These amendments did not result in a material impact to these consolidated financial statements.

TAXATION

Taxation of LREIT

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

Legislation relating to the taxation of specified investment flow-through trusts ("SIFT" trusts) was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2016, are referred to as the "SIFT Rules". LREIT became a SIFT trust and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, subject to the REIT Exception (discussed below), distributions of income from a SIFT trust are not deductible in computing a SIFT trust's taxable income, and a SIFT trust is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

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

The REIT Exception is applied on an annual basis. Previously, LREIT did not qualify for the REIT Exception and therefore was subject to the SIFT Rules in 2011 and 2012. Prior to the end of 2012, LREIT disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of certain non-qualifying properties and other transactions, LREIT qualified for the REIT Exception in 2013, 2014, 2015 and 2016.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of LREIT. The determination as to whether LREIT qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that LREIT will qualify for the REIT Exception in 2017 and subsequent years. There can be no assurance that LREIT will qualify for the REIT Exception and that LREIT will not be subject to income taxes imposed by the SIFT Rules in 2017 or any subsequent year.

If LREIT qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to LREIT during that year, and LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, LREIT intends to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation.

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

Taxation of Unitholders

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

The cash distributions paid to the Unitholders since the inception of LREIT as a real estate investment trust in September 2002, have exceeded the income of LREIT, as calculated for income tax purposes, at such time. As a result, all of the distributions paid by LREIT since inception, have represented a reduction in adjusted cost base of the units, with the exception of the special distributions paid by LREIT in December 2009, December 2010, December 2013 and December 2015.

If LREIT does not qualify for the REIT Exception, distributions from LREIT which would otherwise have been ordinary income will be characterized as dividends in addition to being subject to tax in LREIT at rates similar to the combined federal and provincial corporate tax rates. Distributions to Canadian resident individuals will be deemed to be "eligible dividends", qualifying for the enhanced dividend tax credit.

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

2016 Tax Considerations

The sales of Beck Court and Willowdale Gardens resulted in capital gains of approximately $6,800,000 and $4,300,000 respectively and recaptured depreciation of approximately $1,000,000 and $400,000 respectively. The sales of Elgin Lodge and the condominium unit at Lakewood Townhomes resulted in capital losses of approximately $5,200,000. Consequently, for 2016, the Trust's estimated net capital gain and recaptured depreciation for tax purposes were approximately $5,900,000 and $1,400,000 respectively. The foregoing income for tax purposes was fully offset by the Trust's losses for tax purposes from rental operations such that a distribution of taxable income to the Unitholders was not required in 2016.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Disclosure controls and procedures ("DC&P") are designed to provide reasonable assurance that information required to be disclosed by the Trust is recorded, processed, summarized and reported within the time periods specified under Canadian securities law, and include controls and procedures designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as to allow timely decisions regarding required disclosure.

In accordance with National Instrument 51-109 - Certification of Disclosure in Issuers' Annual and Interim Filings, the CEO and CFO of LREIT have evaluated, or caused to be evaluated under their supervision, the effectiveness of DC&P as at December 31, 2016. Based on the evaluation performed, the CEO and CFO have concluded that the DC&P of the Trust are appropriately designed and were operating effectively as at December 31, 2016.

During 2016, there were no changes to LREIT's DC&P. LREIT continuously reviews the design of the DC&P in order to provide reasonable assurance that material information required to be disclosed by the Trust is recorded, processed, summarized and reported within the time periods specified under Canadian securities law, as defined in National Instrument 51-109 - Certification of Disclosure in Issuers' Annual and Interim Filings.

Internal Control over Financial Reporting

LREIT's internal control over financial reporting ("ICFR") is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Readers are cautioned, however, that a control system can only provide reasonable, not absolute, assurance that the objectives of the control system are achieved. Due to the inherent limitations in all control systems, an evaluation of controls cannot provide absolute assurance that all control issues, including instances of fraud, if any, have been detected. Inherent limitations include the possibility that the assumptions and judgments of management could ultimately prove to be incorrect under varying conditions and circumstances; or that isolated errors could prove to have a significant impact on the reliability of information.

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

In accordance with National Instrument 51-109 - Certification of Disclosure in Issuers' Annual and Interim Filings, the CEO and CFO of LREIT have evaluated, or caused to be evaluated under their supervision, the effectiveness of ICFR as at December 31, 2016. Based on the evaluation performed, the CEO and CFO have concluded that the ICFR of the Trust are appropriately designed and were operating effectively as at December 31, 2016. The evaluation was performed in accordance with the Committee of Sponsoring Organizations of the Treadway Commission ("2013 COSO") control framework.

During 2016, no changes were made to the design of the internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the effectiveness of the internal control system.

ADDITIONAL INFORMATION

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

APPROVAL BY TRUSTEES

The content of the 2016 Annual Report of Lanesborough Real Estate Investment Trust and the delivery of the report to the Unitholders has been approved by the Trustees.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
March 13, 2017

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

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

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

"Gino Romagnoli"

Gino Romagnoli
Chief Executive Officer

"Gary Benjaminson"

Gary Benjaminson
Chief Financial Officer

March 13, 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, 2016 and 2015 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, 2016 and 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

2500-201 Portage Avenue, Winnipeg, Manitoba, R3B 3K6, Phone: (204) 775-4531, 1 (877) 500-0795

MNP LLP

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, 2016 has incurred a loss before discontinued operations of $1,264,483 during the year ended December 31, 2016 and, as at that date, has a working capital deficit of $1,333,161 and is in breach of certain debt covenants. These conditions, along with other matters as set forth in Note 2, indicate the existence of a material uncertainty that may cast significant doubt about the Trust's ability to continue as a going concern.

MNP LLP

Winnipeg, Manitoba
March 13, 2017

Chartered Professional Accountants

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31 2016	December 31 2015
ASSETS		
Non-current assets		
Investment properties (Note 5)	**$198,099,131**	$216,434,958
Loan receivable (Note 7)	**4,000,000**	-
Restricted cash (Note 8)	**2,650,066**	2,850,478
Total non-current assets	**204,749,197**	219,285,436
Current assets		
Cash	**706,768**	407,513
Rent and other receivables (Note 9)	**394,131**	419,815
Deposits and prepaids (Note 10)	**780,126**	1,037,538
Defeasance assets (Note 11)	**-**	2,580,343
	1,881,025	4,445,209
Assets held for sale (Note 12)	**38,772,107**	54,794,159
Total current assets	**40,653,132**	59,239,368
TOTAL ASSETS	**$245,402,329**	$278,524,804
LIABILITIES AND EQUITY		
Liabilities		
Non-current liabilities		
Long-term debt (Note 13)	**$110,597,313**	$122,080,890
Total non-current liabilities	**110,597,313**	122,080,890
Current liabilities		
Trade and other payables (Note 14)	**3,207,534**	1,735,601
Current portion of long-term debt (Note 13)	**130,720,198**	141,300,008
Deposits from tenants	**1,529,110**	1,510,790
	135,456,842	144,546,399
Liabilities held for sale (Note 12)	**3,953,317**	14,772,534
Total current liabilities	**139,410,159**	159,318,933
Total liabilities	**250,007,472**	281,399,823
Total deficit	**(4,605,143)**	(2,875,019)
TOTAL LIABILITIES AND EQUITY	**$245,402,329**	$278,524,804

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 2016	2015
Rentals from investment properties	**$ 18,328,212**	$ 30,215,224
Property operating costs	**10,513,925**	14,063,358
Net operating income	**7,814,287**	16,151,866
Interest income	**149,576**	86,998
Interest expense (Note 15)	**(19,076,586)**	(23,272,205)
Trust expense	**(1,883,331)**	(1,816,996)
Gain (loss) on sale of investment property (Note 12) (Note 5)	**86,167**	(100,711)
Fair value adjustments (Note 16)	**11,645,404**	(87,443,849)
Loss before discontinued operations	**(1,264,483)**	(96,394,897)
Loss from discontinued operations (Note 12)	**(465,641)**	(2,370,746)
Loss and comprehensive loss	**$ (1,730,124)**	$ (98,765,643)
Loss per unit before discontinued operations:		
Basic and diluted	**$ (0.060)**	$ (4.558)
Loss per unit from discontinued operations:		
Basic and diluted	**$ (0.022)**	$ (0.112)
Loss per unit:		
Basic and diluted	**$ (0.082)**	$ (4.670)

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 2016	2015
Issued capital (Note 18)		
Balance, beginning of year	**$ 125,641,529**	$ 116,841,529
Units issued on payment of distributions	**-**	8,800,000
Balance, end of year	**125,641,529**	125,641,529
Contributed surplus		
Balance, beginning and end of year	**17,027,907**	17,027,907
Cumulative (deficit) earnings		
Balance, beginning of year	**(62,394,420)**	36,371,223
Loss and comprehensive loss	**(1,730,124)**	(98,765,643)
Balance, end of year	**(64,124,544)**	(62,394,420)
Cumulative distributions to unitholders		
Balance, beginning of year	**(83,150,035)**	(74,350,035)
Distributions declared	**-**	(8,800,000)
Balance, end of year	**(83,150,035)**	(83,150,035)
Total deficit	**$ (4,605,143)**	$ (2,875,019)

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 2016	2015
Operating activities		
Loss and comprehensive loss	**$ (1,730,124)**	$ (98,765,643)
Adjustments to reconcile income to cash flows		
Fair value adjustments (Note 16)	**(11,645,404)**	87,443,849
Fair value adjustment - Property and equipment (Note 12)	**1,051,899**	2,794,716
(Gain) loss on sale of properties	**(139,427)**	100,711
Accrued rental revenue	**60,930**	324,258
Gain on debenture repurchases	**-**	(11,654)
Interest income	**(149,576)**	(86,998)
Interest received	**135,593**	90,089
Interest expense	**19,891,238**	24,281,823
Interest paid	**(11,301,370)**	(21,214,950)
Cash used in operations	**(3,826,241)**	(5,043,799)
(Increase) decrease in rent and other receivables	**(38,610)**	633,638
Decrease in deposits and prepaids	**280,063**	151,199
Decrease in tenant deposits	**(254,838)**	(1,013,211)
Increase (decrease) in trade and other payables	**585,246**	(1,220,051)
	(3,254,380)	(6,492,224)
Cash provided by (used in) financing activities		
Proceeds of mortgage loan financing	**-**	39,800,000
Repayment of mortgage loans on refinancing	**(5,800,000)**	(36,614,684)
Repayment of interest rate swap liability	**-**	(1,601,000)
Redemption of mortgage bonds	**-**	(6,000,000)
Repayment of long-term debt	**(4,598,670)**	(7,221,562)
Prepayment of mortgage loans	**(12,956,865)**	(3,000,000)
Proceeds of revolving loan facility	**24,650,000**	9,804,000
Repayment of revolving loan facility	**(9,450,000)**	(17,204,000)
Proceeds of Shelter Canadian Properties Limited advances	**650,000**	15,615,000
Repayment of Shelter Canadian Properties Limited advances	**(650,000)**	(15,615,000)
Expenditures on transaction costs	**(698,291)**	(3,206,208)
Debentures purchased and cancelled under normal course issuer bid	**-**	(51,346)
Repayment of defeased liability (Note 11)	**(2,499,289)**	-
	(11,353,115)	(25,294,800)
Cash provided by (used in) investing activities		
Capital expenditures on investment properties	**(1,609,115)**	(697,896)
Capital expenditures on investment properties held for sale	**(29,868)**	(171,356)
Capital expenditures on property and equipment	**(453,533)**	(129,737)
Decrease in defeasance assets (Note 11)	**2,580,343**	151,604
Proceeds of sale	**13,746,212**	30,818,514
Change in restricted cash	**202,036**	659,338
	14,436,075	30,630,467
Cash decrease	**(171,420)**	(1,156,557)
Add (deduct) decrease (increase) in cash from discontinued operations (Note 12)	**470,675**	(399,665)
	299,255	(1,556,222)
Cash, beginning of year	**407,513**	1,963,735
Cash, end of year	**$ 706,768**	$ 407,513

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

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

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, 2016 and 2015 ("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 13, 2017.

The Financial Statements of the Trust reflect the operations of the Trust, LREIT Holdings 32 Corporation and LREIT Holdings 39 Corporation, which are wholly owned operating subsidiaries under its control. The Financial Statements have been prepared on a historical cost basis except for investment properties 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 deterioration of the Fort McMurray rental apartment market that occurred as a result of the decline in oil prices that began in 2014; 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.

The Trust incurred a loss before discontinued operations of $1,264,483 for the year ended December 31, 2016 (2015 - a loss of $96,394,897). The Trust incurred a cash deficiency from operating activities of $3,254,380 for the year ended December 31, 2016 (2015 - $6,492,224). 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 $10,643,857 for the year ended December 31, 2016 (2015 - $17,918,983).

In addition, the Trust has a working capital deficit of $1,333,161 as at December 31, 2016 (December 31, 2015 - working capital of $115,955).

2 Basis of presentation and continuing operations (continued)

As of December 31, 2016, the Trust is current with respect to all debt service payments. However, the lender of five mortgage loans on eight properties with an aggregate principal balance of $65,119,595 that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain in default. As a result of the lender's position, the financial statements as at December 31, 2016 reflect such mortgage loans 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 on the mortgage loans in default as of the date of this report, the Trust would be unable to satisfy these obligations with its current resources.

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 with consideration of the debt reduction 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 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 accomodations 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.

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

2 Basis of presentation and continuing operations (continued)

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 13, 2017.

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.

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.

3 Significant accounting policies (continued)

(b) Investment Properties (continued)

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

(c) Property and Equipment

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

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

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

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

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

(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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

3 Significant accounting policies (continued)

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

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

3 Significant accounting policies (continued)

(g) Mortgage loans, mortgage bonds, and debentures

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

(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.

3 Significant accounting policies (continued)

(j) Revenue recognition (continued)

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

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

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

A property is regarded as sold and the gain or loss on sale is recognized when the significant risks and 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.

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

3 Significant accounting policies (continued)

(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.

(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:

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

3 Significant accounting policies (continued)

(n) Financial instruments (continued)

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

The Trust assesses impairment of all financial assets, except those classified as 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.

(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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

3 Significant accounting policies (continued)

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

(ii) IFRS 15 - Revenue from Contracts with Customers

IFRS 15 - Revenue form 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 form 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 accout 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 period beginning on or after January 1, 2019, with earlier adoption permitted. LREIT's leasing activity is primarily comprised of leasing at Investment Properties whereby residential units are leased 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.

Management is still in the process of determining the impact of these standards on the financial statements and does not anticipate a material impact.

(p) Adoption of accounting standards

Amendments to IAS 1 - Presentation of Financial Statements ("IAS 1"): Disclosure Initiative

The amendments to IAS 1 clarify, rather than significantly change, existing IAS 1 requirements. The amendments clarify: the materiality requirements in IAS 1; that specific line items in the statement(s) of profit or loss and other comprehensive income ("OCI") and the statement of financial position may be disaggregated; that entities have flexibility as to the order in which they present the notes to the financial statements; and that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement(s) of profit or loss and OCI. These amendments are effective for annual periods beginning on or after January 1, 2016, with early adoption permitted.

These amendments did not result in a material impact to these consolidated financial statements.

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:

- 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 2016 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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

4 Significant accounting judgments, estimates and assumptions (continued)

(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.

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	
	2016	2015
Balance, beginning of year	$216,434,958	$406,619,555
Additions - capital expenditures	1,609,115	697,896
Fair value adjustments (Note 16)	9,278,305	(92,005,738)
Dispositions	(277,152)	-
Investment properties transferred to held for sale (Note 12)	(28,946,095)	(98,876,755)
Balance, end of year	$198,099,131	$216,434,958

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 outflow 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.

During 2015, the Trust did not sell any property classified as investment properties, however, $98,876,755 was transferred to investment properties held for sale.

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, 2016

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 assumption is the capitalization rates which are based on reports from external knowledgeable property valuators. The capitalization rate reports provide a range of rates for various geographic regions and for various types and qualities of properties within each region.

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

	December 31 2016		December 31 2015	
	Low	High	Low	High
Fort McMurray	8.25 %	8.25 %	8.00 %	8.00 %
Yellowknife	N/A	N/A	6.75 %	6.75 %
Other	5.25 %	7.50 %	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 inflation rates applied to the first year cash flows, and the discount rate applied over the useful life of the investment property.

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

	December 31 2016		December 31 2015	
	Low	High	Low	High
Fort McMurray	10.25 %	10.25 %	10.00 %	10.00 %
Yellowknife	N/A	N/A	8.75 %	8.75 %
Other	7.25 %	9.50 %	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 (2015 - Beck Court, Willowdale Gardens and Lakewood Townhomes).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

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

(iv) *External appraisals and reports.* Independent valuations on all investment properties are carried out in order to support and assist in determination of fair value of each investment property. The most recent external appraisals for the 16 investment properties as at December 31, 2016 were obtained as follows: 2 properties representing 19.5% of the total carrying value of the investment properties in 2016; 4 properties representing 39.1% of the total carrying value of the investment properties in 2015; 1 properties representing 6.5% of the total carrying value of investment properties in 2014; 2 properties representing 26.1% of the total carrying value of investment properties in 2013; 7 properties representing 8.8% of the total carrying value of investment properties in 2012.

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

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

The capitalized net operating income method and discounted cash flow method, as noted above, would be categorized as level 3 valuation 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 inputs used in the valuation at December 31, 2016 were:

Description	Input
Inferred normalized net operating income	$18,817,552
Weighted average capitalization rate	8.20%
Long-term growth rate	2.00%
Weighted average discount rate	10.20%

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

8 Restricted cash

	December 31 2016	December 31 2015
Tenant security deposits	$ 1,522,458	$ 1,497,480
Reserves required by mortgage loan agreements	1,127,608	1,352,998
	$ 2,650,066	$ 2,850,478

9 Rent and other receivables

	December 31 2016	December 31 2015
Rent receivable	$ 303,373	$ 98,854
Less: allowance for uncollectible accounts	(109,748)	(31,502)
	193,625	67,352
Other receivables	156,836	247,863
Deferred rent receivable	43,670	104,600
	$ 394,131	$ 419,815

10 Deposits and prepaids

	December 31 2016	December 31 2015
Deposits		
Property tax deposits	$ 182,037	$ 543,599
Other	4,135	14,509
	186,172	558,108
Prepaid expenses	593,954	479,430
	$ 780,126	$ 1,037,538

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

11 Defeasance assets and defeased liability

In conjunction with the sale of Woodlily Court on September 1, 2010, an existing $2,818,509 mortgage loan payable was defeased ("Defeased Liability"). The Trust purchased Government of Canada bonds, Government of Canada treasury bills and Canada mortgage bonds ("Defeasance Assets") in the amount of $3,338,341 and pledged the Defeasance Assets as security to the debt holder. The Defeasance Assets matured on June 1, 2016 and were used to extinguish the Defeased Liability on July 1, 2016.

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

	Recorded as	Year Ended December 31 2016	2015
Interest income on Defeasance Assets	Interest income	$ 22,095	$ 54,693
Interest expense on Defeased Liability	Interest expense	(69,840)	(143,000)
Amortization of transaction costs	Interest expense	(2,759)	(10,784)
		$ (50,504)	$ (99,091)

12 Assets and liabilities of properties held for sale

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

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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

	December 31 2016	December 31 2015
ASSETS		
Investment properties held for sale (a)	$ 31,343,062	$ 31,960,000
Assets in discontinued operations		
Property and equipment (b)	7,422,485	22,350,000
Cash (bank indebtedness)	(47,318)	423,356
Restricted cash	18,795	20,419
Rent and other receivables	24,502	7,152
Deposits, prepaids and other	10,581	33,232
	7,429,045	22,834,159
Assets held for sale	$ 38,772,107	$ 54,794,159
LIABILITIES		
Liabilities in discontinued operations		
Long term debt (c)	$ 3,712,306	$ 14,196,924
Trade and other payables	226,406	287,847
Deposits from tenants	14,605	287,763
Liabilities held for sale	$ 3,953,317	$ 14,772,534

Income information relating to discontinued operations are as follows:

	Year Ended December 31 2016	2015
Rental income	$ 4,488,348	$ 5,362,196
Property operating expenses	3,140,698	3,928,608
Net operating income	1,347,650	1,433,588
Interest expense (d)	(814,652)	(1,009,618)
Gain on sale	53,260	-
Fair value adjustment	(1,051,899)	(2,794,716)
Loss from discontinued operations	$ (465,641)	$ (2,370,746)

Cash flow information relating to discontinued operations are as follows.

	Year Ended December 31 2016	2015
Cash inflow from operating activities	$ 271,130	$ 526,826
Cash outflow from financing activities	(4,672,304)	(26,981)
Cash inflow (outflow) from investing activities	3,930,499	(100,180)
Increase (decrease) in cash from discontinued operations	$ (470,675)	$ 399,665

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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12 Assets and liabilities of properties held for sale (continued)

(a) Investment properties held for sale

	December 31 2016	December 31 2015
Beck Court	$ -	$ 22,975,000
Willowdale Gardens	-	8,985,000
Woodland Park	31,343,062	-
	$ 31,343,062	$ 31,960,000

	Year Ended December 31 2016	Year Ended December 31 2015
Balance, beginning of year	$ 31,960,000	$ -
Investment properties transferred to held for sale (Note 5)	28,946,095	98,876,755
Additions - capital expenditures	29,868	171,356
Fair value adjustments (Note 16)	2,367,099	4,561,889
Dispositions	(31,960,000)	(71,650,000)
Balance, end of year	$ 31,343,062	$ 31,960,000

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

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

(a) Investment properties held for sale (continued)

During 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	9,000,000	(10,920)	5,948,114	(8,985,000)	4,080
	$ 32,000,000	$ (19,014)	$ 9,420,067	$ (31,960,000)	$ 20,986

During 2015, the Trust sold 156/204 East Lake Blvd. on April 1, 2015 and Colony Square on November 1, 2015:

Property	Selling Price	Selling Costs and Other	Net Cash Proceeds after debt repaid/assumed	Carrying Value	Gain(Loss) on Sale
156/204 East Lake Blvd.	$ 4,000,000	$ (301,215)	$ 2,441,375	$ (3,900,000)	$ (201,215)
Colony Square	68,710,000	(859,496)	28,377,139	(67,750,000)	100,504
	$ 72,710,000	$ (1,160,711)	$ 30,818,514	$ (71,650,000)	$ (100,711)

(b) Property and equipment

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	393,198	28,752	(139,195)	(38,898)	243,857
	26,407,110	453,533	(18,964,772)	(941,108)	6,954,763
Fair value adjustments	(3,116,002)	(1,051,899)	4,635,623	-	467,722
	$ 23,291,108	$ (598,366)	$ (14,329,149)	$ (941,108)	$ 7,422,485

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

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

(b) Property and equipment (continued)

December 31 2015	Cost, Beginning of Period	Additions	Disposals	Accumulated Amortization	Carrying Value
Land	$ 4,132,100	$ -	$ -	$ -	$ 4,132,100
Buildings and improvements	21,754,064	127,748	-	(902,210)	20,979,602
Furniture, equipment and appliances	391,209	1,989	-	(38,898)	354,300
	26,277,373	129,737	-	(941,108)	25,466,002
Fair value adjustments	(321,286)	(2,794,716)	-	-	(3,116,002)
	$ 25,956,087	$ (2,664,979)	$ -	$ (941,108)	$ 22,350,000

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.

(c) Long term debt

	December 31 2016	December 31 2015
Secured debt		
Mortgage loans	$ 3,716,431	$ 14,199,674
Unamortized transaction costs	(4,125)	(2,750)
Total long term debt	$ 3,712,306	$ 14,196,924

The mortgage loan is due September 30, 2017 and is subject to covenants, including debt service coverage requirements. As of December 31, 2016, the Trust was in compliance with all covenant requirements.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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12 Assets and liabilities of properties held for sale (continued)

(d) Interest expense

	Year Ended December 31 2016	2015
Mortgage loan interest	$ 747,221	$ 930,644
Amortization of transaction costs	67,431	78,974
	$ 814,652	$ 1,009,618

(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 2016	2015
Property and equipment	$ 699,545	$ 4,965,827
Transaction costs	$ 12,954	$ 199,659

Unused tax losses expiring in:

	2016	2015
2028	$ -	$ 75,077
2029	-	447,270
2036	26,601	-
	$ 26,601	$ 522,347

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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13 Long-term debt

	December 31 2016	December 31 2015
Secured debt		
Mortgage loans (a)	$ 192,674,077	$ 230,897,904
Debentures (b)	24,810,800	24,810,800
Defeased liability (Note 11)	-	2,520,859
Revolving loan from 2668921 Manitoba Ltd. (c)	22,300,000	7,100,000
Total secured debt	239,784,877	265,329,563
Accrued interest payable	2,610,724	1,139,300
Unamortized transaction costs		
Mortgage loans	(1,047,413)	(2,352,726)
Debentures	-	(685,797)
Defeased liability	-	(2,759)
Revolving loan from 2668921 Manitoba Ltd.	(30,677)	(46,683)
Total unamortized transaction costs	(1,078,090)	(3,087,965)
	241,317,511	263,380,898
Less current portion		
Mortgage loans	(106,278,394)	(131,925,665)
Defeased liability	-	(2,520,859)
Revolving loan from 2668921 Manitoba Ltd.	(22,300,000)	(7,100,000)
Accrued interest payable	(2,610,724)	(1,139,300)
Unamortized transaction costs	468,920	1,385,816
Total current portion	(130,720,198)	(141,300,008)
	$ 110,597,313	$ 122,080,890

Current portion of unamortized transaction costs		
Mortgage loans	$ 438,243	$ 1,083,858
Debentures	-	252,516
Defeased liability	-	2,759
Revolving loan	30,677	46,683
	$ 468,920	$ 1,385,816

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

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

	Mortgage Loans				
Year ending December 31	Normal Principal Installments	Principal Maturities	Other Debt (1)	Total Long-term Debt	Weighted average interest rate of long-term debt
2017	$ 3,133,570	$ 56,248,752	$ -	$ 59,382,322	6.5 %
2018	1,229,571	92,438,219	22,300,000	115,967,790	5.6 %
2019	385,225	27,302,754	-	27,687,979	5.0 %
2020	261,845	-	-	261,845	4.4 %
Thereafter	1,303,667	10,370,474	24,810,800	36,484,941	4.8 %
	$ 6,313,878	$ 186,360,199	$ 47,110,800	$ 239,784,877	5.6 %

(1) Other debt includes a revolving loan with balance outstanding of $22,300,000, maturing June 30, 2018, and Series G debentures with balance outstanding of $24,810,800, due on June 30, 2022.

A forbearance agreement and four loan agreements have been negotiated with the lenders for five mortgage loans affecting 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 February 28, 2018. Over the period from December 31, 2016 to maturity, $2,612,064 of accrued interest will be incurred and added to the outstanding mortgage principal.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

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

(a) Mortgage loans

	Weighted average interest rates		Amount	
	December 31 2016	December 31 2015	December 31 2016	December 31 2015
First mortgage loans				
Fixed rate	5.1%	4.6%	$ 80,471,688	$ 125,497,028
Variable rate	6.1%	6.9%	107,209,774	87,994,589
Total first mortgage loans	5.6%	5.5%	$ 187,681,462	$ 213,491,617
Second mortgage loans				
Fixed rate	11.8%	11.8%	$ 4,992,615	$ 4,500,000
Variable rate	n/a	10.4%	-	12,906,287
Total second mortgage loans	11.8%	10.7%	$ 4,992,615	$ 17,406,287
All mortgage loans				
Fixed rate	5.5%	4.8%	$ 85,464,303	$ 129,997,028
Variable rate	6.1%	7.3%	107,209,774	100,900,876
Total mortgage loans	5.8%	5.9%	$ 192,674,077	$ 230,897,904

As of December 31, 2016, the Trust was in default of five mortgage loans in the aggregate principal amount of $65,119,595 related to eight properties in its Fort McMurray portfolio.

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

All mortgages which have matured prior to the date of the Financial Statements have been repaid, renewed or refinanced, except for one mortgage loan in forbearance with a balance of $25,170,364 and one mortgage loan with a balance of $3,212,873 that are currently overholding past their maturity dates of February 28, 2017 and March 1, 2017, respectively.

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.

13 Long-term debt (continued)

(b) Debentures

The Series G debentures bear interest at 5.0% (2015 - 9.5%) 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.

On June 22, 2016, the terms of the Series G debentures were amended to extend the maturity date of the debentures to June 30, 2022, to reduce the interest rate for the period commencing June 30, 2016 from 9.5% to 5.0%, and to defer all payments of interest to the amended maturity date.

Included in accrued interest payable under current portion of long-term debt at December 31, 2016 is a balance of $1,798,783 (December 31, 2015 - nil) in regard to the deferred interest on the Series G debentures.

The amended terms were considered to be substantially different than the previous terms and the transaction was accounted for as an extinguishment of the original financial liability and the recognition of the new financial liability, resulting in the immediate amortization of $625,180 of transaction costs.

On June 30, 2015, LREIT initiated a normal course issuer bid for the Series G debentures under which, the Trust is entitled to purchase up to $2,470,080 of Series G debentures. The normal course issuer bid expired on June 29, 2016. During the period from January 1, 2016 to June 29, 2016, the Trust did not purchase any Series G debentures under the normal course issuer bid.

(c) 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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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14 *Trade and other payables*

	December 31 2016	December 31 2015
Accounts payable	$ 2,390,614	$ 798,373
Accrued payables	506,655	588,348
Prepaid rent	310,265	348,880
	$ 3,207,534	$ 1,735,601

15 *Interest expense*

	Year Ended December 31 2016	2015
Mortgage loan interest	$ 11,878,008	$ 15,772,616
Revolving loan interest	1,374,123	1,689,898
Change in fair value of interest rate swap	-	159,295
Mortgage bond interest	-	123,616
Accretion of mortgage bonds	-	213,774
Debenture interest	1,798,783	2,357,026
Amortization of transaction costs	4,025,672	2,955,980
	$ 19,076,586	$ 23,272,205

16 *Fair value adjustments*

Fair value adjustments consist of the following:

	Year Ended December 31 2016	2015
Fair value adjustments - investment properties (Note 5)	$ 9,278,305	$(92,005,738)
Fair value adjustments - investment properties held for sale (Note 12)	2,367,099	4,561,889
	$ 11,645,404	$(87,443,849)

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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17 Per unit calculations

	Year Ended December 31 2016	Year Ended December 31 2015
Loss before discontinued operations	$ (1,264,483)	$ (96,394,897)
Loss from discontinued operations	(465,641)	(2,370,746)
Loss	$ (1,730,124)	$ (98,765,643)

	Year Ended December 31 2016	Year Ended December 31 2015
Weighted average number of units:		
Units	20,466,506	20,252,386
Deferred units	682,390	896,510
Total basic and diluted	21,148,896	21,148,896

18 Units

	Year Ended December 31, 2016		Year Ended December 31, 2015	
	Units	Amount	Units	Amount
Outstanding, beginning of year	20,252,386	$125,641,529	20,252,386	$116,841,529
Units issued on:				
Payment of distribution	-	-	67,692,308	8,800,000
Consolidation of units	-	-	(67,692,308)	-
Redemption of deferred units (Note 20)	304,934	-	-	-
Outstanding, end of year	20,557,320	$125,641,529	20,252,386	$125,641,529

Units issued on payment of distributions
As a result of realized capital gains, the Trust paid "special" distributions in the form of additional units on December 31, 2015. The distributions were followed by an immediate consolidation of units resulting in Unitholders holding the same number of units after the distributions as were held prior to the distributions.

19 *Unit option plan*

The Trust may grant options to the Trustees, senior officers and consultants of the Trust. The maximum number of units reserved for issuance under the unit option plan and the deferred unit plan will be limited to 10% of the total number of issued and outstanding units. The Trustees shall set the exercise price at the time that an option is granted under the plan, which exercise price shall not be less than the discounted market price of the units as determined under the policies of the TSX on the date of grant. Options granted to Trustees vest immediately. With the exception of options granted on November 19, 2012, 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-31-16		Year Ended December 31, 2015	
	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price
Outstanding, beginning of year	446,000	$ 0.71	466,000	$ 0.72
Cancelled, July 14, 2015	-	-	(20,000)	1.11
Cancelled, July 10, 2016	(20,000)	0.60	-	-
Cancelled, July 10, 2016	(10,000)	0.65	-	-
Cancelled, December 12, 2016	(176,000)	0.34	-	-
Outstanding, end of year	240,000	$ 0.99	446,000	$ 0.71
Vested, end of year	240,000		446,000	

At December 31, 2016 the following unit options were outstanding:

Exercise price	Options outstanding	Options vested	Expiry date
$ 0.60	40,000	40,000	November 19, 2017
0.65	20,000	20,000	January 15, 2018
1.11	180,000	180,000	May 19, 2019
	240,000	240,000	

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20 Deferred unit plan

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

Deferred units granted to Trustees 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	
	2016	2015
Outstanding and vested, beginning of year	896,510	896,510
Redeemed during the year	(304,934)	-
Outstanding and vested, end of year	591,576	896,510

All deferred units outstanding as of December 31, 2016 were fully vested.

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21 Related party transactions

Related party transactions have occurred in the normal course of operations and are measured at the exchange amount which is the amount established and agreed by the related parties. Shelter is a related party by virtue of the property management agreement and services agreement with the Trust and 2668921 Manitoba Ltd., the parent company to Shelter, is a related party 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 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.

The Trust incurred property management fees payable to Shelter of $757,104 for the year ended December 31, 2016 (2015 - $1,187,470).

Included in trade and other payables at December 31, 2016 is a balance of $92,097 payable to Shelter (December 31, 2015 - $87,442 receivable) in regard to outstanding property management fees.

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 $990,458 for the year ended December 31, 2016 (2015 - $1,263,673).

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21 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 $19,425 for the year ended December 31, 2016 (2015 - nil).

Financing
Revolving loan
On January 1, 2014, the Trust had a $15 Million revolving loan facility from 2668921 Manitoba Ltd. for general operating purposes. The revolving loan facility was increased to $18.0 Million on July 1, 2015 and to $30.0 Million effective November 14, 2016.

A summary of the terms for the revolving loan facility from October 1, 2014 is provided in the following chart.

Revolving Loan Term		Renewal	Interest	Maximum	Maximum Loan
From	To	Fees	Rate	Interest Charge	Commitment
October 1, 2014	June 30, 2015	$ 25,000	12.00 %	$ 1,375,000	$ 15,000,000
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 year ended December 31, 2016, the Trust received advances of $24,650,000 (2015 - $9,804,000) and repaid advances of $9,450,000 (2015 - $17,204,000) against the revolving loan, resulting in a balance of $22,300,000 (December 31, 2015 - $7,100,000). The revolving loan balance is included in current portion of long-term debt.

Interest on the revolving loan of $1,374,123 for the year ended December 31, 2016 (2015 - $1,689,898) is included in interest expense.

21 Related party transactions (continued)

Financing (continued)
Revolving loan (continued)
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.

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 in the amount of $4,992,615, inclusive of accrued interest, with an interest rate of 11.75% and maturity date of November 1, 2016.

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. The amended mortgage loan terms provide for the deferred interest to be capitalized to the principal balance of the mortgage loan.

Shelter advances
During the year ended December 31, 2016, Shelter advanced $650,000 (2015 - $15,615,000) on an interest-free basis as an interim funding measure. The Trust made repayments of $650,000 (2015 - $15,615,000), resulting in an outstanding balance of nil at December 31, 2016 (December 31, 2015 - nil).

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, 2016 was $314,000 (2015 - $564,000).

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

22 Financial instruments and risk management

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

Liquidity risk - defaults
The lender of five mortgage loans on eight properties with an aggregate principal balance of $65,119,595 that were previously in default of debt service payments maintains that there are service fees outstanding with respect to these mortgage loans and that until such fees are paid the loans will remain in default. As a result of the lender's position, the financial statements as at December 31, 2016 reflect such mortgage loans 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 loan. In the event that full repayment is demanded on the mortgage loans in default as of the date of this report, the Trust would be unable to satisfy these obligations 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 accomodations 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 December 31, 2016, the weighted average term to maturity of the fixed rate mortgages on investment properties is 2.4 years (December 31, 2015 - 3.0 years).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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22 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:

December 31, 2016	Long-term Debt Obligations (1) (Note 13)	Other Payables (2)	Total
2017	$ 59,382,322	$ 7,347,368	$ 66,729,690
2018	115,967,790	-	115,967,790
2019	27,687,979	-	27,687,979
2020	261,845	-	261,845
Thereafter	36,484,941	-	36,484,941
	$ 239,784,877	$ 7,347,368	$ 247,132,245

(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 long-term debt due in 2017 would increase to $105,879,797, the total long-term debt due in 2018 would decrease to $96,907,642, the total long-term debt due in 2019 would decrease to $250,652, and the total long-term debt due in 2020 and beyond would remain the same.

(2) 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, 2016 the percentage of fixed rate mortgage loans to total mortgage loans was 44% (December 31, 2015 - 56%).

The Trust has variable rate mortgage loans on investment properties totaling $107,209,774, or 56% of the total mortgage loans at December 31, 2016 (December 31, 2015 - 44%). Should interest rates change by 1%, interest expense would change by $1,072,098 per year.

As at December 31, 2016, the Trust has total mortgage principal maturities on investment properties which mature on or prior to December 31, 2019 of $180,416,421 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 $1,804,164 per year.

With the exception of the interest rate swap arrangement eliminated in the first quarter of 2015, the Trust has not traded in derivative financial instruments.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

22 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:

	December 31 2016	December 31 2015
Rent receivable overdue:		
0 to 30 days	$ 76,506	$ 51,497
31 to 60 days	55,348	4,562
More than 60 days	171,519	42,795
	$ 303,373	$ 98,854

	Year Ended December 31 2016	2015
Balance, beginning of year	$ 31,502	$ 18,789
Amount charged to bad debt expense relating to impairment of rent receivable	126,207	50,998
Amounts written off as uncollectible	(47,961)	(38,285)
Balance, end of year	$ 109,748	$ 31,502
Amount charged to bad debts as a percent of rentals from investment properties	0.69%	0.17%

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, 2016, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is $29,312,604 (December 31, 2015 - $45,382,027) which expires between 2017 and 2022 (December 31, 2015 - expires between 2016 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.

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.

22 Financial instruments and risk management (continued)

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 2016	December 31 2015	December 31 2016	December 31 2015
Financial assets				
Defeasance assets	$ -	$ 2,580,343	$ -	$ -
Restricted cash	2,650,066	2,850,478	2,127,195	2,192,702
Cash	706,768	407,513	706,768	407,513
Rent and other receivables	394,131	419,815	394,131	419,815
Deposits	186,172	558,108	186,172	558,108
Financial liabilities				
Mortgages loans	192,674,077	230,897,904	209,179,279	232,347,987
Debentures	24,810,800	24,810,800	5,830,338	11,901,341
Defeased liability	-	2,520,859	-	-
Trade and other payables	3,207,534	1,735,601	3,207,534	1,735,601
Deposits from tenants	1,529,110	1,510,790	1,529,110	1,510,790

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 mortgage bonds and 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 CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

22 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 3.88% and 4.96%.
- 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.

23 Management of capital

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

	December 31 2016	December 31 2015
Mortgage loans *	$191,626,664	$228,545,178
Debentures *	24,810,800	24,125,003
Revolving loan from 2668921 Manitoba Ltd. *	22,269,323	7,053,317
Deficit	(4,605,143)	(2,875,019)
	$234,101,644	$256,848,479

***** Amounts are inclusive of unamortized transaction costs.

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.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016

23 Management of capital (continued)

The overall capital management strategy addresses the following considerations:

- The equity component of acquired properties is primarily funded from the proceeds of trust units, debentures or other securities of the Trust.
- Mortgage debt financing is arranged to optimise the leveraged returns from the real estate portfolio.
- Total mortgage debt financing is maintained within the overall debt limits as established by the Declaration of Trust. The Declaration of Trust provides for mortgage indebtedness of the Trust up to 75% of the appraised value of all properties.
- Whenever possible, the Trust will utilize fixed rate debt financing.
- Mortgage due dates are structured to reflect the properties being financed and debt maturity dates will be staggered, to the extent possible, in order to reduce refinancing risk.
- The Trust is undertaking a divestiture program targeting the sale of assets 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, 2016

24 Segmented financial information (continued)

Year ended December 31, 2016:

	Investment Properties				
	Fort McMurray	Other	Held for sale and/or sold	Trust	Total
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 12) at December 31, 2016	188,686,260	12,737,785	31,932,743	4,616,496	237,973,284

Year ended December 31, 2015:

	Investment Properties				
	Fort McMurray	Other	Held for sale and/or sold	Trust	Total
Rental revenue	17,052,331	1,935,784	11,227,109	-	30,215,224
Property operating costs	8,090,681	1,119,567	4,853,110	-	14,063,358
Net operating income	8,961,650	816,217	6,373,999	-	16,151,866
Interest income	16,140	2,942	8,913	59,003	86,998
Interest expense	14,787,078	477,026	3,060,997	4,947,104	23,272,205
Income (loss) before discontinued operations	(86,506,837)	(904,747)	(2,281,416)	(6,701,897)	(96,394,897)
Cash from (used in) operating activities	(3,935,625)	316,949	2,484,619	(5,884,993)	(7,019,050)
Cash from (used in) financing activities	3,434,271	(76,570)	(34,253,160)	5,627,640	(25,267,819)
Cash from (used in) investing activities	(341,468)	(280,133)	31,198,002	154,246	30,730,647
Total assets excluding discontinued operations (Note 12) at December 31, 2015	176,920,334	14,059,384	61,651,889	3,059,038	255,690,645

During 2016, one property previously included in the Fort McMurray segment was reclassified as Held for sale. The 2015 segmented financial information has been restated to reflect the reclassification.

25 Commitments

Management Contracts

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

Property	Manager	Term Expiring
Chateau St. Michael's	Integrated Life Care Inc.	October 31, 2017

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.

27 Subsequent events

Sale of condominium unit at Lakewood Townhomes
Subsequent to December 31, 2016, LREIT sold one condominium unit at Lakewood Townhomes for gross proceeds of $360,000. The sale resulted in net cash outflow of $99,802 after selling costs of $22,063 and mortgage loan repayment of $441,635.

Revolving loan
Subsequent to December 31, 2016, the Trust received advances of $2,600,000 and repaid nil on the revolving loan, resulting in a balance of $24,900,000 as of the date of the Financial Statements.

UNITHOLDER INFORMATION

Trustees and Officers

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

The current trustees of LREIT are Mr. Charles Loewen, Mr. Earl Coleman, and Mr. Arni Thorsteinson, CFA. Mr. Loewen is the Chief Executive Officer of Online Business Systems and serves as Chairman of LREIT. Mr. Coleman is an entrepreneur, formerly President of Big Freight Systems Inc. Mr. Thorsteinson is the President of Shelter and is the appointee of Shelter.

The Chief Executive Officer is Mr. Gino Romagnoli, CPA, CGA, Senior Manager - Investor Services for Shelter.

The Chief Financial Officer and Secretary of LREIT is Mr. Gary Benjaminson, CA, MBA, Senior Manager - Corporate Accounting and Reporting for Shelter.

Administrator of the Trust

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

Property Management

Shelter has been appointed by the Trustees, pursuant to the terms of the Property Management Agreement, to act as the Property Manager for all of the investment properties in the LREIT portfolio. Shelter manages all of the investment properties except for the seniors' housing complex, where the Trust has retained a third party property manager to provide on-site management services, due to the nature of the operations.

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Unit Listing

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

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