



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**JUNE 30, 2008**

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## 2008 SECOND QUARTER HIGHLIGHTS

### Acquisition and Development

- During the second quarter of 2008, LREIT completed the construction and lease-up of Laird's Landing and the property began contributing to the operating income of the Trust, effective June 1, 2008. Laird's Landing is a 189 suite apartment complex in Fort McMurray, Alberta.
- Property portfolio as of June 30, 2008 consists of 42 properties, comprised of 3,343 suites and 224,545 square feet of commercial leasable area.

### Financial

Second quarter of 2008, compared to the second quarter of 2007:

- Rental revenues increased by \$4 Million or 38%, with \$3.4 Million derived from properties in Fort McMurray, Alberta.
- Net operating income increased by \$2.6 Million or 40% in total and by \$0.146 on a per unit basis.
- Operating margin for property portfolio improved from 59% in 2007 to 61% in 2008.
- "Same property" revenues increased by \$1.1 Million or 12%, while "same property" net operating income increased by \$0.7 Million or 13%.
- FFO increased by \$1.15 Million and \$0.065 on a per unit basis.
- AFFO increased by \$1.24 Million and \$0.070 on a per unit basis.

### Capital Structure

- Weighted average interest rate on the aggregate mortgage loan balance of 6.3% at June 30, 2008, compared to 6.2% at December 31, 2007.
- Mortgage loan debt to estimated current value ratio of 59.4% at June 30, 2008, the same as 59.4% at December 31, 2007.

### Ongoing Investment Activities - 2008

- On July 2, 2008, LREIT acquired the Siena Apartments, a 66-suite luxury apartment property in Fort McMurray, Alberta, at a price of \$30 Million.
- Acquisition of Parsons Landing, a 160-suite apartment property in Fort McMurray, Alberta is contracted for acquisition in 2008 at a cost of \$60.7 Million plus GST.
- Acquisition of Colony Square, a 89.4% interest in a mixed use development in downtown Winnipeg, Manitoba, comprised of 428 suites and 83,190 square feet of leasable office/commercial space, is scheduled to close on October 1, 2008 at a purchase price of \$34.2 Million.

### Estimated Current Value

- The real estate portfolio of LREIT has an estimated current market value of \$655 Million as of June 30, 2008.

**Unitholder Returns**

|   | <u>Six Months Ended</u> | <u>Year Ended</u>        |
|---|-------------------------|--------------------------|
|   | <u>June 30, 2008</u>    | <u>December 31, 2007</u> |
| Distribution per unit   | \$0.28                  | \$0.56                   |
| Opening unit price  | \$4.99                  | \$5.90                   |
| Closing unit price  | \$5.40                  | \$4.99                   |
| Annualized yield on opening price (distribution/opening unit price) | 11.2%                   | 9.5%                     |
| Current cash distribution (per annum)                               | \$0.56                  |                          |
| Closing unit price - August 12, 2008:                               | \$5.21                  |                          |
| Current yield:  | 10.7%                   |                          |

Lanesborough Real Estate Investment Trust Units are listed on the Toronto Stock Exchange under the symbol "LRT.UN". The Series F and Series G convertible debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.F" and "LRT.DB.G", respectively.

## REPORT TO UNITHOLDERS

Management previously projected that significant improvements in operating income and cash flows would occur throughout 2008, as additional properties in Fort McMurray moved from the development stage to the income-producing stage. As anticipated, the operating results of LREIT for the second quarter of 2008 have improved significantly in comparison to both the second quarter results for 2007 and the first quarter results for 2008, as summarized in the following chart:

|                                       | Per Unit - Basic |    |                    |          |                    |          |
|---------------------------------------|------------------|----|--------------------|----------|--------------------|----------|
|                                       | 2008 Q2          |    | 2008 Q1 Comparison |          | 2007 Q2 Comparison |          |
|                                       | Amount           |    | Amount             | Increase | Amount             | Increase |
| Net operating income (NOI)            | \$ 0.520         | \$ | 0.455              | \$ 0.065 | \$ 0.374           | \$ 0.146 |
| Funds from operations (FFO)           | \$ 0.094         | \$ | 0.023              | \$ 0.071 | \$ 0.029           | \$ 0.065 |
| Adjusted funds from operations (AFFO) | \$ 0.117         | \$ | 0.061              | \$ 0.056 | \$ 0.047           | \$ 0.070 |
| Distributable income                  | \$ 0.147         | \$ | 0.085              | \$ 0.062 | \$ 0.084           | \$ 0.063 |

In addition to the growth in the per unit amounts for Distributable Income, FFO and AFFO, the second quarter results for 2008 are highlighted by the improvement in the distribution payout ratio. During the second quarter of 2008, distributable income exceeded distributions declared by \$103,603 or 4.2%, while cash flow from operating activities exceeded distributions declared by \$573,973 or 23.3%.

The improvement in operating results for the second quarter of 2008 reflect the impact of property acquisitions in 2007; an improvement in the operating results of properties which were acquired prior to 2007; and the inclusion of Laird's Landing as an income-producing property, effective June 1, 2008. In particular, the portfolio of income-producing properties in Fort McMurray, Alberta has continued to achieve favourable operating margins (73% for the second quarter of 2008) and has accounted for approximately 84% of the total increase in NOI in the second quarter of 2008, compared to the second quarter of 2007.

The favourable operating results for the second quarter of 2008 are a positive indicator for ongoing improvements in the second half of the year, after considering the following variables:

- (i) during the third quarter of 2008, Laird's Landing will contribute three months of operating income to the Trust, compared to one month in the second quarter of 2008. Laird's Landing is a fully occupied 189 suite apartment complex located in Fort McMurray, Alberta. (The NOI for Laird's Landing was \$436,991 for the month of June 2008.);
- (ii) on July 2, 2008, LREIT acquired the Siena Apartments, a 66 suite luxury apartment property in Fort McMurray, Alberta. The property is 100% leased on a net basis for four years and will essentially make a full contribution to the NOI of the Trust during the third quarter of 2008;
- (iii) on May 14, 2008, LREIT acquired Phase I of the Parsons Landing Apartments and it is anticipated that the remaining portion (Phase II) will be acquired in September 2008. The lease-up of the property is expected to be completed in October 2008, at which time the property will begin contributing to the operating income of the Trust. Parsons Landing is a 160 suite apartment building located in Fort McMurray, Alberta;
- (iv) the \$34 Million acquisition of Colony Square is scheduled to close on October 1, 2008. The property is located near the centre of the Winnipeg business district, is 100% leased and will add 428 residential suites and 83,190 square feet of leasable commercial area to the property portfolio of the Trust; and
- (v) additional properties to be added to the portfolio of income-producing properties include the 60 suite expansion of Elgin Lodge (Q4 2008) and the 126 suite Clarington Seniors Residence (2009).

In summary, LREIT is well-positioned to achieve significant growth in operating income and cash flows in

the second half of 2008, especially given the favourable returns from the new Fort McMurray properties.

The Board of Trustees and the management team of Shelter Canadian Properties Limited remain fully committed to maximizing the long-term investment returns of the Unitholders.

A handwritten signature in black ink, appearing to read "A.C. Thorsteinson". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

ARNI C. THORSTEINSON, CFA  
Chief Executive Officer  
August 13, 2008

**Property Portfolio - June 30, 2008**

| <u>Property</u>                     | <u>Location</u> | <u>Purchase Price</u>        | <u>Acquisition Date</u> | <u>Suites/<br/>Leasable Area<br/>- Sq. Ft.</u> | <u>Occupancy<br/>June 30<br/>2008</u> |
|-------------------------------------|-----------------|------------------------------|-------------------------|--|---------------------------------------|
| <b>RESIDENTIAL</b>                  |                 |                              |                         |  |                                       |
| <b>Manitoba</b>                     |                 |                              |                         |  |                                       |
| Highland Tower (1)                  | Thompson        | \$ 5,700,000                 | January 2005            | 77   | 99 %                                  |
| Chancellor Gate                     | Winnipeg        | 6,750,000                    | August 2005             | 48   | 96 %                                  |
| Willowdale Gardens                  | Brandon         | 4,326,000                    | January 2006            | 88   | 100 %                                 |
| <b>Saskatchewan</b>                 |                 |                              |                         |  |                                       |
| Borden Estates                      | Prince Albert   | 5,315,000                    | February 2005           | 144  | 91 %                                  |
| Cedar Village                       | Prince Albert   | 2,700,000                    | February 2005           | 72   | 94 %                                  |
| Carlton Manor                       | Prince Albert   | 410,000                      | February 2005           | 19   | 84 %                                  |
| Riverside Apartments                | Prince Albert   | 265,000                      | February 2005           | 12   | 92 %                                  |
| MGM Apartments                      | Prince Albert   | 650,000                      | February 2005           | 28   | 54 %                                  |
| Marquis Towers                      | Prince Albert   | 6,200,000                    | August 2005             | 129  | 100 %                                 |
| Riverside Terrace (2)               | Saskatoon       | 24,000,000                   | July 2005               | 181  | 100 %                                 |
| Village West                        | Saskatoon       | 5,113,800                    | June 2006               | 100  | 96 %                                  |
| Sir Robert Borden Place             | Saskatoon       | 5,600,000                    | May 2007                | 113  | 97 %                                  |
| Chateau St. Michael's (2)           | Moose Jaw       | 7,600,000                    | June 2006               | 93   | 100 %                                 |
| Woodlily Courts                     | Moose Jaw       | 3,700,000                    | June 2006               | 102  | 100 %                                 |
| <b>Alberta</b>                      |                 |                              |                         |  |                                       |
| Nova Villa                          | Edmonton        | 5,400,000                    | May 2004                | 61   | 93 %                                  |
| Nova Manor                          | Edmonton        | 2,615,000                    | May 2004                | 32   | 88 %                                  |
| Nova Ridge Estates                  | Spruce Grove    | 8,800,000                    | July 2004               | 102  | 95 %                                  |
| Norglen Terrace                     | Peace River     | 2,500,000                    | October 2004            | 72   | 96 %                                  |
| Broadview Meadows                   | Sherwood Park   | 6,790,000                    | January 2006            | 93   | 96 %                                  |
| Nelson Ridge Estates                | Fort McMurray   | 40,575,000                   | April 2005              | 225  | 99 %                                  |
| Gannet Place                        | Fort McMurray   | 6,873,700                    | June 2006               | 37   | 100 %                                 |
| Lunar Apartments                    | Fort McMurray   | 4,457,100                    | June 2006               | 24   | 100 %                                 |
| Parkland Apartments                 | Fort McMurray   | 2,230,200                    | June 2006               | 12   | 92 %                                  |
| Skyview Apartments                  | Fort McMurray   | 5,385,800                    | June 2006               | 29   | 97 %                                  |
| Snowbird Manor                      | Fort McMurray   | 6,314,500                    | June 2006               | 34   | 97 %                                  |
| Whimbrel Terrace                    | Fort McMurray   | 6,873,700                    | June 2006               | 37   | 97 %                                  |
| Laird's Landing                     | Fort McMurray   | 51,350,000                   | August 2006             | 189  | 98 %                                  |
| Woodland Park                       | Fort McMurray   | 37,865,000                   | March 2007              | 107  | 90 %                                  |
| Lakewood Manor                      | Fort McMurray   | 59,900,000                   | July 2007               | 175  | 100 %                                 |
| Millennium Village                  | Fort McMurray   | 24,220,000                   | August 2007             | 72   | 96 %                                  |
| Parsons Landing - Phase I (5)       | Fort McMurray   | 33,054,000                   | May 2008                | 84   | 100 %                                 |
| Westhaven Manor                     | Edson           | 4,050,000                    | May 2007                | 48   | 92 %                                  |
| <b>Northwest Territories</b>        |                 |                              |                         |  |                                       |
| Beck Court                          | Yellowknife     | 14,300,000                   | April 2004              | 120  | 96 %                                  |
| Three Lakes Village                 | Yellowknife     | 10,900,000                   | May 2005                | 50   | 94 %                                  |
| Nova Court (3)                      | Yellowknife     | 15,000,000                   | March 2007              | 106  | 100 %                                 |
| <b>Ontario</b>                      |                 |                              |                         |  |                                       |
| Elgin Lodge (2)(4)                  | Port Elgin      | 18,122,000                   | June 2006               | 124  | 66 %                                  |
| Clarington Seniors Residence (2)(5) | Bowmanville     | 22,400,000                   | February 2007           | 121  | 46 %                                  |
| <b>British Columbia</b>             |                 |                              |                         |  |                                       |
| Greenwood Gardens                   | Surrey          | <u>10,950,000</u>            | April 2004              | <u>183</u>                                     | 94 %                                  |
| <b>Total - Residential</b>          |                 | <b><u>\$ 479,255,800</u></b> | Total suites            | <b><u>3,343</u></b>                            |                                       |

**Property Portfolio - June 30, 2008 (continued)**

| <u>Property</u>                    | <u>Location</u> | <u>Purchase Price</u>        | <u>Acquisition Date</u> | <u>Suites/<br/>Leasable Area<br/>- Sq. Ft.</u> | <u>Occupancy<br/>June 30<br/>2008</u> |
|------------------------------------|-----------------|------------------------------|-------------------------|--|---------------------------------------|
| <b>Total - Residential</b>         |                 | <b><u>\$ 479,255,800</u></b> | Total suites            | <b><u>3,343</u></b>                            |                                       |
| <b>COMMERCIAL</b>                  |                 |                              |                         |  |                                       |
| <b>Retail and Office</b>           |                 |                              |                         |  |                                       |
| Kenaston (1)                       | Winnipeg, MB    | 12,656,200                   | April 2002              | 103,209  | 92 %                                  |
| Mclvor Mall                        | Winnipeg, MB    | <u>6,700,000</u>             | February 2004           | <u>65,283</u>                                  | 97 %                                  |
|                                    |                 | <u>19,356,200</u>            |                         | <u>168,492</u>                                 |                                       |
| <b>Light Industrial</b>            |                 |                              |                         |  |                                       |
| MAAX (6)                           | Aidrie, AB      | 1,600,000                    | June 2003               | 39,936   | 100 %                                 |
| Purolator                          | Burlington, ON  | <u>1,200,000</u>             | September 2003          | <u>16,117</u>                                  | 100 %                                 |
|                                    |                 | <u>2,800,000</u>             |                         | <u>56,053</u>                                  |                                       |
| <b>Total - Commercial</b>          |                 | <b><u>22,156,200</u></b>     | Total leasable<br>area  | <b><u>224,545</u></b>                          |                                       |
| <b>Total real estate portfolio</b> |                 | <b><u>\$ 501,412,000</u></b> |                         |  |                                       |

Notes to the Property Portfolio:

- (1) Includes the cost of major renovations and asset additions.
- (2) Seniors housing complex.
- (3) Property includes 8,400 square feet of commercial space.
- (4) Costs in regard to the expansion of \$9,821,000 are classified as "properties under development".
- (5) Properties are classified as "properties under development".
- (6) Tenant has filed for creditor protection, rental payments ceased, effective July 1, 2008.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

Lanesborough Real Estate Investment Trust ("LREIT") is an unincorporated closed-end real estate investment trust created by the Declaration of Trust and governed by the laws of the Province of Manitoba. The trust units of LREIT are listed on the Toronto Stock Exchange under the symbol "LRT.UN".

Management's Discussion and Analysis ("MD&A") of Lanesborough Real Estate Investment Trust ("LREIT" or the "Trust") should be read in conjunction with the financial statements of LREIT for the six months ended June 30, 2008 and with reference to the first quarter report for 2008 and the Annual Report for 2007.

### Forward-Looking Information

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

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

### Purchase Price Information

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

### **Estimated Current Value**

In this management discussion and analysis, references are made to the estimated current value of LREIT's property portfolio, which is an estimate of the current value of LREIT's property portfolio as at June 30, 2008 made by management of LREIT.

In summary, the total estimated current value of the property portfolio of \$654,823,000 is 6.1% in excess of the total appraised value of \$615,558,000. For 22 properties, representing 53% of total appraised value, management assumed current value was equal to the appraisal values of the applicable properties, for 18 properties, representing 44% of total appraised value, the total estimated current value of the applicable properties was 14% in excess of total appraised value of the properties and for 1 property, management estimated current value to be the total of the cost of the building expansion and the appraised value of the property before the expansion.

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

There can be no assurance that appraised value of a property is an accurate reflection of the value of such property as at the effective date set forth in the appraisal or on any other date, including on June 30, 2008, the date of management's estimate of the current value of such property. In addition, there can be no assurance that the valuation method or the capitalization rate(s) used in appraising a property (and used by management of LREIT in estimating the current value of the portfolio) was appropriate for such property as at the effective date set forth in the appraisal or on any other date, including on June 30, 2008, the date of management's estimate of the current value of such property.

LREIT undertakes no obligation to update or revise its estimated current value of its portfolio from time to time.

## Financial and Operating Summary

|  | Three Months Ended<br>June 30 |                | Six Months Ended<br>June 30 |                |
|--|-------------------------------|----------------|-----------------------------|----------------|
|  | 2008                          | 2007           | 2008                        | 2007           |
| <b>DISTRIBUTIONS</b>                               |                               |                |                             |                |
| Total  | \$ 2,463,744                  | \$ 2,439,035   | \$ 4,920,645                | \$ 4,865,858   |
| Per unit   | \$ 0.14                       | \$ 0.14        | \$ 0.28                     | \$ 0.28        |
| <b>KEY PERFORMANCE INDICATORS (1)</b>              |                               |                |                             |                |
| <b>Operations</b>                                  |                               |                |                             |                |
| Average residential occupancy rate                 | 96.0 %                        | 94.3 %         | 95.0 %                      | 93.7 %         |
| Operating residential cost ratio                   | 39.0 %                        | 43.0 %         | 41.0 %                      | 45.0 %         |
| <b>Operating Results</b>                           |                               |                |                             |                |
| Total revenue                                      | \$ 14,975,258                 | \$ 11,127,584  | \$ 28,604,251               | \$ 20,179,348  |
| Net operating income *                             | \$ 9,111,999                  | \$ 6,519,763   | \$ 17,061,941               | \$ 11,404,540  |
| Loss for the period, before future income tax *    | \$ (752,648)                  | \$ (1,417,123) | \$ (2,705,546)              | \$ (3,203,090) |
| Income (loss) for the period                       | \$ (4,988,811)                | \$ 688,355     | \$ (4,988,510)              | \$ (1,017,738) |
| <b>Cash Flows</b>                                  |                               |                |                             |                |
| Cash flow from operating activities                | \$ 3,037,717                  | \$ 1,044,668   | \$ 4,369,932                | \$ 2,181,114   |
| Funds from Operations (FFO) *                      | \$ 1,655,318                  | \$ 504,160     | \$ 2,055,887                | \$ 409,396     |
| Adjusted Funds from Operations (AFFO) *            | \$ 2,054,414                  | \$ 814,053     | \$ 3,114,458                | \$ 1,162,078   |
| Distributable income *                             | \$ 2,567,347                  | \$ 1,456,792   | \$ 4,055,399                | \$ 2,238,941   |
| <b>Financing</b>                                   |                               |                |                             |                |
| Mortgage loans to estimated current value ratio *  |                               |                | 59.4 %                      | 56.7 %         |
| Weighted average interest rate of mortgage loans * |                               |                | 6.3 %                       | 6.2 %          |
| <b>Per Unit</b>                                    |                               |                |                             |                |
| Net operating income *                             |                               |                |                             |                |
| - basic  | \$ 0.520                      | \$ 0.374       | \$ 0.975                    | \$ 0.654       |
| - diluted  | \$ 0.357                      | \$ 0.295       | \$ 0.670                    | \$ 0.516       |
| Loss for the period, before future income tax*     |                               |                |                             |                |
| - basic  | \$ (0.043)                    | \$ (0.081)     | \$ (0.155)                  | \$ (0.184)     |
| - diluted  | \$ (0.043)                    | \$ (0.081)     | \$ (0.155)                  | \$ (0.184)     |
| Income (loss) for the period                       |                               |                |                             |                |
| - basic  | \$ (0.284)                    | \$ 0.039       | \$ (0.285)                  | \$ (0.058)     |
| - diluted  | \$ (0.284)                    | \$ 0.039       | \$ (0.285)                  | \$ (0.058)     |
| Distributable income *                             |                               |                |                             |                |
| - basic  | \$ 0.147                      | \$ 0.084       | \$ 0.232                    | \$ 0.128       |
| - diluted  | \$ 0.139                      | \$ 0.082       | \$ 0.219                    | \$ 0.126       |
| Funds from Operations (FFO) *                      |                               |                |                             |                |
| - basic  | \$ 0.094                      | \$ 0.029       | \$ 0.118                    | \$ 0.023       |
| - diluted  | \$ 0.094                      | \$ 0.028       | \$ 0.116                    | \$ 0.023       |
| Adjusted Funds from Operations (AFFO) *            |                               |                |                             |                |
| - basic  | \$ 0.117                      | \$ 0.047       | \$ 0.178                    | \$ 0.067       |
| - diluted  | \$ 0.117                      | \$ 0.046       | \$ 0.172                    | \$ 0.065       |

### (1) Non-GAAP Measurements

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

## **INVESTMENT OBJECTIVES AND STRATEGY**

### **General**

The primary objectives of the Lanesborough Real Estate Investment Trust ("LREIT") are to maximize unit values and provide stable cash distributions to the Unitholders by creating a large diversified portfolio of quality real estate investments through the ongoing acquisition of additional multi-unit residential properties. The overall investment strategy of LREIT is to focus on the acquisition of properties with stable yields, low vacancy levels and growth potential. LREIT then strives to maximize operating income through the implementation of sophisticated and prudent financial management practices, superior operating procedures, high caliber and responsive management services, proactive leasing strategies and, where appropriate, capital improvement and renovation programs.

In order to maximize the yield on its portfolio of income-producing properties, LREIT also undertakes appropriate capital improvement projects, renovations and re-marketing initiatives for certain properties. The benefits of major renovations are typically identified during the property acquisition process, with renovations commencing within a relatively short time frame after the property acquisition is complete.

For the foreseeable future, the investment strategy of LREIT will continue to focus on the acquisition of multi-family residential properties in markets across western Canada, including continued investments in smaller centres.

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

## **REAL ESTATE PORTFOLIO**

### **Investment in Properties - June 30, 2008**

#### **Portfolio Summary - June 30, 2008**

As of June 30, 2008, the property portfolio of LREIT consists of 38 multi-family residential properties and four commercial properties, with a total purchase price of approximately \$501 Million, encompassing 3,343 suites and 224,545 square feet of leasable area.

Two properties, which are currently in the lease-up stage of development, namely, the Clarington Seniors Residence and the building addition at Elgin Lodge, are classified as "Properties Under Development" as of June 30, 2008. During the second quarter of 2008, the construction of Laird's Landing was substantially completed at a cost of \$50.4 Million plus GST and the property was reclassified as an income property, effective June 1, 2008. The final construction cost is estimated to be \$52.8 Million plus GST. The cost to complete is expected to be funded with the mortgage loan financing.

## Properties Under Development

### *Status of Properties*

- multi-level building addition at Elgin Lodge - the building addition was completed during the fourth quarter of 2007 at a cost of approximately \$9.8 Million. The lease-up of the building addition (60 suites in total) is expected to be completed by the end of 2008.
- The Clarington Seniors Residence - the property was acquired by LREIT in 2007 in the lease-up stage of development. Lease-up is expected to be completed in 2009.

### *Capitalization of Costs*

The reclassification of "Properties Under Development" to "Income Properties" occurs when the lease-up stage is completed. As construction and/or carrying costs of a property under development are capitalized, the properties do not contribute to the operating income of the Trust until the property is reclassified as an income property.

## Contracted Property Acquisitions - Subsequent to June 30, 2008

### **Siena Apartments**

On July 2, 2008, LREIT acquired a 66 suite luxury apartment property in Fort McMurray, Alberta, known as Siena Apartments, for a purchase price of \$30 Million. The property consists of a four-storey apartment building, with a 93 stall underground parkade and is comprised of six one-bedroom and 60 two-bedroom suites. All of the suites are fully furnished and have individual condominium title.

The property is 100% leased to a major oil sands operating company on a net rent basis until May 1, 2012. The lease agreement provides the tenant with an option to extend the lease in 2012 for an additional five years at the current market rents at that time.

The purchase price was funded by a new first mortgage loan in the amount of \$21 Million, a vendor take-back mortgage loan of \$4 Million and the balance in cash. The first mortgage loan bears interest at a rate of 5.7% for a five-year term. The vendor take-back mortgage loan is a 5% "interest-only" mortgage with a due date of July 1, 2010.

LREIT also has a right of first refusal to acquire Phase II of Siena Apartments, which recently completed construction. Phase II consists of 57 suites and is also 100% leased to the same major oil sands operating company on a net rent basis for a five-year term until 2013.

### **Parsons Landing**

In September 2007, LREIT entered into an agreement to acquire Parsons Landing, a 160 suite apartment property in the Timberlea area of Fort McMurray, Alberta. At the completion of construction, the property will consist of a four-storey apartment building, with a 219 stall parkade and 37 surface parking stalls and will be comprised of 32 one-bedroom, 124 two-bedroom and four three-bedroom suites, the majority of which will be fully furnished. Each of the suites will have individual condominium title.

The purchase price of the property is \$60.7 Million plus GST. After accounting for the \$10 Million second mortgage loan that was provided to the vendor in November 2007 and additional deposits of \$5 Million, the remaining amount payable for the property is \$45.7 Million, plus GST.

The acquisition of Parsons Landing is occurring in two phases upon the issuance of occupancy certificates. The acquisition of Phase I closed on May 14, 2008 and the acquisition of Phase II is expected to close in September 2008. The purchase price of Phase I, excluding GST, was approximately \$31.9 Million.

The purchase agreement for Parsons Landing provides for the balance of the purchase price to be paid subsequent to the property acquisition dates. After applying \$5.25 Million of the second mortgage loan advance and \$2.5 Million of the additional deposits to the purchase price of Phase I, the balance owing in regard to Phase I is approximately \$24.1 Million plus GST. The balance owing bears interest at 8%. Upon the closing of Phase II, the balance owing will increase to \$45.7 Million, plus GST. The payment of the balance owing is expected to occur in December 2008, from the receipt of a new first mortgage loan in the amount of \$50 Million. The excess amount of mortgage loan proceeds over the amounts due on closing will serve to improve the working capital of the Trust.

As of August 13, 2008, Phase I is 100% leased and Phase II is 20% leased. Parsons Landing is expected to be transferred from properties under development to income properties in October 2008.

### Colony Square

In March 2008, LREIT agreed to acquire an 89.4% beneficial interest in an apartment/office complex in Winnipeg, Manitoba, known as Colony Square, at a purchase price of \$34.2 Million. LREIT currently owns a 1.5% beneficial interest in the property and is permitting certain owners, who own an aggregate of 9.1% beneficial interest to remain as part of the ownership syndicate.

Colony Square consists of two apartment towers (one with 16 storeys and one with 17 storeys), a seven storey office building and a 270 stall underground parkade. The two apartment towers contain a total of 428 suites, while the office building contains 80,935 square feet of leasable area. An additional 2,255 square feet of leasable commercial area is available on the main floors of the apartment towers.

The acquisition will be funded by the pro-rata assumption of a \$21 Million 5.5% first mortgage loan, a \$6.7 Million subordinate loan, and the balance in cash. The acquisition is scheduled to close on October 1, 2008.

### Mortgage Loan Receivable

|                   |               |
|-------------------|---------------|
| June 30, 2008     | \$ 4,750,000  |
| December 31, 2007 | \$ 10,000,000 |

As of December 31, 2007, "Mortgage Loan Receivable" consisted of the \$10 Million second mortgage loan which was provided in regard to the construction of Parsons Landing. As disclosed above, \$5.25 Million of the loan was applied to the purchase price of Phase I of Parsons Landing, resulting in a balance of \$4.75 Million as of June 30, 2008.

## CAPITAL STRUCTURE

### Capital Structure - June 30, 2008

|   | June 30, 2008         |                | December 31, 2007     |                |
|---|-----------------------|----------------|-----------------------|----------------|
|   | Amount                | %              | Amount                | %              |
| Mortgage loans payable - principal amount | \$ 389,019,025        | 74.8 %         | \$ 343,269,160        | 72.2 %         |
| Convertible debentures - face value       | 51,362,000            | 9.9 %          | 52,955,000            | 11.1 %         |
| Trust units (net of issue costs)          | <u>79,991,818</u>     | <u>15.3 %</u>  | <u>79,124,607</u>     | <u>16.7 %</u>  |
| Total capitalization                      | <u>\$ 520,372,843</u> | <u>100.0 %</u> | <u>\$ 475,348,767</u> | <u>100.0 %</u> |

## Overall Financing Strategy

The overall strategy of LREIT is to fund the equity component of new property acquisitions through the issuance of additional trust units or convertible debentures. The upward refinancing of property debt also serves as a source of capital. LREIT will also utilize operating lines of credit, bridge financing and other short-term financing facilities as a source of interim investment capital.

## Trust Units

### Units Outstanding

|                   |            |
|-------------------|------------|
| Authorized        | unlimited  |
| Issued as of,     |            |
| - June 30, 2008   | 17,604,444 |
| - August 12, 2008 | 17,567,129 |

As of June 30, 2008, LREIT had 17,604,444 units outstanding, representing an increase of 74,550 units or 0.4%, compared to the number of units outstanding as of December 31, 2007. The increase in units originated from the following transactions:

| <u>Issue Date</u>  | <u>Units Issued</u> | <u>Equity Raised</u> |
|--|---------------------|----------------------|
| Units outstanding, December 31, 2007                         | 17,529,894          | \$ 65,962,557        |
| Units issued under DRIP                                      | 116,350             | 546,278              |
| Units purchased and cancelled under normal course issuer bid | <u>(41,800)</u>     | <u>(199,976)</u>     |
| Units outstanding, June 30, 2008                             | <u>17,604,444</u>   | <u>\$ 66,308,859</u> |

### Distribution Reinvestment Plan ("DRIP")

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

As noted above, 116,350 units were issued under the Distribution Reinvestment Plan during the six months ended June 30, 2008.

### Normal Course Issuer Bid

In January 2008, the Toronto Stock Exchange (the "Exchange") approved LREIT's Notice of Intention to make a normal course issuer bid for its trust units, with the bid period being established as the 12 month period commencing January 21, 2008. During the bid period, LREIT may acquire a maximum of 876,494 units, representing 5% of the issued and outstanding units, as of January 10, 2008. Purchases will be made at market prices through the facilities of the Exchange. Any tendered units taken up and paid for by LREIT will be cancelled.

LREIT believes that the ongoing purchase of units, pursuant to the bid, is an appropriate use of LREIT's resources, given the disparity between the market price of the units and the underlying value of the units, as determined by LREIT. LREIT also believes that the purchase of units pursuant to the bid will benefit all remaining Unitholders by increasing their proportionate equity interest and voting interest in LREIT, while affording liquidity to anyone who desires to sell their units.

As of June 30, 2008, LREIT has purchased 41,800 units under its normal course issuer bid at an average price of \$4.78 per unit.

### **Unit Options**

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

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

As of June 30, 2008, LREIT had 1,480,000 units options outstanding.

In accordance with Canadian generally accepted accounting principles, the estimated fair value of the options is expensed over the vesting period of the options and the expense is recorded as "unit-based compensation". Unit-based compensation expense is included in trust expense in the Consolidated Statements of Income (Loss) and Comprehensive Income (Loss). During the first six months of 2008, unit-based compensation expense related to the unit options amounted to \$227,937, including \$143,880 relating to the 370,000 units which were issued in January 2008.

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

### **Limited Partnership Units**

In June 2006, LREIT acquired the Village West Townhouses in Saskatoon, Saskatchewan. The acquisition of the property encompassed the issuance of 456,617 Class B Limited Partnership Units ("LPU's") of a wholly owned Limited Partnership which was established by the Trust (the LREIT Village West Limited Partnership). The LPU's were issued at a value of \$6 per LPU, representing total consideration of \$2,739,704. Each LPU is entitled to receive cash distributions equal to the cash distributions which are paid on the trust units of LREIT. The vendor has the right to exchange each LPU for LREIT trust units on a one for one basis. The LPU's are also transferable.

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

### **Distribution Dates and Amounts**

The distribution policy of LREIT is to pay distributions on a monthly basis. The distribution for each month, excluding December, is paid on or about the 15th day of the following month to the Unitholders of record on each month end. The distribution for December is paid on or before December 31 to the Unitholders of record on or about December 15.



During the first six months of 2008, LREIT declared distributions of \$0.28 per unit or \$0.56 per unit on an annualized basis. The cash distribution for June 2008 was paid on July 15, 2008. Distributions are comprised of the following components:

|  | <u>Trust Units</u>  | <u>LP Units</u> |
|--|---------------------|-----------------|
| Cash distributions paid for January to May, 2008 | \$ 3,559,269        | \$ 83,210       |
| Cash distributions payable at June 30, 2008      | <u>821,599</u>      | <u>16,642</u>   |
|  | 4,380,868           | <u>99,852</u>   |
| Value of units issued under DRIP                 | <u>539,777</u>      |                 |
| Distributions declared, per Statement of Equity  | <u>\$ 4,920,645</u> |                 |

A cash distribution of \$0.04667 per unit, or \$0.56 on an annualized basis, was also declared for the month of July 2008 and will be paid on August 15, 2008.

## Convertible Debentures

The Declaration of Trust for LREIT does not impose any limitations on the amount of convertible debt which may be issued by the Trust. The following is a summary of the debenture offerings which have been undertaken by LREIT, as of June 30, 2008.

### Summary of Debenture Offerings

| Issue Date/Maturity Date        | Series | Interest Rate | Amount Issued        | Repayments/Unit Conversions    |                         | Net Amount Outstanding June 30, 2008 |
|---------------------------------|--------|---------------|----------------------|--------------------------------|-------------------------|--------------------------------------|
|                                 |        |               |                      | Six Months Ended June 30, 2008 | As of December 31, 2007 |                                      |
| Aug. 30/02/Aug. 30/07           | A      | 10.0 %        | \$ 3,000,000         | \$ -                           | \$ (3,000,000)          | \$ -                                 |
| Aug. 30/02/Aug. 30/05           | B      | 8.0 %         | 1,000,000            | -                              | (1,000,000)             | -                                    |
| Jan. 30/04/Jan. 30/06           | C      | 8.0 %         | 10,131,000           | -                              | (10,131,000)            | -                                    |
| Mar. 16/04/Mar. 16/08           | D      | 8.0 %         | 4,000,000            | (1,593,000)                    | (2,407,000)             | -                                    |
| Feb. 17/05/Feb. 17/10           | E      | 8.0 %         | 12,000,000           | -                              | (50,000)                | 11,950,000                           |
| Mar. 10/06/Mar. 11/11           | F      | 7.5 %         | 13,680,000           | -                              | -                       | 13,680,000                           |
| Dec. 8/06/Dec. 31/11            | G      | 7.5 %         | <u>25,732,000</u>    | -                              | -                       | <u>25,732,000</u>                    |
| Face value                      |        |               | <u>\$ 69,543,000</u> | <u>\$ (1,593,000)</u>          | <u>\$ (16,588,000)</u>  | 51,362,000                           |
| Net accumulated accretion       |        |               |                      |                                |                         | 4,555,633                            |
| Unamortized transaction costs   |        |               |                      |                                |                         | <u>(1,957,796)</u>                   |
| Book value, June 30, 2008       |        |               |                      |                                |                         | <u>\$ 53,959,837</u>                 |
| <u>Allocation of book value</u> |        |               |                      |                                |                         |                                      |
| Debt component                  |        |               |                      |                                |                         | \$ 42,812,996                        |
| Equity component                |        |               |                      |                                |                         | 13,104,637                           |
| Unamortized transaction costs   |        |               |                      |                                |                         | <u>(1,957,796)</u>                   |
|                                 |        |               |                      |                                |                         | <u>\$ 53,959,837</u>                 |

## Mortgage Loans Payable

June 30, 2008 \$386,650,804  
 December 31, 2007 \$341,334,043

### Summary of Mortgage Loans Payable

| Year of Maturity   | Weighted Average Interest Rate | Amount<br>June 30, 2008 | Percentage of Total |
|--|--------------------------------|-------------------------|---------------------|
| Fixed rate   |                                |                         |                     |
| 2008   | 5.2 %                          | \$ 9,576,173            | 2.5 %               |
| 2009   | 7.5 %                          | 51,349,855              | 13.2 %              |
| 2010   | 8.4 %                          | 33,693,955              | 8.7 %               |
| 2011   | 8.5 %                          | 7,272,940               | 1.9 %               |
| 2012   | 5.6 %                          | 33,932,160              | 8.7 %               |
| 2013   | 5.9 %                          | 25,660,880              | 6.6 %               |
| 2014   | 6.3 %                          | 43,824,393              | 11.3 %              |
| 2015   | 5.7 %                          | 36,708,714              | 9.4 %               |
| 2016   | 5.2 %                          | 42,956,383              | 11.0 %              |
| 2017   | 5.7 %                          | 5,799,418               | 1.5 %               |
| 2018   | 5.8 %                          | <u>22,781,500</u>       | <u>5.9 %</u>        |
|  |                                | 313,556,371             | 80.6 %              |
| Demand/floating rate   | 5.9 %                          | <u>75,462,654</u>       | <u>19.4 %</u>       |
| Principal amount   |                                | 389,019,025             | <u>100.0 %</u>      |
| Difference between contractual and market interest rates on mortgage loans assumed |                                | 132,325                 |                     |
| Unamortized transaction costs  |                                | <u>(2,500,546)</u>      |                     |
|  |                                | <u>\$ 386,650,804</u>   |                     |
| Principal amount:  |                                |                         |                     |
| Income properties  |                                | \$ 365,327,512          |                     |
| Properties under development   |                                | <u>23,691,513</u>       |                     |
|  |                                | <u>\$ 389,019,025</u>   |                     |

### Mortgage Loan Portfolio

The general policy of LREIT is to utilize fixed rate financing with terms which are appropriate for the nature of the properties being financed. Upward refinancing opportunities are also pursued, when appropriate, in order to provide a source of additional capital and to minimize the impact of capital expenditures on ongoing operating cash flows. The mortgage loan indebtedness of the Trust is restricted to 75% of the appraised value of the real estate portfolio.

During the first six months of 2008, the balance of mortgage loans payable increased by \$45,316,761, comprised of the following amounts:

|  | Three Months<br>Ended<br>June 30, 2008 | Three Months<br>Ended<br>March 31, 2008 | Six Months<br>Ended<br>June 30, 2008 |
|--|--|---|--------------------------------------|
| Mortgage loans on existing properties (1)  | \$ 24,131,500                          | \$ -                                    | \$ 24,131,500                        |
| Increase in mortgage loans for properties under development                                      | 820,208                                | 6,494,520                               | 7,314,728                            |
| Interim financing  | <u>12,000,000</u>                      | <u>5,400,000</u>                        | <u>17,400,000</u>                    |
|  | <u>\$ 36,951,708</u>                   | <u>\$ 11,894,520</u>                    | 48,846,228                           |
| Principal repayments   |  |   | (3,096,363)                          |
| Change in the difference between contractual and market interest rates on mortgage loans assumed |  |   | (168,735)                            |
| Change in the unamortized component of transaction costs   |  |   | <u>(264,369)</u>                     |
|  |  |   | <u>\$ 45,316,761</u>                 |

(1) Included in mortgage loans on existing properties is a \$22,781,500 floating interest rate mortgage, the interest rate of which has been fixed at 5.82% through an interest rate swap arrangement.

A summary of interest rates and debt ratios for the mortgage loan portfolio is provided in the following chart.

#### **Mortgage Loan Debt Summary**

|   | 2008    |          | 2007        |         |          |
|---|---------|----------|-------------|---------|----------|
|   | June 30 | March 31 | December 31 | June 30 | March 31 |
| Weighted average interest rate  |         |          |             |         |          |
| Fixed rate mortgage loans   | 6.4%    | 6.2%     | 6.0%        | 6.2%    | 6.0%     |
| Floating rate mortgage loans  | 5.9%    | 6.4%     | 7.1%        | 7.1%    | 6.9%     |
| Ratio of mortgage loans payable, compared to:   |         |          |             |         |          |
| Total acquisition cost of income-producing properties   | 78%     | 81%      | 80%         | 78%     | 84%      |
| Estimated current value of entire property portfolio  | 59%     | 60%      | 59%         | 57%     | 60%      |
| Ratio of mortgage loans payable and convertible debenture debt (at face value), compared to total acquisition cost of income-producing properties | 96%     | 90%      | 89%         | 97%     | 97%      |

#### **Interim Mortgage Loan Financing**

As of June 30, 2008, the mortgage loans payable of LREIT includes \$45.9 Million of interim mortgage loan financing, comprised of the following:

- \$18 Million due on October 31, 2010;
- \$4.5 Million due on January 1, 2009;
- \$2 Million due on September 1, 2008;
- \$5.4 Million due on January 1, 2009;
- \$4 Million due on April 1, 2009; and
- \$12 Million due on October 1, 2010.

LREIT expects to renew the remaining interim mortgage loans maturing during 2008 for an additional one year term.

The interim mortgage loans are secured by charges registered against two or more properties, bear interest at an average rate of 9.3% and require payments of interest only.

#### **Vendor Take-Back Mortgages**

The vendor take-back mortgage loan balance consists of a \$1,600,000 mortgage, bearing interest at a rate of 6.25%, obtained upon the purchase of Westhaven Manor in May 2007. The loan is repayable on demand.

#### **Revolving Line of Credit**

The Trust utilizes a revolving line of credit with an authorized limit of \$5 Million. The line of credit bears interest at the Royal Bank prime rate and is payable on demand. As of June 30, 2008, the amount available on the line of credit was \$5 Million.

#### **Mortgage Loan Financing for Millennium Village and Parsons Landing**

##### **Millennium Village**

In accordance with the terms of the purchase agreement, the balance owing on the purchase price of Millennium Village was paid in May 2008.

The payment was funded by a new floating interest rate mortgage of \$22,781,500, the interest rate of which has been fixed at 5.82% with the use of an interest rate swap arrangement.

## Parsons Landing

As previously disclosed in this report, the purchase agreement for Parsons Landing also provides for a portion of the purchase price to be paid subsequent to the acquisition date of the property. As of June 30, 2008, the balance owing was approximately \$24.1 Million, excluding the GST payable of approximately \$1.2 Million.

The balance owing is expected to be paid in full in December 2008 from the proceeds of a new first mortgage loan.

## ANALYSIS OF INCOME/LOSS

### General

#### Changes in Property Portfolio

The ongoing growth in the portfolio of income-producing properties of LREIT is one of the main factors affecting the comparability of financial results in different reporting periods. A summary of the change in the cost base of the portfolio of income-producing properties is provided below.

#### ***Q2 2008 vs. Q2 2007***

During the second quarter of 2008, the cost base of the portfolio of income-producing properties of LREIT was approximately \$110 Million greater in comparison to the cost base for the second quarter of 2007, based on property acquisition costs, pro-rated for the month of acquisition. Properties which were added to the income-producing portfolio subsequent to June 30, 2007 include Lakewood Manor, Millennium Village, and Laird's Landing, effective June 1, 2008.

#### ***Six Months Ended June 30, 2008 vs. Six Months Ended June 30, 2007***

During the six month period ended June 30, 2008, the cost base of the income-producing properties of LREIT was approximately \$130 Million greater in comparison to the cost base for the first six months of 2007, based on property acquisition costs, pro-rated for the month of acquisition. The increase in the cost base reflects properties which were added to the portfolio subsequent to June 30, 2007, as well as properties which were added during the first six months of 2007, namely Nova Court, Woodland Park, Borden Estates and Westhaven Manor.

#### ***Q2 2008 vs. Q1 2008***

After pro-rating the \$54.5 Million purchase price of Laird's Landing to reflect one month of rental operations, the asset base of the income-producing portfolio was approximately \$18.15 Million greater than the second quarter of 2008, compared to the first quarter of 2008.

### Overall Results

A comparison of the 2008 and 2007 financial results of LREIT, for the three and six month periods ended June 30th, is provided in the following chart. Excluding future income tax, the loss of LREIT decreased by \$664,475 in the second quarter of 2008, compared to the second quarter of 2007, and by \$497,544 for the six month period ended June 30, 2008, compared to the six month period ended June 30, 2007. The decrease in the loss before future income tax in both the three and six month periods reflects an increase in net operating income, largely offset by an increase in financing expense, amortization charges and trust expense.

The increase in net operating income mainly reflects an increase in rental revenue, partially offset by an increase in property operating costs.

**Analysis of Income (Loss)**

|  | Three Months Ended    |                   | Six Months Ended      |                       |
|--|-----------------------|-------------------|-----------------------|-----------------------|
|  | June 30               |                   | June 30               |                       |
|  | 2008                  | 2007              | 2008                  | 2007                  |
| Rental revenue   | \$ 14,768,829         | \$ 10,737,804     | \$ 28,045,650         | \$ 19,357,786         |
| Interest and other income  | 206,429               | 389,780           | 558,601               | 821,562               |
| Property operating costs   | <u>5,863,259</u>      | <u>4,607,821</u>  | <u>11,542,310</u>     | <u>8,774,808</u>      |
| Net operating income (NOI) *   | 9,111,999             | 6,519,763         | 17,061,941            | 11,404,540            |
| Trust expense  | <u>551,996</u>        | <u>533,736</u>    | <u>1,286,903</u>      | <u>992,058</u>        |
| Income before financing expense,<br>amortization, non-controlling interest and<br>taxes (EBITDA) * | 8,560,003             | 5,986,027         | 15,775,038            | 10,412,482            |
| Financing expense  | <u>6,904,685</u>      | <u>5,481,867</u>  | <u>13,719,151</u>     | <u>10,003,086</u>     |
| Income (loss) before amortization, non-<br>controlling interest and taxes *                        | 1,655,318             | 504,160           | 2,055,887             | 409,396               |
| Amortization   | 2,390,830             | 1,936,304         | 4,722,928             | 3,651,471             |
| Non-controlling interest   | <u>(17,136)</u>       | <u>15,021</u>     | <u>(38,505)</u>       | <u>38,985</u>         |
| Loss before future income tax *  | (752,648)             | (1,417,123)       | (2,705,546)           | (3,203,090)           |
| Future income tax (expense) recovery   | <u>(4,236,163)</u>    | <u>2,105,478</u>  | <u>(2,282,964)</u>    | <u>2,185,352</u>      |
| Income (loss) for the period   | <u>\$ (4,988,811)</u> | <u>\$ 688,355</u> | <u>\$ (4,988,510)</u> | <u>\$ (1,017,738)</u> |

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

**Revenue****Total Revenue****Operating Segments**

The operations of LREIT encompass the acquisition and management of a growing portfolio of income-producing properties located in rental markets across western Canada and in Ontario and the Northwest Territories. Aside from four commercial properties which were acquired in the initial years of operation, all of the properties in the LREIT portfolio are residential properties.

For financial reporting purposes, the operating results of LREIT, are segmented geographically and between "residential", "commercial", "light industrial" and "Trust" components. The "Trust" component reflects amounts pertaining to the overall asset management and administrative activities of LREIT.

The percentage of revenue generated by each operating segment for the six month period ended June 30, 2008, as well as a comparison of the 2008 and 2007 revenue results for the six month period ended June 30th, is disclosed in the following charts.

**Analysis of Total Revenue**

|                           | Six Months Ended June 30, 2008 |            |       |
|---------------------------|--------------------------------|------------|-------|
|                           | Income Properties              |            |       |
|                           | Residential                    | Commercial | Trust |
| Rental revenue            | 93%                            | 7%         | n/a   |
| Interest and other income | 42%                            | 3%         | 55%   |
| Total revenue             | 92%                            | 7%         | 1%    |

**Increase in Total Revenue**

|             | Total Revenues           |                      |                     |              |
|-------------|--------------------------|----------------------|---------------------|--------------|
|             | Six Months Ended June 30 |                      | Increase (Decrease) |              |
|             | 2008                     | 2007                 | Amount              | % of Total   |
| Residential | \$ 26,209,216            | \$ 17,329,513        | \$ 8,879,703        | 105 %        |
| Commercial  | 2,085,647                | 2,245,942            | (160,295)           | (2)%         |
| Trust       | 309,388                  | 603,893              | (294,505)           | (3)%         |
| Total       | <u>\$ 28,604,251</u>     | <u>\$ 20,179,348</u> | <u>\$ 8,424,903</u> | <u>100 %</u> |

**Residential Properties**

The revenue of LREIT is primarily generated from the portfolio of residential properties. During the six month period ended June 30, 2008, the portfolio of residential properties accounted for 92% of total revenues of the Trust.

The growth in the revenue of LREIT is also primarily attributable to the portfolio of residential properties. During the six month period ended June 30, 2008, the total revenue of LREIT increased by \$8.4 Million, compared to the first six months of 2007, with the residential property portfolio essentially accounting for all of the increase.

**Commercial Properties***Total Revenues*

During the six month period ended June 30, 2008, the portfolio of four commercial properties accounted for 7% of total revenue of LREIT. In comparison to the first six months of 2007, the revenue of the commercial portfolio decreased by \$160,294 during the first six months of 2008, primarily due to the increase in vacancy loss at the Kenaston Property.

*MAAX Warehouse*

The four commercial properties in the real estate portfolio of LREIT include the MAAX Warehouse building, a 39,936 square foot building in Airdrie, Alberta. Since the acquisition of the property in June 2003, the MAAX Warehouse building has been 100% leased to MAAX Inc. In 2007, the MAAX Warehouse building accounted for less than one half of a percent of the total revenue and operating income of the Trust.

In June 2008, MAAX Inc. successfully filed for creditor protection and advised that rent payments for the warehouse lease in Airdrie would be discontinued effective July 1, 2008 to the end of the lease term on December 31, 2008. Pending the releasing of the space, the reduction in revenue from the loss of the MAAX Warehouse lease will have a minimal impact on the overall financial position and results of operation of the Trust.

**Trust Operations**

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

As disclosed on the preceding chart, revenue from Trust operations accounted for 1% of the total revenue of LREIT during the six month period ended June 30, 2008. In comparison to the first six months of 2007, revenue from Trust operations decreased by \$294,505 during the the first six months of 2008. The decrease mainly reflects a reduction in interest income on mortgage loans receivable.

## Rental Revenue from Residential Properties

### Overall Increase

As noted above, revenue from residential properties increased by \$8,879,702 during the first six months of 2008. The increase is comprised of a \$8,850,992 increase in rental revenue and a \$28,710 increase in interest and other income.

The increase in residential rental revenue is mainly attributable to the acquisition of additional residential properties, as well as an improvement in the operating results of the residential properties which have been in the LREIT portfolio since January 1, 2007.

### Analysis of Residential Rental Revenue by Geographic Segment

#### Analysis of Residential Rental Revenue

|                             | Residential Rental Revenue |                     |                        |                          |                      |                        |
|-----------------------------|----------------------------|---------------------|------------------------|--------------------------|----------------------|------------------------|
|                             | Three Months Ended June 30 |                     |                        | Six Months Ended June 30 |                      |                        |
|                             | 2008                       | 2007                | Increase<br>(decrease) | 2008                     | 2007                 | Increase<br>(decrease) |
| Alberta                     |                            |                     |                        |                          |                      |                        |
| Fort McMurray               | \$ 6,982,132               | \$ 3,602,477        | \$ 3,379,655           | \$ 12,884,246            | \$ 6,019,267         | \$ 6,864,979           |
| Other Alberta               | <u>1,083,262</u>           | <u>864,384</u>      | <u>218,878</u>         | <u>2,152,482</u>         | <u>1,729,001</u>     | <u>423,481</u>         |
| Total - Alberta             | 8,065,394                  | 4,466,861           | 3,598,533              | 15,036,728               | 7,748,268            | 7,288,460              |
| Saskatchewan                | 2,923,431                  | 2,581,313           | 342,118                | 5,781,542                | 5,052,519            | 729,023                |
| Northwest Territories       | 1,510,116                  | 1,492,649           | 17,467                 | 3,027,429                | 2,223,560            | 803,869                |
| Manitoba                    | 531,260                    | 403,613             | 127,647                | 1,014,484                | 785,162              | 229,322                |
| British Columbia            | 366,765                    | 360,058             | 6,707                  | 734,864                  | 726,196              | 8,668                  |
| Ontario                     | <u>422,128</u>             | <u>408,008</u>      | <u>14,120</u>          | <u>614,169</u>           | <u>793,809</u>       | <u>(179,640)</u>       |
| Total Residential Portfolio | <u>\$ 13,819,094</u>       | <u>\$ 9,712,502</u> | <u>\$ 4,106,592</u>    | <u>\$ 26,209,216</u>     | <u>\$ 17,329,514</u> | <u>\$ 8,879,702</u>    |

#### Analysis of Rental Revenue by Geographic Market Segment - Residential Properties

|                       | Percentage of Total Rental Revenue |              |                          |              |
|-----------------------|------------------------------------|--------------|--------------------------|--------------|
|                       | Three Months Ended June 30         |              | Six Months Ended June 30 |              |
|                       | 2008                               | 2007         | 2008                     | 2007         |
| Alberta               |                                    |              |                          |              |
| Fort McMurray         | 50 %                               | 37 %         | 49 %                     | 35 %         |
| Other Alberta         | <u>8 %</u>                         | <u>9 %</u>   | <u>8 %</u>               | <u>10 %</u>  |
| Total - Alberta       | 58 %                               | 46 %         | 57 %                     | 45 %         |
| Saskatchewan          | 21 %                               | 27 %         | 22 %                     | 28 %         |
| Northwest Territories | 11 %                               | 15 %         | 12 %                     | 13 %         |
| Manitoba              | 4 %                                | 4 %          | 4 %                      | 5 %          |
| British Columbia      | 3 %                                | 4 %          | 3 %                      | 4 %          |
| Ontario               | <u>3 %</u>                         | <u>4 %</u>   | <u>2 %</u>               | <u>5 %</u>   |
|                       | <u>100 %</u>                       | <u>100 %</u> | <u>100 %</u>             | <u>100 %</u> |

The investment strategy of LREIT is to focus on the acquisition of multi-family residential properties primarily in markets across western and northern Canada. During the past two fiscal years however, the majority of new property acquisitions by LREIT have been located in Fort McMurray, Alberta, due to the favourable rental market conditions and the high operating margins which are being achieved in that city. In regard to the 18-month period between January 1, 2007 and June 30, 2008, LREIT expended approximately \$188 Million on property acquisitions and construction and development projects, of which approximately 75% pertains to new properties in Fort McMurray.

The acquisition of additional properties in Fort McMurray has resulted in a significant increase in the percentage of revenues contributed by the Fort McMurray property portfolio. During the second quarter of 2008, revenues from residential properties in Fort McMurray increased by \$3,379,655, compared to the second quarter 2007, representing 82% of the total increase in residential rental revenue (please refer to first chart, above). As a percentage of total rental revenues, the contribution by the Fort McMurray portfolio increased from 37% during the second quarter of 2007 to 50% during the second quarter of 2008 (please refer to second chart, above).

During the first six months of 2008, residential rental revenues increased by \$8,879,702 or 51%, compared to the first six months of 2007, primarily due to the same factors which contributed to the increase in residential rental revenue during the second quarter of 2008 and, in particular, the acquisition of additional properties in Fort McMurray. Overall, the Fort McMurray portfolio accounted for 49% of the total residential rental revenues for the six months ended June 30, 2008, compared to 35% for the first six months of 2007. The Fort McMurray portfolio also accounted for 77% of the total increase in residential rental revenues during the first six months of 2008.

### Vacancy Loss

#### Analysis of Vacancy by Geographic Market Segment

|                             | Percentage of Vacancy Loss |      |                          |      |
|-----------------------------|----------------------------|------|--------------------------|------|
|                             | Three Months Ended June 30 |      | Six Months Ended June 30 |      |
|                             | 2008                       | 2007 | 2008                     | 2007 |
| Alberta                     |                            |      |                          |      |
| Fort McMurray               | 3 %                        | 5 %  | 5 %                      | 5 %  |
| Other Alberta               | 2 %                        | 2 %  | 2 %                      | 2 %  |
| Total - Alberta             | 3 %                        | 4 %  | 5 %                      | 4 %  |
| Saskatchewan                | 2 %                        | 10 % | 3 %                      | 10 % |
| Northwest Territories       | - %                        | - %  | - %                      | - %  |
| Manitoba                    | 3 %                        | 17 % | 5 %                      | 20 % |
| British Columbia            | 5 %                        | 3 %  | 5 %                      | 2 %  |
| Ontario                     | 34 %                       | 7 %  | 34 %                     | 7 %  |
| Total Residential Portfolio | 4 %                        | 6 %  | 5 %                      | 6 %  |

As disclosed in the chart above, the overall vacancy loss of the property portfolio decreased from 6% during the second quarter of 2007 to 4% during the second quarter of 2008. The decrease is mainly due to a reduction in the vacancy loss for the property portfolios in Saskatchewan and Manitoba, partially offset by an increase in the vacancy loss for the property portfolio in British Columbia and Ontario. The improvement for the Saskatchewan portfolio reflects a significant reduction in the overall vacancy loss for all three of the rental markets where LREIT properties are located (Prince Albert, Moose Jaw and Saskatoon), while the improvement for the Manitoba portfolio is mainly due to the completion of the major renovation program at Highland Towers. The increase in the vacancy loss for the Ontario portfolio is associated with the new 60-suite addition at Elgin Lodge.

For the six month period ended June 30, 2008, the overall vacancy loss of the property portfolio was 5%, compared to 6% during the first six months of 2007. The overall change in vacancy is mainly attributable to the same factors for the change in the three months ended June 30, 2008, as compared to the same corresponding period in 2007.



## Operating Costs

### Analysis of Operating Costs

|                             | Property Operating Costs   |                     |                        |                          |                     |                        |
|-----------------------------|----------------------------|---------------------|------------------------|--------------------------|---------------------|------------------------|
|                             | Three Months Ended June 30 |                     | Increase<br>(Decrease) | Six Months Ended June 30 |                     | Increase<br>(Decrease) |
|                             | 2008                       | 2007                |                        | 2008                     | 2007                |                        |
| Alberta                     |                            |                     |                        |                          |                     |                        |
| Fort McMurray               | \$ 1,919,543               | \$ 1,068,182        | \$ 851,361             | \$ 3,799,362             | \$ 1,771,849        | \$ 2,027,513           |
| Other Alberta               | <u>430,163</u>             | <u>413,475</u>      | <u>16,688</u>          | <u>918,318</u>           | <u>898,838</u>      | <u>19,480</u>          |
| Total - Alberta             | 2,349,706                  | 1,481,657           | 868,049                | 4,717,680                | 2,670,687           | 2,046,993              |
| Saskatchewan                | 1,558,665                  | 1,430,328           | 128,337                | 3,213,270                | 2,916,260           | 297,010                |
| NWT                         | 594,537                    | 572,765             | 21,772                 | 1,208,758                | 890,251             | 318,507                |
| Manitoba                    | 248,746                    | 205,325             | 43,421                 | 490,952                  | 415,056             | 75,896                 |
| British Columbia            | 218,131                    | 199,592             | 18,539                 | 435,376                  | 431,472             | 3,904                  |
| Ontario                     | <u>271,301</u>             | <u>260,755</u>      | <u>10,546</u>          | <u>392,924</u>           | <u>519,935</u>      | <u>(127,011)</u>       |
| Total Residential Portfolio | 5,241,086                  | 4,150,422           | 1,090,664              | 10,458,960               | 7,843,661           | 2,615,299              |
| Total Commercial Portfolio  | <u>622,173</u>             | <u>457,399</u>      | <u>164,774</u>         | <u>1,083,350</u>         | <u>931,147</u>      | <u>152,203</u>         |
| Total                       | <u>\$ 5,863,259</u>        | <u>\$ 4,607,821</u> | <u>\$ 1,255,438</u>    | <u>\$ 11,542,310</u>     | <u>\$ 8,774,808</u> | <u>\$ 2,767,502</u>    |

During the second quarter of 2008, property operating costs for the residential portfolio increased by \$1,090,664 or 26%, compared to the second quarter of 2007, with the Fort McMurray portfolio accounting for the majority of the increase. As disclosed in the preceding chart, operating costs for the Fort McMurray portfolio increased by \$851,361 during the second quarter of 2008, representing 78% of the total increase in property operating costs for the residential portfolio. As with the second quarter revenue increase, the increase in operating costs in the Fort McMurray portfolio reflects the acquisition of Lakewood Manor and Millennium Village in the second half of 2007, as well as the inclusion of Laird's Landing as an income-producing property, effective June 1, 2008.

For the six month period ended June 30, 2008, property operating for the residential portfolio increased by \$2,615,299 or 33%, compared to the first six months of 2007, with the Fort McMurray portfolio accounting for the majority of the increase due to the additional property acquisitions in Fort McMurray, subsequent to January 1, 2007. The property portfolio in the Northwest Territories and in Saskatchewan account for the majority of the remaining increase in property operating costs. For the Northwest Territories portfolio, the increase in property operating costs is mainly due to the acquisition of Nova Court on March 22, 2007. Similarly, for the Saskatchewan portfolio, the increase in property operating costs is mainly due to the acquisition of Sir Robert Borden Place on May 1, 2007.

The decrease in operating costs for the Ontario portfolio for the six month period ended June 30, 2008, is mainly due to the temporary increase in vacancy associated with the expansion of Elgin Lodge.

## Net Operating Income and Operating Margin

### Overall

#### Summary Analysis of Net Operating Income

|              | Net Operating Income               |                     |                        | Operating Margin |             |
|--------------|------------------------------------|---------------------|------------------------|------------------|-------------|
|              | For the Three Months Ended June 30 |                     |                        |                  |             |
|              | Amount                             |                     | Increase<br>(Decrease) |                  |             |
|              | 2008                               | 2007                |                        | 2008             | 2007        |
| Residential  | \$ 8,578,009                       | \$ 5,562,073        | \$ 3,015,936           | 62 %             | 57 %        |
| Commercial   | 440,418                            | 668,489             | (228,071)              | 41 %             | 59 %        |
| Trust        | 93,572                             | 289,201             | (195,629)              | n/a              | n/a         |
| <b>Total</b> | <b>\$ 9,111,999</b>                | <b>\$ 6,519,763</b> | <b>\$ 2,592,236</b>    | <b>61 %</b>      | <b>59 %</b> |

  

|              | Net Operating Income             |                      |                        | Operating Margin |             |
|--------------|----------------------------------|----------------------|------------------------|------------------|-------------|
|              | For the Six Months Ended June 30 |                      |                        |                  |             |
|              | Amount                           |                      | Increase<br>(Decrease) |                  |             |
|              | 2008                             | 2007                 |                        | 2008             | 2007        |
| Residential  | \$ 15,750,257                    | \$ 9,485,853         | \$ 6,264,404           | 60 %             | 55 %        |
| Commercial   | 1,002,296                        | 1,314,794            | (312,498)              | 48 %             | 59 %        |
| Trust        | 309,388                          | 603,893              | (294,505)              | n/a              | n/a         |
| <b>Total</b> | <b>\$ 17,061,941</b>             | <b>\$ 11,404,540</b> | <b>\$ 5,657,401</b>    | <b>60 %</b>      | <b>57 %</b> |

After reflecting "interest and other income" from Trust operations, the net operating income ("NOI") of the Trust increased by \$2,592,236 during the second quarter of 2008, compared to the second quarter of 2007. For the six month period ended June 30, 2008, the NOI of the Trust increased by \$5,657,401, compared to the first six months of 2007.

### Residential Properties

During the second quarter of 2008, the NOI for the residential portfolio increased by \$3,015,936 or 54%, compared to the second quarter of 2007. The increase in NOI for the residential property portfolio mainly reflects the new income-producing properties in Fort McMurray and the fact that the operating margin for the Fort McMurray portfolio continues to be significantly higher in comparison to properties in other locations. During the second quarter of 2008, the NOI from the Fort McMurray portfolio increased by \$2.3 Million, representing 71% of the total increase in the NOI from the residential property portfolio. As disclosed in the following chart, during the second quarter of 2008, the operating margin for the Fort McMurray portfolio remained high at 73%, compared to an average of 50% for the remainder of the residential property portfolio.

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

|                       | Net Operating Income |                     |                      |                     | Operating Margin   |             |                  |             |
|-----------------------|----------------------|---------------------|----------------------|---------------------|--------------------|-------------|------------------|-------------|
|                       | Amount               |                     |                      |                     | Three Months Ended |             | Six Months Ended |             |
|                       | Three Months Ended   |                     | Six Months Ended     |                     | 2008               | 2007        | 2008             | 2007        |
|                       | 2008                 | 2007                | 2008                 | 2007                | 2008               | 2007        | 2008             | 2007        |
| Alberta               |                      |                     |                      |                     |                    |             |                  |             |
| Fort McMurray         | \$ 5,062,589         | \$ 2,534,295        | \$ 9,084,884         | \$ 4,247,418        | 73 %               | 70 %        | 71 %             | 71 %        |
| Other Alberta         | <u>653,099</u>       | <u>450,909</u>      | <u>1,234,164</u>     | <u>830,163</u>      | 60 %               | 52 %        | 57 %             | 48 %        |
| Total - Alberta       | 5,715,688            | 2,985,204           | 10,319,048           | 5,077,581           | 71 %               | 67 %        | 69 %             | 66 %        |
| Saskatchewan          | 1,364,766            | 1,150,985           | 2,568,274            | 2,136,261           | 47 %               | 45 %        | 44 %             | 42 %        |
| Northwest Territories | 915,579              | 919,884             | 1,818,671            | 1,333,309           | 61 %               | 62 %        | 60 %             | 60 %        |
| Manitoba              | 282,514              | 198,288             | 523,532              | 370,106             | 53 %               | 49 %        | 52 %             | 47 %        |
| British Columbia      | 148,634              | 160,466             | 299,488              | 294,724             | 41 %               | 45 %        | 41 %             | 41 %        |
| Ontario               | <u>150,828</u>       | <u>147,246</u>      | <u>221,244</u>       | <u>273,872</u>      | 36 %               | 36 %        | 36 %             | 35 %        |
| Total Residential     | <u>\$ 8,578,009</u>  | <u>\$ 5,562,073</u> | <u>\$ 15,750,257</u> | <u>\$ 9,485,853</u> | <u>62 %</u>        | <u>57 %</u> | <u>60 %</u>      | <u>55 %</u> |

The most significant change in the operating margin occurred in the "Other Alberta" portfolio, with the margin increasing from 52% in 2007 to 60% in 2008. The improvement in the operating margin reflects rental rate increases offset by a marginal increase in vacancy loss.

Overall, the operating margin for the property portfolio improved during the second quarter of 2008, resulting in an increase in the operating margin for the entire residential portfolio from 57% during the second quarter of 2007 to 62% during the second quarter of 2008.

During the six month period ended June 30, 2008, the NOI of the residential portfolio increased by \$6,264,404 or 66%, compared to the six month period ended June 30, 2007, with the Fort McMurray portfolio accounting for 77% of the increase.

**Same Property Analysis**

The same property analysis for the first six months of 2008 encompasses 29 income-producing properties and 30 income-producing properties for the second quarter of 2008, as a result of the acquisition of Nova Court in March 2007.

As disclosed in the following analysis, the combined revenue of the 29 properties increased by 8.8% during the first six months of 2008, compared to the first six months of 2007, while net operating income increased by 9.5%. For the second quarter of 2008, the revenue and NOI increase was 11.7% and 12.8%, respectively, compared to the second quarter of 2007.

The improvement in net operating income is mainly attributable to the improvement in the operating margins, as discussed above. Specifically, the improvement in same property NOI reflects rental rate increases and an improvement in occupancy levels at the majority of the "same" properties.

|                      | Six Months Ended June 30   |               | Increase (Decrease) |        |
|----------------------|----------------------------|---------------|---------------------|--------|
|                      | 2008                       | 2007          | Amount              | %      |
| Total revenue        | \$ 16,722,063              | \$ 15,365,626 | \$ 1,356,437        | 8.8 %  |
| Net operating income | \$ 8,984,045               | \$ 8,202,436  | \$ 781,609          | 9.5 %  |
|                      | Three Months Ended June 30 |               | Increase (Decrease) |        |
|                      | 2008                       | 2007          | Amount              | %      |
| Total revenue        | \$ 10,636,933              | \$ 9,519,903  | \$ 1,117,030        | 11.7 % |
| Net operating income | \$ 6,123,769               | \$ 5,427,672  | \$ 696,097          | 12.8 % |

### Trust Expense

Trust expense increased by \$18,260 during the second quarter of 2008, compared to the second quarter in 2007. The increase mainly reflects the following factors:

- an increase of \$115,386 in the service fee of Shelter Canadian in regard to administrative and asset management services due to the increased size of the Trust's assets. The fee is equal to 0.3% of the net book value of the assets of LREIT, excluding cash and accumulated amortization, as of the date of the most recently issued financial statements.

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

- a decrease in unit-based compensation expense of \$92,683. The decrease reflects the fact that unit-based compensation expense was relatively high during the second quarter of 2007, as the 2007 second quarter results included a portion of unit-based compensation expense related to unit options that were issued in 2006, and 100% of the unit-based compensation expense related to the unit options that were issued in June 2007.

For the six month period ended June 30, 2008, Trust expense increased by \$294,845, mainly due to an increase of \$276,526 in the service fee of Shelter Canadian. Unit-based compensation expense increased by \$15,537 during the majority of six month period ended June 30, 2008, as unit-based compensation expense related to the unit options that were issued in January 2008 was recorded in the first quarter of 2008, thereby offsetting the decrease in unit compensation expense which occurred during the second quarter of 2008.

### Financing Expense

Financing expense increased by \$1,422,818 or 26% in during the second quarter of 2008, compared to the second quarter of 2007, of which \$1,457,896 pertains to mortgage loan financing. For the six month period ended June 30, 2008, financing expense increased by \$3,716,065 or 37%, of which 99% pertains to mortgage loan financing (please refer to the following chart).

Financing expense for the three and six month period ended June 30, 2008 includes amortization charges for transaction costs, accretion and the change in fair value of interest rate swap of \$944,549 and \$1,916,166, respectively.

**Analysis of Financing Expense**

|                                    | Three Months Ended June 30 |                     | Six Months Ended June 30 |                      |
|------------------------------------|----------------------------|---------------------|--------------------------|----------------------|
|                                    | 2008                       | 2007                | 2008                     | 2007                 |
| <b>Mortgage Loans</b>              |                            |                     |                          |                      |
| Mortgage loan interest             | \$ 4,982,161               | \$ 3,496,450        | \$ 9,815,175             | \$ 6,047,854         |
| Amortization of transaction costs  | 261,924                    | 238,710             | 480,345                  | 482,213              |
| Change in value - swap asset       | (51,029)                   | -                   | (51,029)                 | -                    |
| Total - mortgage loans             | <u>5,193,056</u>           | <u>3,735,160</u>    | <u>10,244,491</u>        | <u>6,530,067</u>     |
| <b>Debentures</b>                  |                            |                     |                          |                      |
| Interest on convertible debentures | 977,975                    | 1,053,821           | 1,987,810                | 2,108,360            |
| Accretion of debt component        | 593,791                    | 556,557             | 1,192,301                | 1,094,021            |
| Amortization of transaction costs  | <u>139,863</u>             | <u>136,329</u>      | <u>294,549</u>           | <u>270,638</u>       |
| Total - debentures                 | <u>1,711,629</u>           | <u>1,746,707</u>    | <u>3,474,660</u>         | <u>3,473,019</u>     |
| <b>Total - financing expense</b>   | <u>\$ 6,904,685</u>        | <u>\$ 5,481,867</u> | <u>\$ 13,719,151</u>     | <u>\$ 10,003,086</u> |

**Financing Expense - Mortgage Loans**

Mortgage loan interest increased by \$1,485,711 or 42% during the second quarter of 2008, compared to the second quarter of 2007 and by \$3,763,321 or 62% for the comparative six month periods. The increase reflects the increase in mortgage loan debt, as discussed in the "Mortgage Loans Payable" section of this report.

**Financing Expense - Debentures**

During the three and six month period ended June 30, 2008, interest on convertible debentures decreased by \$75,846 or 7% and by \$120,550 or 6% , respectively, compared to the same period in 2007. The decrease mainly reflects the retirement of \$1.6 Million of Series D Convertible Debentures in March 2008.

**Total Interest Expense**

As a percentage of operating income, total interest for mortgage loans and convertible debentures decreased from 70% during the second quarter of 2007 to 65% during the same period in 2008 and from 72% to 69% for the comparable six month periods. The decrease in the ratio of interest, relative to operating income, reflects the extent to which the increase in net operating income has exceeded the increase in interest expense during the first six months of the year, due to the following inter-related factors:

- (i) an improvement in NOI returns from the asset base of the Trust, particularly in regard to properties which progressed from the development stage to the income-producing stage; and
- (ii) a decrease in the amount of convertible debenture debt; partially offset by
- (iii) an increase in the mortgage loan debt ratio of income-producing properties.

The percentage of total interest expense to operating income of 69% for the first six months of 2008 reflects a percentage of 73% for the first quarter of 2008 and a percentage of 65% for the second quarter of 2008. The lower percentage for the second quarter of 2008 mainly reflects an ongoing improvement in operating income, net of interest expense, throughout the first six months of 2008.

**Amortization Expense**

During the three and six month period ended June 30, 2008, amortization expense increased by \$454,526 or 23% and by \$1,071,457 or 29%, respectively, compared to the same period in 2007. The increase is mainly due to amortization charges for the additional income-producing properties which were in the LREIT property portfolio during the first half of 2008. Amortization expense on the Consolidated Statement of Income (Loss) excludes amortization charges for transaction costs.

## Comparison to Preceding Quarter

### Analysis of Income (Loss) - Second Quarter 2008 vs. First Quarter 2008

|  | Three Months Ended    |                  | Increase<br>(Decrease) |          |
|--|-----------------------|------------------|------------------------|----------|
|  | June 30, 2008         | March 31, 2008   |                        |          |
| Rental revenue   | \$ 14,768,829         | \$ 13,276,821    | \$ 1,492,008           | 11.2 %   |
| Interest and other income  | 206,429               | 352,172          | (145,743)              | (41.4)%  |
| Property operating costs   | <u>5,863,259</u>      | <u>5,679,051</u> | <u>184,208</u>         | 3.2 %    |
| Net Operating Income (NOI)   | 9,111,999             | 7,949,942        | 1,162,057              | 14.6 %   |
| Trust expense  | <u>551,996</u>        | <u>734,907</u>   | <u>(182,911)</u>       | (24.9)%  |
| Income before financing expense, amortization, non-controlling interest and taxes (EBITDA) | 8,560,003             | 7,215,035        | 1,344,968              | 18.6 %   |
| Financing expense  | <u>6,904,685</u>      | <u>6,814,465</u> | <u>90,220</u>          | 1.3 %    |
| Income before amortization, non-controlling interest and taxes                             | 1,655,318             | 400,570          | 1,254,748              | 313.2 %  |
| Amortization   | 2,390,830             | 2,332,098        | 58,732                 | 2.5 %    |
| Non-controlling interest   | <u>17,136</u>         | <u>21,370</u>    | <u>(4,234)</u>         | (19.8)%  |
| Loss before future income tax recoveries   | (752,648)             | (1,952,898)      | 1,200,250              | (61.5)%  |
| Future income tax (expense) recovery   | <u>(4,236,163)</u>    | <u>1,953,199</u> | <u>(6,189,362)</u>     | (316.9)% |
| Income (loss) for the period   | <u>\$ (4,988,811)</u> | <u>\$ 301</u>    | <u>\$ (4,989,112)</u>  |          |

Excluding future income tax recoveries, LREIT incurred a loss of \$752,648 during the second quarter of 2008, compared to a loss of \$1,952,898 during the first quarter of 2008. The decrease in the loss mainly reflects an increase in net operating income of \$1,162,057 due to an improvement in overall occupancy level of the property portfolio, as well as the inclusion of Laird's Landing as an income-producing property, effective June 1, 2008.

Other factors which affected the comparative results for the first and second quarter of 2008 are as follows:

- financing expense increased by \$90,220 or 1.3%. The increase mainly reflects incremental interest on the mortgage loan financing for Laird's Landing.
- Trust expense decreased by \$182,911 or 24.9%. The decrease mainly reflects the fact that unit-based compensation expense was comparatively high in the first quarter of 2008, as the majority of the unit-based compensation expense for the unit options which were issued in January 2008 was recorded in the first quarter.
- amortization expense increased by \$58,732 or 2.5%, mainly due to the inclusion of Laird's Landing as an income-producing property, effective June 1, 2008.

After reflecting a decrease in future income tax recoveries of approximately \$6.2 Million in the second quarter, LREIT completed the three month period ended June 30, 2008 with a loss of \$4,988,811, compared to income of \$301 during the first quarter of 2008. The decrease in the amount of the future income tax recoveries mainly reflects an adjustment to the future projected taxable income of the Trust, as a result of the favourable results of new property acquisitions.

## Summary of Quarterly Results

### Quarterly Analysis

|   | 2008           |                | 2007           |                |
|---|----------------|----------------|----------------|----------------|
|   | Q2             | Q1             | Q4             | Q3             |
| Total revenue                                 | \$ 14,975,258  | \$ 13,628,993  | \$ 13,534,875  | \$ 12,597,091  |
| Net operating income                          | \$ 9,111,999   | \$ 7,949,942   | \$ 7,822,808   | \$ 7,845,308   |
| Income (loss) for the period                  | \$ (4,988,811) | \$ 301         | \$ (1,108,898) | \$ 725,735     |
| Loss for the period, before future income tax | \$ (752,648)   | \$ (1,952,898) | \$ (1,742,327) | \$ (1,188,347) |

### PER UNIT

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Net operating income                          |            |            |            |            |
| - basic                                       | \$ 0.520   | \$ 0.455   | \$ 0.447   | \$ 0.449   |
| - diluted                                     | \$ 0.357   | \$ 0.312   | \$ 0.330   | \$ 0.331   |
| Income (loss) for the period                  |            |            |            |            |
| - basic                                       | \$ (0.284) | \$ -       | \$ (0.064) | \$ 0.042   |
| - diluted                                     | \$ (0.284) | \$ -       | \$ (0.064) | \$ 0.042   |
| Loss for the period, before future income tax |            |            |            |            |
| - basic                                       | \$ (0.043) | \$ (0.112) | \$ (0.100) | \$ (0.068) |
| - diluted                                     | \$ (0.043) | \$ (0.112) | \$ (0.100) | \$ (0.068) |

### Quarterly Analysis

|   | 2007           |                | 2006             |                  |
|---|----------------|----------------|------------------|------------------|
|   | Q2             | Q1             | Q4<br>(restated) | Q3<br>(restated) |
| Total revenue                                 | \$ 11,127,584  | \$ 9,051,765   | \$ 8,835,557     | \$ 8,370,252     |
| Net operating income                          | \$ 6,519,763   | \$ 4,884,730   | \$ 4,796,613     | \$ 4,912,506     |
| Income (loss) for the period                  | \$ 688,355     | \$ (1,706,093) | \$ (563,581)     | \$ (829,956)     |
| Loss for the period, before future income tax | \$ (1,417,123) | \$ (1,032,626) | \$ (1,066,410)   | \$ (807,917)     |

### PER UNIT

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Net operating income                          |            |            |            |            |
| - basic                                       | \$ 0.374   | \$ 0.281   | \$ 0.278   | \$ 0.284   |
| - diluted                                     | \$ 0.295   | \$ 0.255   | \$ 0.267   | \$ 0.266   |
| Income (loss) for the period                  |            |            |            |            |
| - basic                                       | \$ 0.039   | \$ (0.033) | \$ (0.048) | \$ (0.045) |
| - diluted                                     | \$ 0.039   | \$ (0.033) | \$ (0.048) | \$ (0.045) |
| Loss for the period, before future income tax |            |            |            |            |
| - basic                                       | \$ (0.081) | \$ (0.060) | \$ (0.062) | \$ (0.047) |
| - diluted                                     | \$ (0.081) | \$ (0.060) | \$ (0.062) | \$ (0.047) |

**Loss Per Unit****Analysis of Loss per Unit**

|   | Six Months Ended June 30 |            | Change     |        |
|---|--------------------------|------------|------------|--------|
|   | 2008                     | 2007       |            |        |
| Income (loss) for the period                  |                          |            |            |        |
| - basic                                       | \$ (0.285)               | \$ (0.058) | \$ (0.227) | (391)% |
| - diluted                                     | \$ (0.285)               | \$ (0.058) | \$ (0.227) | (391)% |
| Loss for the period, before future income tax |                          |            |            |        |
| - basic                                       | \$ (0.155)               | \$ (0.184) | \$ 0.029   | 16 %   |
| - diluted                                     | \$ (0.155)               | \$ (0.184) | \$ 0.029   | 16 %   |

Excluding future income tax recoveries, LREIT incurred a loss of \$0.155 per unit during the six months ended June 30, 2008, compared to a loss of \$0.184 per unit during the same period in 2007. As the weighted average number of units only increased by 0.5% during the six months ended June 30, 2008 compared to the same period in 2007, the decrease in the loss per unit mainly reflects the decrease in the overall loss of the trust before future tax recoveries.

**ANALYSIS OF CASH FLOWS****Operating****Cash from Operating Activities***Second Quarter Comparatives*

|   | Three Months Ended June 30 |               | Increase<br>(Decrease) |
|---|----------------------------|---------------|------------------------|
|   | 2008                       | 2007          |                        |
| Rental revenue  | \$ 14,768,829              | \$ 10,737,804 | \$ 4,031,025           |
| Interest and other income   | 206,429                    | 389,780       | (183,351)              |
| Property operating costs  | 5,863,259                  | 4,607,821     | 1,255,438              |
| Net operating income (NOI)  | 9,111,999                  | 6,519,763     | 2,592,236              |
| Non-cash components of revenue  | 680                        | 10,509        | (9,829)                |
|   | 9,111,319                  | 6,509,254     | 2,602,065              |
| Financing expense   | 6,904,685                  | 5,481,867     | 1,422,818              |
| Non-cash component of financing expense   | 944,549                    | 931,596       | 12,953                 |
|   | 5,960,136                  | 4,550,271     | 1,409,865              |
| Trust expense   | 551,996                    | 533,736       | 18,260                 |
| Non-cash component of trust expense   | 36,046                     | 128,729       | (92,683)               |
|   | 515,950                    | 405,007       | 110,943                |
| Cash provided by operating activities, before changes in non-cash operating activities, tenant inducements and leasing expenses | 2,635,233                  | 1,553,976     | 1,081,257              |
| Tenant inducements and leasing expenses   | -                          | 31,369        | (31,369)               |
|   | 2,635,233                  | 1,522,607     | 1,112,626              |
| Changes in non-cash operating items   | 402,484                    | (477,939)     | 880,423                |
| Cash provided by operating activities   | \$ 3,037,717               | \$ 1,044,668  | \$ 1,993,049           |



During the second quarter of 2008, LREIT generated cash from operating activities of \$3,037,717. After excluding changes in non-cash operating items, cash from operating activities increased by \$1,112,626 or 73% during the second quarter of 2008, compared to the second quarter of 2007. The increase mainly reflects an increase in net operating income, partially offset by an increase in the cash component of financing expense. Specifically, net operating income increased by \$2,592,236, while the cash component of financing expense increased by \$1,409,865. The cash component of financing expense reflects mortgage loan interest, interest on the line of credit and convertible debenture payments and is calculated by excluding amortization of transaction costs, the change in the fair value of the swap asset and the accretive portion of the debt component of convertible debentures.

The increase in mortgage loan interest accounts for the majority of the increase in the cash component of financing expense. Specifically, mortgage loan interest increased by \$1,376,516 during the second quarter of 2008, representing 98% of the increase in the cash component of financing expense. The increase in mortgage loan interest is mainly attributable to the mortgage financing for 2007 property acquisitions and the interim financing which has been arranged since June 30, 2007.

The cash component of trust expense increased by \$110,943 during the second quarter of 2008 and is mainly due to an increase in the service fee of Shelter Canadian. The cash component of trust expense excludes unit compensation expense.

#### *Six Month Comparatives*

|   | Six Months Ended June 30 |                     | Increase<br>(Decrease) |
|---|--------------------------|---------------------|------------------------|
|   | 2008                     | 2007                |                        |
| Rental revenue  | \$ 28,045,650            | \$ 19,357,786       | \$ 8,687,864           |
| Interest and other income   | 558,601                  | 821,562             | (262,961)              |
| Property operating costs  | <u>11,542,310</u>        | <u>8,774,808</u>    | <u>2,767,502</u>       |
| Net operating income (NOI)  | 17,061,941               | 11,404,540          | 5,657,401              |
| Non-cash components of revenue  | <u>1,254</u>             | <u>32,079</u>       | <u>(30,825)</u>        |
|   | <u>17,060,687</u>        | <u>11,372,461</u>   | <u>5,688,226</u>       |
| Financing expense   | 13,719,151               | 10,003,086          | 3,716,065              |
| Non-cash component of financing expense   | <u>1,916,166</u>         | <u>1,846,872</u>    | <u>69,294</u>          |
|   | <u>11,802,985</u>        | <u>8,156,214</u>    | <u>3,646,771</u>       |
| Trust expense   | 1,286,903                | 992,058             | 294,845                |
| Non-cash component of trust expense   | <u>227,937</u>           | <u>212,400</u>      | <u>15,537</u>          |
|   | <u>1,058,966</u>         | <u>779,658</u>      | <u>279,308</u>         |
| Cash provided by operating activities, before changes in non-cash operating activities, tenant inducements and leasing expenses | 4,198,736                | 2,436,589           | 1,762,147              |
| Tenant inducements and leasing expenses   | <u>2,178</u>             | <u>95,853</u>       | <u>(93,675)</u>        |
|   | 4,196,558                | 2,340,736           | 1,855,822              |
| Changes in non-cash operating items   | <u>173,374</u>           | <u>(159,622)</u>    | <u>332,996</u>         |
| Cash provided by operating activities   | <u>\$ 4,369,932</u>      | <u>\$ 2,181,114</u> | <u>\$ 2,188,818</u>    |

During the six month period ended June 30, 2008, cash from operating activities, excluding changes to non-cash operating items, increased by \$1,855,822 or 79%, compared to the first six months of 2007. The increase is mainly due to the same factors which contributed to the increase for the second quarter of 2008, namely an increase in net operating income, partially offset by an increase in the cash component of financing expense.

Overall, the increase in cash from operating activities for the first six months of 2008 is comprised of an increase of \$195,769 in the first quarter of 2008 and an increase of \$1,993,049 in the second quarter of 2008. The significantly higher increase in the second quarter of 2008 reflects an ongoing improvement in the NOI return on the total asset base of the Trust, net of the cash component of financing expense.

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

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

During the three months ended June 30, 2008, FFO increased by \$1,151,158, compared to the same period in 2007, while AFFO increased by \$1,240,361. On a basic per unit basis, FFO increased by \$0.065 per unit, while AFFO increased by \$0.070 per unit. For the six month comparative figures, FFO and AFFO increased by \$1,646,491 and \$1,952,380, respectively, in 2008, representing an increase of \$0.095 per unit for FFO and \$0.111 per unit for AFFO.

#### Funds from Operations/Adjusted Funds from Operations \*

|  | Three Months Ended June 30 |                   | Six Month Ended June 30 |                     |
|--|----------------------------|-------------------|-------------------------|---------------------|
|  | 2008                       | 2007              | 2008                    | 2007                |
| Income (loss) for the year                             | \$ (4,988,811)             | \$ 688,355        | \$ (4,988,510)          | \$ (1,017,738)      |
| Add (deduct):  |                            |                   |                         |                     |
| Amortization expense                                   | 2,390,830                  | 1,936,304         | 4,722,928               | 3,651,471           |
| Future income tax                                      | 4,236,163                  | (2,105,478)       | 2,282,964               | (2,185,352)         |
| Non-controlling interest                               | 17,136                     | (15,021)          | 38,505                  | (38,985)            |
| <b>Funds from operations</b>                           | <b>1,655,318</b>           | <b>504,160</b>    | <b>2,055,887</b>        | <b>409,396</b>      |
| Add (deduct):  |                            |                   |                         |                     |
| Straight-line rent adjustment                          | (1,122)                    | (10,908)          | (2,141)                 | (32,878)            |
| Net amortization of above/below market in-place leases | 444                        | 399               | 887                     | 799                 |
| Accretion of debt component of convertible debentures  | 593,791                    | 556,557           | 1,192,301               | 1,094,021           |
| Unit-based compensation                                | 33,046                     | 128,729           | 227,937                 | 212,400             |
| Tenant inducement and leasing expenses                 | -                          | (31,369)          | (2,178)                 | (95,853)            |
| Ongoing improvements to income properties              | (227,063)                  | (333,515)         | (358,235)               | (425,807)           |
| <b>Adjusted funds from operations</b>                  | <b>\$ 2,054,414</b>        | <b>\$ 814,053</b> | <b>\$ 3,114,458</b>     | <b>\$ 1,162,078</b> |
| FFO per unit   |                            |                   |                         |                     |
| - basic  | \$ 0.094                   | \$ 0.029          | \$ 0.118                | \$ 0.023            |
| - diluted  | \$ 0.094                   | \$ 0.028          | \$ 0.116                | \$ 0.023            |
| AFFO per unit  |                            |                   |                         |                     |
| - basic  | \$ 0.117                   | \$ 0.047          | \$ 0.178                | \$ 0.067            |
| - diluted  | \$ 0.117                   | \$ 0.046          | \$ 0.172                | \$ 0.065            |

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

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

## Distributable Income

### General

The stated policy of LREIT is to distribute cash to the Unitholders, on a monthly basis, in an amount which is approximately equal to 90% of the annual "Distributable income" of the Trust. Cash distributions may also be established at a specific level, as determined by the Trust and, as such, may exceed distributable income.

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

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

|  | Three Months Ended June 30 |                     | Six Months Ended June 30 |                     |
|--|----------------------------|---------------------|--------------------------|---------------------|
|  | 2008                       | 2007                | 2008                     | 2007                |
| Cash provided by operating activities, per Statement of Cash Flows | \$ 3,037,717               | \$ 1,044,668        | \$ 4,369,932             | \$ 2,181,114        |
| Changes in non-cash operating items                                | <u>(402,483)</u>           | <u>477,939</u>      | <u>(173,374)</u>         | <u>159,622</u>      |
|  | 2,635,234                  | 1,522,607           | 4,196,558                | 2,340,736           |
| Add (deduct):  |                            |                     |                          |                     |
| Tenant inducement and leasing expenses                             | -                          | 31,369              | 2,178                    | 95,853              |
| Amortization of tenant inducement and leasing expenses             | <u>(67,887)</u>            | <u>(97,184)</u>     | <u>(143,337)</u>         | <u>(197,648)</u>    |
| Distributable income   | <u>\$ 2,567,347</u>        | <u>\$ 1,456,792</u> | <u>\$ 4,055,399</u>      | <u>\$ 2,238,941</u> |
| Per unit   |                            |                     |                          |                     |
| - Basic  | \$ 0.147                   | \$ 0.084            | \$ 0.232                 | \$ 0.128            |
| - Diluted  | \$ 0.139                   | \$ 0.082            | \$ 0.219                 | \$ 0.126            |

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

Tenant inducements and leasing expense fluctuate significantly throughout the year. Accordingly, the cash outlay for tenant inducements and leasing expenses is added-back for purposes of calculating distributable income, while amortization charges for cumulative tenant inducements and leasing expenses are deducted, as the amortization charges are considered to provide a more even distribution of leasing expenditures.

### Distribution Variances

As disclosed in the following chart, distributable income exceeded total distributions by \$103,603 or 4% for the three months ended June 30, 2008. For the six month period ended June 30, 2008, there was a shortfall in distributable income, compared to total distributions of \$865,246 or 18%. For the three and six months ended June 30, 2007, the shortfall in distributable income was 40% and 54%, respectively.

For the three months ended June 30, 2008, cash from operating activities exceeded total distributions by \$573,973 or 23%, while distributions exceeded cash from operating activities by \$550,713 or 11% for the six months ended June 30, 2008. The six month variance between cash flows and distributions in 2008 of 11%, is comprised of a 46% unfavourable variance in the first quarter of 2008 and a 23% favourable variance in the second quarter of 2008 and also reflects an ongoing improvement in NOI returns during the first six months of 2008.

For the three and six month periods ended June 30, 2007, the shortfall in distributable income, compared to cash from operating activities, was 57% and 55%, respectively.

|  | Three Months Ended June 30 |                       | Six Months Ended June 30 |                       |
|--|----------------------------|-----------------------|--------------------------|-----------------------|
|  | 2008                       | 2007                  | 2008                     | 2007                  |
| Total distributions  | <u>\$ 2,463,744</u>        | <u>\$ 2,439,035</u>   | <u>\$ 4,920,645</u>      | <u>\$ 4,865,858</u>   |
| Distributable income   | <u>\$ 2,567,347</u>        | <u>\$ 1,456,792</u>   | <u>\$ 4,055,399</u>      | <u>\$ 2,238,941</u>   |
| Excess of distributions over distributable income                  | <u>\$ 103,603</u>          | <u>\$ (982,243)</u>   | <u>\$ (865,246)</u>      | <u>\$ (2,626,917)</u> |
| Cash provided by operating activities                              | <u>\$ 3,037,717</u>        | <u>\$ 1,044,668</u>   | <u>\$ 4,369,932</u>      | <u>\$ 2,181,114</u>   |
| Excess of distributions over cash provided by operating activities | <u>\$ 573,973</u>          | <u>\$ (1,394,367)</u> | <u>\$ (550,713)</u>      | <u>\$ (2,684,744)</u> |

To the extent that the cash outflow from distributions exceeds the cash inflow from operating activities, the difference was effectively funded from financing activities, or more specifically, from mortgage loan proceeds.

The significant improvement in the variance between total distributions declared, compared to distributable income and cash from operating activities, for both the three and six month periods in 2008, mainly reflects the extent to which the increase in net operating income has exceeded the increase in financing expense during the year. As additional properties move from the development stage to the income-producing stage and as additional properties are acquired, it is anticipated that the variance between the total distributions and operating cash flows will continue to improve, although there is no assurance that this will be the case.

## Financing/Investment Activities

The following chart provides a summary of the cash flow activities of the Trust.

As disclosed in the chart, the net cash provided by financing activities, excluding distributions, exceeded the net cash used in investment activities by \$10,480,174 during the first six months of 2008. Financing activities consisted primarily of transactions related to mortgage loan financing, as well as the repayment of the outstanding principal balance of the Series D debentures and the purchase of units under the normal course issue bid. Investment activities consisted primarily of cash outflows associated with property acquisitions, the development of new properties and the funding for new deposits on potential acquisitions.

An analysis of the components of mortgage loan financing transactions is also provided in the section of this Report entitled "Mortgage Loans Payable".

After providing for the cash inflows from operating activities and the cash outflow in regard to distributions, the net cash increase for the first six months of 2008 was \$11,207,627. After accounting for the opening bank indebtedness of \$1,623,651, LREIT completed the six month period ended June 30, 2008 with a cash balance of \$9,583,976.

**Cash Flow Analysis (Note 1)**

|  | Three Months Ended<br>June 30, 2008 | Three Months Ended<br>March 31, 2008 | Six Months Ended<br>June 30, 2008 |
|--|-------------------------------------|--------------------------------------|-----------------------------------|
| <b>Financing Activities:</b>                         |                                     |                                      |                                   |
| Mortgage proceeds                                    | \$ 36,951,706                       | \$ 11,894,520                        | \$ 48,846,226                     |
| Mortgage principal payments                          | (1,675,160)                         | (1,421,203)                          | (3,096,363)                       |
| Repayment of Series D debentures                     | -                                   | (1,593,000)                          | (1,593,000)                       |
| Normal course issuer bid                             | (188,120)                           | (11,856)                             | (199,976)                         |
| Transaction costs                                    | (450,987)                           | (221,020)                            | (672,007)                         |
| Total financing                                      | <u>34,637,439</u>                   | <u>8,647,441</u>                     | <u>43,284,880</u>                 |
| <b>Investing Activities:</b>                         |                                     |                                      |                                   |
| Property acquisitions                                | (21,720,000)                        | -                                    | (21,720,000)                      |
| Improvements to income properties                    | (227,063)                           | (131,172)                            | (358,235)                         |
| Construction of income properties                    | (417,154)                           | -                                    | (417,154)                         |
| Properties under development                         | (2,739,676)                         | (6,290,300)                          | (9,029,976)                       |
| Deposits   | (860,000)                           | -                                    | (860,000)                         |
| Restricted cash                                      | (267,655)                           | (151,686)                            | (419,341)                         |
| Total investing                                      | <u>(26,231,548)</u>                 | <u>(6,573,158)</u>                   | <u>(32,804,706)</u>               |
| <b>Net cash inflow of investment capital</b>         | 8,405,891                           | 2,074,283                            | 10,480,174                        |
| Operating activities                                 | <u>3,037,717</u>                    | <u>1,332,215</u>                     | <u>4,369,932</u>                  |
| Cash before distributions                            | 11,443,608                          | 3,406,498                            | 14,850,106                        |
| Cash distributions                                   | <u>(2,161,895)</u>                  | <u>(1,480,584)</u>                   | <u>(3,642,479)</u>                |
| <b>Cash increase</b>                                 | 9,281,713                           | 1,925,914                            | 11,207,627                        |
| <b>Cash (bank indebtedness), beginning of period</b> | <u>302,263</u>                      | <u>(1,623,651)</u>                   | <u>(1,623,651)</u>                |
| <b>Cash, end of period</b>                           | <u>\$ 9,583,976</u>                 | <u>\$ 302,263</u>                    | <u>\$ 9,583,976</u>               |

**Note 1 - GAAP Measurements**

The preceding cash flow analysis represents the re-formatting of balances from the Consolidated Statement of Cash Flows in the financial statements in order to provide Unitholders with a direct depiction of the net inflow/outflow of investment capital, before considering the impact of operating activities and cash distributions. The components of financing activities, investing activities and operating activities, as disclosed in the analysis, agree to the Consolidated Statement of Cash Flows, with the exception of cash distributions which are excluded from financing activities and disclosed as a separate line item. The order of presentation of financing, investing and operating activities also differs from the Consolidated Statement of Cash Flows, in order to derive the subtotal entitled "net cash outflow of investment capital". Aside from the exclusion of cash distributions from financing activities and the subtotal entitled "net cash outflow of investment capital", the analysis consists entirely of GAAP measurements.

**CAPITAL RESOURCES AND LIQUIDITY****Working Capital Requirements**

On an annual basis, LREIT is generating sufficient cash from operating activities to fully fund monthly mortgage loan principal payments and ongoing improvements to income properties. After deducting mortgage loan principal payments of \$3,096,363 and improvement costs for income properties of \$358,235 from the cash provided by operating activities of \$4,369,932, the cash surplus was \$915,334 for the six months ended June 30, 2008.

LREIT requires other sources of capital in order to fund property acquisitions, major renovations and expansion projects, lump-sum convertible debenture repayments and a portion of the monthly distributions.

## Contractual Obligations

### Property Acquisitions

The following chart provides a summary of the approximate amount of the capital commitments of LREIT in regard to property acquisitions subsequent to June 30, 2008.

| Property   | Approximate Amount     | Description  |
|--|------------------------|--|
| <b>Siena Apartments</b><br>(closed, July 2, 2008)                | \$4.7 Million          | - represents the purchase price of \$30 Million and estimated closing costs, less mortgage financing and deposits  |
| <b>Parsons Landing</b><br>(additional deposit in September 2008) | 2.5 Million            | - represents the total purchase price of \$60.7 Million plus GST and estimated closing costs, less the projected mortgage loan financing of \$50.0 Million, the \$4.75 Million mortgage loan receivable, payments of \$7.75 Million and the \$2.5 Million additional deposit |
| (mortgage proceeds, net of acquisition payable in December 2008) | (1.8 Million)          |  |
| <b>Colony Square</b><br>(closing date, October 1, 2008)          | 5.3 Million            | - represents the purchase price of \$34.2 Million for an 89.4% interest and estimated closing costs, less pro-rata assumed mortgage financing of \$21 Million and a subordinate loan of \$6.7 Million.   |
|  | <u>\$ 10.7 Million</u> |  |

### Mortgage Loan Debt

A summary of the debt obligations of LREIT for the remainder of 2008 and for each of the next five years and thereafter, is provided in the following chart:

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

| <u>Payments Due by Period</u>   | <u>Total</u>          | <u>≤ 1 Year</u>      | <u>2 - 3 Years</u>   | <u>4 - 5 Years</u>   | <u>≥ 5 Years</u>      |
|---------------------------------|-----------------------|----------------------|----------------------|----------------------|-----------------------|
| Mortgage loans                  | \$ 341,519,025        | \$ 55,685,792        | \$ 61,516,299        | \$ 14,808,062        | \$ 209,508,872        |
| Interim mortgage loans          | 45,900,000            | 33,900,000           | 12,000,000           | -                    | -                     |
| Vendor take-back mortgage loans | 1,600,000             | 1,600,000            | -                    | -                    | -                     |
| Total                           | <u>\$ 389,019,025</u> | <u>\$ 91,185,792</u> | <u>\$ 73,516,299</u> | <u>\$ 14,808,062</u> | <u>\$ 209,508,872</u> |

To the extent that the amount due for mortgage loans includes the balance due on maturity, management intends to renew or refinance the amounts due effective on the maturity date of the loans.

### Convertible Debentures

Since the inception as a real estate investment trust, LREIT has issued seven series of convertible debentures, of which four have matured and been retired through conversion prior to maturity or repayment upon maturity, including the Series D debentures which were retired on March 16, 2008 with an outstanding balance of \$1,593,000. A summary of the net amount outstanding in regard to the three remaining series of convertible debentures is provided in the following chart.

| Issue Date/Maturity Date | Series | Amount Issued        | Net Amount Outstanding<br>June 30, 2008 |
|--------------------------|--------|----------------------|---|
| Feb. 17/05/Feb. 17/10    | E      | \$ 12,000,000        | \$ 11,950,000                           |
| Mar. 10/06/Mar. 11/11    | F      | 13,680,000           | 13,680,000                              |
| Dec. 8/06/Dec. 31/11     | G      | <u>25,732,000</u>    | <u>25,732,000</u>                       |
| Face Value               |        | <u>\$ 51,412,000</u> | <u>\$ 51,362,000</u>                    |

### Improvements to Existing Properties

During 2008, ongoing improvements to income properties are projected to be approximately \$2.8 Million. The cash flow for the entire year in 2008 is expected to be sufficient to fully fund property improvement costs.

### Operating Line of Credit

As previously disclosed, \$5,000,000 is available to the Trust under the terms of the line of credit.

### Normal Course Issuer Bid

As previously noted in this report, LREIT may acquire a maximum of 876,944 units during the 12 month period commencing January 21, 2008, pursuant to its normal course issuer bid. The Trust is not required to purchase any units under the normal course issuer bid.

### Sources of Capital

#### Short-term

As of June 30, 2008, the total cash balance of LREIT was \$9,583,976, while the working capital balance, excluding mortgage loans receivable and accrued liabilities for property acquisitions or properties under development, was approximately \$5.2 Million. LREIT also has access to a \$5 Million revolving line of credit.

The refinancing of under-leveraged properties is expected to serve as the primary source of additional capital for the last six months of 2008, supplemented with draws on the line of credit. The refinancing may occur in the form of an upward refinanced loan on a specific property or as an interim mortgage loan secured by two or more properties. As disclosed in the analysis of mortgage loans payable, LREIT received approximately \$49 Million of mortgage loan proceeds during the first six months of 2008, of which \$17.4 Million was interim financing. Financing proposals for an additional \$23 Million of loans on existing properties are under negotiation with lenders.

The proceeds from the refinancing of under-leveraged properties, combined with the existing working capital and the line of credit, are expected to be sufficient to enable LREIT to fulfil all of its funding commitments for property acquisitions, capital improvements and cash distributions in 2008.

### **Longer Term**

In addition to the refinancing of under-leveraged properties, LREIT will consider additional debenture or trust unit offerings as a source of investment capital. LREIT may also issue trust units to vendors as consideration for real property acquisitions.

The ability of LREIT to raise additional capital and, in turn, proceed with the acquisition of the properties which are under contract or development is subject to uncertainty. Factors which could impair the ability of LREIT to raise additional capital include a downturn in general economic conditions, a change in legislation, fluctuations in the markets for equity securities and numerous other factors beyond the control of LREIT.

### **TRENDS**

During the second half of 2008, the NOI of the Trust is expected to continue to improve as the income contribution from new property acquisitions and leased-up properties continues to gradually accrue to the Trust. Although there will be an increase in financing expense as a result of additional mortgage loan financing, the incremental increase in NOI is expected to be in excess of the incremental increase in financing expense. Accordingly, it is also anticipated that the Trust will achieve an improvement in cash flows and in income before amortization and taxes during 2008.

### **RELATED PARTY TRANSACTIONS**

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

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

Commencing January 1, 2006, the Committee approved a service fee equal to 0.3% of the gross book value of the total assets of the Trust, which is defined as the total assets shown on the most recently issued financial statements, excluding cash and accumulated amortization. Payment of the fee occurs on a monthly basis, on the last day of each month.

The initial term of the Services Agreement expired on August 30, 2007. At the Trustee Meeting on August 30, 2007, the independent Trustees approved a one year extension of the agreement to August 30, 2008. At the Trustee Meeting on August 13, 2008, the independent Trustees approved an extension of the agreement to December 31, 2008.

Shelter Canadian is also the Property Manager for LREIT, pursuant to the Property Management Agreement. Shelter Canadian has a direct involvement in the management of all of the income properties in the portfolio of LREIT and acts as the Property Manager for all of the properties, except for the seniors' housing complexes, which are managed by third party managers who specialize in seniors' housing. Following the expiry date of the initial term of the management agreement on August 30, 2007, the agreement provides for the management term to be automatically renewed for a further five year period, subject to the consent of the independent Trustees. At the Trustee Meeting on August 9, 2007, the independent Trustees approved the five year renewal term to August 30, 2012.



Mr. Arni Thorsteinson, Chief Executive Officer of LREIT and a Trustee, is a Director and President of Shelter Canadian and the President of the parent corporation of Shelter Canadian, 2668921 Manitoba Ltd. As of February 2007, the Governance, Compensation and Nominating Committee is comprised of all of the independent Trustees of LREIT. Prior to February 2007, Mr. Thorsteinson was a member of the Governance and Compensation Committee and, as such, Mr. Thorsteinson abstained from all discussions and voting in regard to the approval of the service fee.

### **Development Agreement for Laird's Landing**

The Laird's Landing apartment complex was constructed pursuant to a development agreement with Shelter Canadian. Pursuant to the development agreement, Shelter Canadian agreed to:

- (i) develop the Project for a total cost not to exceed \$57.75 Million (inclusive of the purchase price of the land);
- (ii) arrange and guarantee construction financing in the approximate amount of \$45 Million and permanent financing after completion of construction; and
- (iii) provide all development and construction supervision services for the Project. The arrangement provides for Shelter Canadian to earn a development fee from LREIT in the maximum amount of \$1,000,000, in consideration for its services under the development agreement, representing approximately 1.73% of the total estimated Project cost.

The development agreement was approved by the independent trustees of LREIT and Mr. Thorsteinson abstained from voting on the resolution approving the transaction.

## **REVENUE/INCOME AND OTHER COMMITMENTS**

### **Lakewood Manor**

The acquisition of Lakewood Manor was completed by LREIT, effective July 1, 2007. A major oil sands company has leased and occupied all of the units at the property under a three year lease agreement. The lessee is responsible for all property operating costs and as a result, the Trust will realize net operating income of \$4,799,800 per annum.

The agreement also provided the oil sands company with an option to extend the lease for an additional two years, at a 10% increase in the annual absolute net operating income, and a three year purchase option to acquire all of the 64 townhouse units. The purchase price option for the townhouse units is set at \$26,873,600 to June 30, 2009 and \$27,667,200 to June 30, 2010.

### **Elgin Lodge**

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

As previously disclosed in this report, a 60 suite expansion was completed at Elgin Lodge during 2007. During the five year period following the closing date of the acquisition, Kingsway is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the expanded property exceeds the total of the cost to LREIT, including the expansion cost and the unpaid portion of a 12% annual return on the LREIT equity investment.

### **The Clarington Seniors Residence**

LREIT has also retained Kingsway to manage The Clarington Seniors Residence for a ten-year term, expiring on February 12, 2017. During the five year period after the "lease-up" date, Kingsway is entitled to a one-time payment equal to 50% of the amount by which the appraised value of the property exceeds the total of the original acquisition cost to LREIT and the unpaid portion of a 8% annual return on the LREIT equity investment.

## **CHANGES IN ACCOUNTING POLICIES**

### **New Accounting Standards - Adopted January 1, 2008**

On January 1, 2008, the Trust adopted CICA Handbook Section 1535 - Capital Disclosures, Section 3862 - Financial Instruments - Disclosures and Section 3863 - Financial Instruments - Presentation. Section 1535 requires the Trust to disclose information that enables users of its financial statements to evaluate the Trust's objectives, policies and processes for managing capital. Sections 3862 and 3863 replace the existing Section 3861, Financial Instruments - Disclosure and Presentation. These new sections revise and enhance disclosure requirements and carry forward unchanged existing presentation requirements. These new sections require disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The new standards do not have any impact on the classification or measurement of financial instruments.

### **Future changes to significant accounting policies**

CICA Handbook Section 3064 - Goodwill and Intangibles will be effective for interim and annual financial statements of the Trust for periods beginning after January 1, 2009. This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and intangible assets by profit-oriented enterprises.

In 2008 the Accounting Standards Board ("AcSB") announced that accounting standards in Canada are to converge with International Financial Reporting Standards ("IFRS"). The AcSB has confirmed the effective date for reporting under IFRS will be January 1, 2011, with appropriate comparative data from the prior year.

The Trust is currently considering the effect on the financial statements of the new standards.

## **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.

The key risks include the following:

### **General**

The properties of LREIT are subject to the normal risks common to real property ownership and operation, including the risk of a reduced demand due to changes in general economic conditions, local real estate markets, competition from other available premises and various other factors. In order to minimize the general market risk and achieve stable or increasing average rental rates, combined with acceptable occupancy levels, LREIT focuses on tenant retention and the marketing of vacant space. LREIT further decreases its operating risk through property and geographic diversification and for commercial properties, through the diversification of tenancies and staggered lease maturities. The risk of revenue losses due to defaults by commercial tenants in respect of lease obligations, is minimized by leasing to tenants with strong financial covenants with the rights of the Landlord strongly entrenched in contractual agreements.

### **Payment of Cash Distributions**

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

### **Public Market Risk**

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

### **Closing of Proposed Acquisitions**

There can be no assurance that LREIT will complete the proposed acquisitions described herein on the basis described herein or on the expected closing dates, if at all. The successful growth of LREIT will depend on the ability of Management to complete the proposed acquisitions and successfully integrate the acquired properties and identify opportunities for future property acquisitions. The ability of Management to generate growth from property acquisitions may be affected by elevated acquisition costs, funding of the acquisitions, unexpected liabilities with regards to the properties and other problems related to the integration of the properties. Management's failure to successfully grow through future property acquisitions could adversely affect LREIT's financial condition, net income from operations and its ability to generate cash available for distribution.

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

The property portfolio of LREIT has significant exposure to the Fort McMurray, Alberta market. As of June 30, 2008, there were 42 properties in the real estate portfolio of LREIT, including four commercial properties and 38 residential properties, comprising 3,343 rental units. Twelve of the residential properties, including Laird's Landing and Parsons Landing - Phase I, comprising a total of 1,025 suites are located in Fort McMurray. The twelve properties have an aggregate acquisition price of \$279.1 Million, which represents approximately 55.7% of the total aggregate purchase price of the real estate portfolio.

LREIT has also entered into an agreement to acquire Siena Apartments in Fort McMurray, Alberta, which comprises 66 suites. After providing for Phase II of Parsons Landing and Siena Apartments, LREIT will have a total of 13 multi-family residential properties in Fort McMurray, comprising a total of 1,167 suites, with an aggregate acquisition price/development cost to LREIT of approximately \$343.6 Million. The 13 Fort McMurray properties will represent approximately 34.2% of the total multi-family residential suites and approximately 64.3% of the total aggregate acquisition price/development cost to LREIT of its real estate portfolio.

### **Changes to Tax Treatment of Trusts**

LREIT currently qualifies as a mutual fund trust for income tax purposes. As required by its Declaration of Trust, LREIT is required to distribute an amount equal to not less than all of its taxable income to its Unitholders and to deduct these distributions for income tax purposes.

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

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

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

### **Estimated Current Value**

Management of LREIT estimates the current value of LREIT's property portfolio as at June 30, 2008.

In summary, the total estimated current value of the property portfolio of \$654,823,000 is 6.1% in excess of the total appraised value of \$615,558,000. For 22 properties, representing 53% of total appraised value, management assumed current value was equal to the appraisal values of the applicable properties, for 18 properties, representing 44% of total appraised value, the total estimated current value of the applicable properties was 14% in excess of total appraised value of the properties and for 1 property, management estimated current value to be the total of the cost of the building expansion and the appraised value of the property before the expansion.

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

There can be no assurance that appraised value of a property is an accurate reflection of the value of such property as at the effective date set forth in the appraisal or on any other date, including on June 30, 2008, the date of management's estimate of the current value of such property. In addition, there can be no assurance that the valuation method or the capitalization rate(s) used in appraising a property (and used by management of LREIT in estimating the current value of the portfolio) was appropriate for such property as at the effective date set forth in the appraisal or on any other date, including on June 30, 2008, the date of management's estimate of the current value of such property.

LREIT undertakes no obligation to update or revise its estimated current value of its portfolio from time to time.

#### **Relationship with Shelter Canadian Properties Limited**

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

#### **Reliance on Key Personnel**

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

#### **Other**

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

### **CRITICAL ACCOUNTING ESTIMATES**

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

Financial statement items which encompass estimates include the following:

- allocation of the cost of property acquisition: a portion of the acquisition cost of an income property is allocated to tenant origination costs associated with in-place leases and the cost of tenant relationships, lease origination costs above market leases and below market leases. The amount allocated to the above is based on the estimated fair market value of each variable. The allocated amounts are of significance, as the costs are amortized over a relatively short time frame (i.e., the term of the respective tenant leases) in comparison to the amount allocated to buildings and equipment;
- amortization of the building component of Income Properties: a portion of the purchase price of an income property is allocated to "building" based on the estimated value of the building on an "as if vacant" basis. Amortization expense is based on the estimated useful life of the building. The estimated useful life of the building may vary and could result in a different amount of amortization charged to income;
- amortization of property improvements: expenditures relating to improvements to income properties are capitalized to the cost of income properties and amortized for a period of five to 25 years, based on the estimated useful life of the improvements. The estimated useful life of improvements may vary and could result in a different amount of amortization charged to income;
- unit-based compensation expense: unit-based compensation expense is based on the estimated fair value of the applicable options using the Black-Scholes option pricing method;
- the determination of the amount of temporary differences, the timing of reversal and the tax rate to be used in calculating future income tax assets and liabilities; and
- the allocation of convertible debentures between debt and equity based on the estimated fair value of the debt using an estimated cost of borrowing.

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

## **TAXATION**

### **Taxation of LREIT**

LREIT qualifies as a mutual fund trust for income tax purposes. Subject to the New SIFT Rules, LREIT is generally subject to tax in Canada under the Income Tax Act (the "Tax Act") in respect to its taxable income each year, except to the extent that such taxable income is paid or deemed to be payable to Unitholders and deducted by LREIT for tax purposes. Pursuant to the Declaration of Trust of LREIT, the Trustees distribute or designate all taxable income directly earned by LREIT to the Unitholders of the Trust in order to ensure that LREIT will not be subject to income tax under Part I of the Tax Act.

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

### **Taxation of Unitholders**

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

The cash distributions which have been paid to the Unitholders since the inception of LREIT as a real estate investment trust in September 2002, have exceeded the income of LREIT, as calculated for income tax purposes. All of the distributions, which have been paid by LREIT from September 2002 to June 30, 2008, have represented a reduction in adjusted cost base of the units.

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

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

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

No changes were made to the design of the internal controls over financial reporting during the three months ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the effectiveness of the internal control system.

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

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

### **ADDITIONAL INFORMATION**

Additional information relating to LREIT, including the Annual Information Form, is available on the SEDAR website at [www.sedar.com](http://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 2008 Second Quarter 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  
August 13, 2008