



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**MARCH 31, 2007**

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## **2007 FIRST QUARTER HIGHLIGHTS**

### **Acquisition and Development**

- Invested \$75.2 Million in the acquisition of three additional properties, representing 339 additional apartment units
- Invested \$7.3 Million in construction, expansion and renovation costs.
- Quarter ending portfolio consists of 36 properties, comprised of 2,607 suites and 232,945 square feet of commercial leasable area.

### **Financial**

First quarter of 2007, compared to first quarter of 2006:

- Operating income increased by \$1.5 Million or 45% in total and by \$0.081 or 40.5% on a per unit basis.
- "Same property" operating income increased by \$506,075 or 17%.
- Cash from operating activities increased by \$605,308 or 114%.
- Average occupancy rate for the residential portfolio increased from 90% to 93%.

### **Capital Structure**

- Financed \$72 Million of mortgage debt.
- Weighted average interest rate on the aggregate mortgage loan balance of 6.3% at March 31, 2007.
- Mortgage loan debt to current value ratio of 60.0% at March 31, 2007.

### **Ongoing Investment Activities**

- Acquired a 113 suite apartment complex on May 1, 2007 at a cost of \$5.6 Million.
- Contracted acquisitions and new properties under construction at a combined acquisition cost of approximately \$118 Million, encompassing 136 townhouse units and 297 apartment suites. The acquisitions are expected to be completed during the third and fourth quarter of 2007.
- A 59 suite expansion to a seniors' residence in Port Elgin, Ontario is in process at an estimated cost of \$9.5 Million.

**Unitholder Returns**

	<u>Three Months Ended</u>	
	<u>March 31</u>	<u>Year Ended December 31</u>
	<u>2007</u>	<u>2006</u>
Distribution per unit	\$0.14	\$0.56
Opening unit price	\$5.90	\$5.25
Closing unit price	\$5.55	\$5.90
Annualized yield on opening price (distribution/opening unit price)	9.5%	10.7%
Projected cash distribution - 2007:	\$0.56	
Closing unit price - May 4, 2007:	\$5.30	
Current yield:	10.6%	

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**

Since its inception as a publicly traded entity in September 2002, LREIT has been in an aggressive growth phase and has been very successful in creating a large, diversified portfolio of quality rental properties. During the past three years, commencing with the 2003 fiscal year, the property portfolio of LREIT increased by approximately \$50 Million, \$100 Million and \$70 Million, respectively, based on property acquisition costs. As of December 31, 2006, the real estate portfolio of LREIT consisted of 33 properties with an acquisition cost of \$233.8 Million, encompassing approximately 2,300 residential units and 225,000 square feet of commercial space.

The 2007 fiscal year is expected to be another period of exceptional growth, with over \$200 Million of new properties targeted for closing by year end. The first quarter results for 2007 are reflective of projected growth trend for the year, as the Trust completed three new property acquisitions at a total cost of \$75.2 Million and incurred approximately \$7.3 Million in construction, expansion and renovation costs for real estate development projects in Manitoba, Alberta and Ontario.

The operating results for the first quarter of 2007, reflect an insignificant amount of operating income from the three new property acquisitions, as one of the property acquisitions was not completed until the end of the first quarter, on March 23, 2007, while the other two properties were in the lease-up stage of development and, as such, all costs and any revenues were capitalized. Conversely, the cost of the capital which was used to fund the cash component of the first quarter property acquisitions, and the properties under construction or expansion, is fully reflected in the operating results of the Trust. Specifically, the equity component for new properties and for properties under construction or development, was primarily funded from the proceeds of the December 2006 Series G debenture offering, with the financing costs thereon comprising approximately \$700,000 or 45% of the first quarter debenture financing expense. In summary, the high level of ongoing investment activity by LREIT is continuing to result in a lag between the cost of capital and the return on capital, with the first quarter operating results reflecting a nominal amount of operating income from new property acquisitions and a very substantial increase in financing expense in regard to the investment capital which was used to fund the equity component of the acquisitions.

Notwithstanding the lag in investment returns, the operating results of LREIT are favourable, with operating income for the first quarter of 2007 increasing by \$1.52 Million or 45%, compared to the first quarter of 2006. On a per unit basis, operating income increased from \$0.200 per unit during the first quarter of 2006 to \$0.281 per unit during the first quarter of 2007. The improvement in operating income reflects the incremental income from properties which were acquired between April 1, 2006 and December 31, 2006, as well as a significant improvement in the operating income of the 22 properties which have been in the LREIT portfolio since January 1, 2006.

Cash from operating activities and distributable income also improved significantly during the first quarter of 2007, increasing by 114% and 4%, respectively, compared to the first quarter of 2006.

In terms of bottom-line results, the net loss of the Trust increased by \$797,249 during the first quarter of 2007, compared to the first quarter of 2006, largely due to the increase in debenture financing expense and the lag in operating income from new investment activity.

While the rental properties recently developed or under construction have not contributed to earnings in a meaningful way to date, the portfolio of real estate assets has substantially increased in value since acquisition. The estimated current value of these assets is \$80 Million in excess of net book value at March 31, 2007. This estimated gain creates a net asset value increment of \$4.59 per unit outstanding.

Overall, the first quarter operating results are generally in accordance with expectations and LREIT remains well positioned to achieve significant growth in operating income and cash flows as the new properties complete the development phase and begin to contribute to the investment returns of the Trust. The Board of Trustees and the management team of Shelter Canadian Properties Limited remain fully committed to the long-term success of the Trust and to maximizing the investment returns to the Unitholders.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST



ARNI C. THORSTEINSON, CFA  
Chief Executive Officer  
May 7, 2007

**Property Portfolio - March 31, 2007**

<u>Property</u>	<u>Location</u>	<u>Purchase Price</u>	<u>Acquisition Date</u>	<u>Suites/ Leasable Area - Sq. Ft.</u>	<u>Occupancy 31/03/2007</u>
<b>RESIDENTIAL</b>					
<b>Manitoba</b>					
Highland Tower	Thompson	\$ 1,350,000	January 2005	77	32 % (3)
Chancellor Gate	Winnipeg	6,750,000	August 2005	48	96 %
Willowdale Gardens	Brandon	4,326,000	January 2006	88	92 %
<b>Saskatchewan</b>					
Borden Estates	Prince Albert	5,315,000	February 2005	144	74 %
Cedar Village	Prince Albert	2,700,000	February 2005	72	78 %
Carlton Manor	Prince Albert	410,000	February 2005	19	74 %
Riverside Apartments	Prince Albert	265,000	February 2005	12	100 %
MGM Apartments	Prince Albert	650,000	February 2005	28	54 %
Marquis Towers	Prince Albert	6,200,000	August 2005	129	88 %
Riverside Terrace	Saskatoon	24,000,000 (1)	July 2005	181	93 %
Village West	Saskatoon	5,113,800	June 2006	100	93 %
Chateau St. Michael's	Moose Jaw	7,600,000 (1)	June 2006	93	90 %
Woodlily Courts	Moose Jaw	3,700,000	June 2006	102	84 %
<b>Alberta</b>					
Nova Villa	Edmonton	5,400,000	May 2004	61	97 %
Nova Manor	Edmonton	2,615,000	May 2004	32	94 %
Nova Ridge Estates	Spruce Grove	8,800,000	July 2004	102	94 %
Norglen Terrace	Peace River	2,500,000	October 2004	72	99 %
Nelson Ridge Estates	Fort McMurray	40,575,000	April 2005	225	95 %
Broadview Meadows	Sherwood Park	6,790,000	January 2006	93	99 %
Gannet Place	Fort McMurray	6,873,700	June 2006	37	87 %
Lunar Apartments	Fort McMurray	4,457,100	June 2006	24	79 %
Parkland Apartments	Fort McMurray	2,230,200	June 2006	12	83 %
Skyview Apartments	Fort McMurray	5,385,800	June 2006	29	72 %
Snowbird Manor	Fort McMurray	6,314,500	June 2006	34	94 %
Whimbrel Terrace	Fort McMurray	6,873,700	June 2006	37	89 %
Woodland Park	Fort McMurray	37,865,000	March 2007	107	67 % (5)
<b>Northwest Territories</b>					
Beck Court	Yellowknife	14,300,000	April 2004	120	93 %
Three Lakes Village	Yellowknife	10,900,000	May 2005	50	96 %
Nova Court (residential) (4)	Yellowknife	15,000,000	March 2007	106	100 %
<b>Ontario</b>					
Elgin Lodge	Port Elgin	8,300,000 (1)	June 2006	64	95 %
Clarington Seniors Residence	Bowmanville	22,400,000 (1)	February 2007	126	30 % (5)
<b>British Columbia</b>					
Greenwood Gardens	Surrey	<u>10,950,000</u>	April 2004	<u>183</u>	99 %
<b>Total - Residential</b>		<b>\$ 286,909,800</b>	Total Suites	<b><u>2,607</u></b>	
<b>COMMERCIAL</b>					
<b>Retail and Office</b>					
Kenaston	Winnipeg, MB	\$ 12,656,200 (2)	April 2002	103,209	97 %
Mclvor Mall	Winnipeg, MB	6,700,000	February 2004	65,283	98 %
Nova Court (commercial) (4)	Yellowknife	-	March 2007	<u>8,400</u>	100 %
		<u>19,356,200</u>		<u>176,892</u>	
<b>Light Industrial</b>					
MAAX	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>\$ 22,156,200</b>	Total leasable area	<b><u>232,945</u></b>	
<b>Total</b>		<b>\$ 309,066,000</b>			

(1) Seniors housing complex.

(2) Includes cost of asset additions.

(3) In-suite renovation program in process. The occupancy rate is based on suites available to lease, as of March 31, 2006.

(4) Consists of a 106 suite apartment complex and 8,400 square feet of commercial space.

(5) Properties are classified as "properties under development".

## 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".

### Forward-Looking Information

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 quarter ended March 31, 2007 and with reference to the 2006 Annual Report.

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, as discussed herein, could cause actual results to differ materially from the results discussed in forward-looking statements. 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.

### 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:

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

**Financial and Operating Summary**

		<u>Three Months Ended March 31</u>			
		<u>2007</u>		<u>2006</u>	
<b>DISTRIBUTIONS</b>					
Amount	- total	\$	2,476,749	\$	2,364,800
	- per unit	\$	0.14	\$	0.14
<b>KEY PERFORMANCE INDICATORS</b>					
Operations					
	Average residential occupancy rate		93.0 %		90.0 %
	Operating residential cost ratio		48.0 %		53.0 %
<b>Operating Results</b>					
	Total revenue	\$	9,051,765	\$	6,442,035
	Operating income	\$	4,884,730	\$	3,362,387
	Loss for the period	\$	(1,769,235)	\$	(971,986)
<b>Cash Flows</b>					
	Cash flow from operating activities	\$	1,136,446	\$	531,138
	Funds from Operations (FFO) *	\$	(157,869)	\$	552,810
	Adjusted Funds from Operations (AFFO) *	\$	284,919	\$	588,593
	Distributable income *	\$	882,564	\$	850,174
<b>Financing</b>					
	Mortgage loan debt to current value ratio *		60.0 %		61.8 %
	Weighted average interest rate of long-term debt *		6.34 %		5.63 %
<b>PER UNIT AMOUNTS</b>					
		<u>Basic</u>	<u>Diluted</u>	<u>Basic</u>	<u>Diluted</u>
	Operating income	\$ 0.281	\$ 0.255	\$ 0.200	\$ 0.187
	Loss for the period	\$ (0.102)	\$ (0.102)	\$ (0.058)	\$ (0.058)
	Distributable income	\$ 0.051	\$ 0.050	\$ 0.050	\$ 0.050
	Funds from operations (FFO)	\$ (0.009)	\$ (0.009)	\$ 0.033	\$ 0.033
	Adjusted funds from operations (AFFO)	\$ 0.016	\$ 0.016	\$ 0.035	\$ 0.035

**\*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.



## OVERALL INVESTMENT OBJECTIVES AND STRATEGY

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 calibre and responsive management services, proactive leasing strategies and, where appropriate, capital improvement and renovation programs.

The investment policies and operations of LREIT are subject to the overall control and direction of the Trustees. Shelter Canadian Properties Limited 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.

## INVESTMENT ACTIVITIES

### Property Acquisitions

#### *General*

Due to the limited construction of new rental properties over the last 25 years and as market values of existing rental properties continue to be well below replacement cost, the multi-family residential sector continues to offer an opportunity to earn high returns and achieve significant gains in value, especially if rental market conditions continue to improve due to rising interest rates and the increasing cost of home ownership. As a result, 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.

#### ***Property Portfolio - March 31, 2007***

As of December 31, 2006, the real estate portfolio of LREIT consisted of 29 multi-family residential properties and four commercial properties with a total acquisition cost of \$233.8 Million.

During the first quarter of 2007, LREIT acquired three additional multi-family residential properties at a total purchase price of \$75.2 Million, resulting in a real estate portfolio of 36 properties with a total cost of \$309.1 Million as of March 31, 2007.

The first quarter acquisitions consisted of The Clarington Seniors Residence, Woodland Park and Nova Court, with closing dates of February 12, 2007, March 12, 2007 and March 23, 2007, respectively.

As disclosed in the 2006 Annual Report, The Clarington Seniors Residence and the Woodland Park complex were acquired in the lease-up stage of development and, as such, the two properties are classified as "Properties Under Development" on the consolidated balance sheet of the Trust. The lease-up stage for Woodland Park was completed on April 1, 2007 and as a result, the apartment complex will be classified under "Income Properties" in the second quarter of 2007. The lease-up of The Clarington Seniors Residence is expected to be completed by July 2008.

The Nova Court apartment complex was classified under "Income Properties", effective from the date of acquisition.

## **Completed and Contracted Property Acquisitions - Subsequent to March 31, 2007**

### **Borden Place**

On May 1, 2007, LREIT acquired Borden Place, a 113 suite apartment complex located in Saskatoon, Saskatchewan.

The purchase price of \$5.6 Million was funded by a first mortgage loan in the amount of \$4.2 Million, with the balance in cash.

### **Lakewood Manor**

Lakewood Manor is a 175 unit multi-family apartment complex which is currently under construction in Fort McMurray, Alberta. The property will consist of 64 three-storey fully furnished townhouses and a four-storey apartment building with 111 fully furnished suites. The acquisition of the property is scheduled to close on July 1, 2007, following completion of construction. The purchase price of the property is \$59,835,825.

The acquisition of the Lakewood Manor will be funded by new first mortgage loans in the minimum amount of \$48 Million, with the balance in cash.

In 2005, LREIT provided partial construction financing for Lakewood Manor in the form of an 8% second mortgage loan of \$8.5 Million. The loan requires payments of interest only, on a quarterly basis, and is subordinate to a construction mortgage in the maximum amount of \$38 Million. The second mortgage loan will be credited to the purchase price on the closing date of the property acquisition.

Additional details regarding the three year lease agreement which has been obtained for all of the suites at Lakewood Manor are provided on page 25.

### **Millennium Village**

Millennium Village is a 72-unit multi-family townhouse complex which is currently under construction in Fort McMurray, Alberta. The property will consist of 18 four-plex buildings with 36 two-bedroom and 36 two-bedroom plus den units, all of which will be fully furnished. Each of the townhouse units will have individual condominium title. The purchase price of the property is \$25,150,000.

The acquisition will be financed with a new first mortgage loan in the amount of \$16,954,000 with the balance in cash. The construction of the property is occurring in three phases and the target closing dates are August 2007 for Phase I, October 2007 for Phase II and November 2007 for Phase III.

In December 2006, LREIT provided partial construction financing for Millennium Village in the form of an 8% second mortgage loan of \$4 Million. The loan requires payments of interest only, on a quarterly basis, and is subordinate to a construction mortgage in the maximum amount of \$15 Million. The second mortgage loan will be credited to the purchase price on the closing date of Phase I.

### **Park View Apartments**

LREIT has entered into a development agreement with Shelter Canadian Properties Limited in regard to the construction of a 186 suite apartment building in Fort McMurray, Alberta, to be known as the Park View Apartments. The land acquisition for the property was completed in July 2006 at a cost of \$9.3 Million, while the construction of the apartment building commenced in August 2006. As of March 31, 2007, the land acquisition costs and the cumulative construction costs amounted to approximately \$24.2 Million and are included in "Properties under development" on the balance sheet of LREIT.

A three year first mortgage loan in the amount of \$45 Million was arranged for the property. The loan agreement provides for funds to be advanced in instalments, based on construction progress billings. As of March 31, 2007, a total of \$6,650,000 has been advanced under the loan.

Pursuant to the development agreement, the total cost of Park View Apartments, including interest costs and development fees, is not to exceed \$57.75 Million. Based on the first mortgage loan of \$45 Million, the projected equity contribution for the development is \$12.75 Million.

In accordance with the accounting policy of LREIT, all acquisition costs, development, leasing, financing and operating costs, less rental revenue, are capitalized for properties under development until the property achieves a satisfactory occupancy level within a predetermined time limit. The construction costs for Park View Apartments include carrying costs of \$338,522, representing interest on the land acquisition/constructing financing.

The construction of the apartment building is expected to be completed not later than November 30, 2007. Please refer to the "Related Party Transactions" section of this report for additional information regarding the development agreement for Park View Apartments.

## **Existing Properties Under Development**

### **Elgin Lodge**

In June 2006, LREIT acquired Elgin Lodge, a 64 suite retirement home in Port Elgin, Ontario. In conjunction with the acquisition of the property, LREIT developed plans for a multi-level extension of the building on excess land. At an estimated cost of \$9.5 Million, the expansion will add an additional 59 suites to the property, of which 12 will be studio suites and 47 will be one-bedroom suites. Based on an increase in the existing mortgage loan by \$6.9 Million, the projected equity contribution for the expansion is \$2.6 Million.

The construction of the 59 suite expansion commenced during the fourth quarter of 2006. As of March 31, 2007, the construction costs amounted to \$2,766,459 and were funded entirely by working capital.

Additional details regarding the guarantees and commitments associated with the Elgin Lodge expansion are provided on page 25 of this report.

## **Major Renovations**

In an effort to maximize the yield on its portfolio of income-producing properties, LREIT also undertakes appropriate capital improvement projects, renovations and remarketing 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 completed.

In 2005, LREIT commenced an extensive major renovations program at the Highland Tower property in Thompson, Manitoba. The renovation program involved the upgrading of an entire floor of suites at a time and the temporary removal of suites from the rental market. The renovation program is expected to be substantially completed by June 30, 2007, with the remaining work consisting primarily of landscaping and parking lot upgrades. As of March 31, 2007, the total cumulative renovation costs at Highland Towers are \$3,268,006, of which \$1,465,578 were incurred in the first quarter of 2007. Renovation costs are being funded from working capital.

In accordance with the accounting policy which was adopted by LREIT, effective July 1, 2005, carrying costs incurred during the period of major in-suite renovations of income properties are capitalized during the period that the suites are removed from the rental market. The total cumulative renovation costs for Highland Towers include carrying costs of \$243,619.

## Mortgage Loans Receivable

March 31, 2007	\$12,500,000
December 31, 2006	\$17,500,000

As of March 31, 2007, "Mortgage Loans Receivable" consist of \$12.5 Million of construction loans for upcoming property acquisitions, comprised of the \$8.5 Million second mortgage loan for Lakewood Manor and the \$4 Million second mortgage loan for Millennium Village. During the three months ended March 31, 2007, \$1 Million of the \$5 Million mortgage loan receivable at December 31, 2006 has been reclassified as a deposit and is included in Other Assets.

## FINANCING ACTIVITIES

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 may also serve as a source of capital.

Depending on the circumstances, LREIT may also consider operating lines of credit, bridge financing and other short-term financing facilities as a source of interim investment capital.

## Trust Units

### Units Outstanding

LREIT is authorized to issue an unlimited number of trust units.

As of March 31, 2007, LREIT had 17,426,874 units outstanding, representing an increase of 34,639 units or 0.2%, compared to the number of units outstanding as of December 31, 2006. All of the units which were issued during the first quarter of 2007 originated from the conversion of Series A and D debentures, aside from 17,273 units which were issued under the Distribution Reinvestment Plan.

### Distribution Reinvestment Plan ("DRIP")

In November 2006, LREIT implemented a "Distribution Reinvestment Plan" whereby 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, 17,273 units were issued or purchased under the Distribution Reinvestment Plan during the first quarter of 2007.

## 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. As of December 31, 2005, LREIT had granted options to acquire a total of 20,000 units, of which 10,000 were exercised.

On January 17, 2006, LREIT granted options to the three Trustees and the Chief Financial Officer to acquire 7,500 units each at a price of \$5.42 per unit. The options are exercisable immediately.

On July 26, 2006, LREIT granted options to each of the independent Trustees, the Chief Executive Officer and the Chief Financial Officer and to 17 management and senior employees of Shelter Canadian Properties Limited, who are engaged in functions related to the Trust, to acquire a total of 960,000 units at a price of \$5.80 per unit. Approximately 40% of the options are exercisable immediately, while the remaining options are exercisable over a period of four years.

In accordance with 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 Operations. During the first quarter of 2007, unit-based compensation expense amounted to \$83,671, of which \$80,824 pertains to the options that were issued in July 2006. The charge to unit-based compensation expense contributed to the increase in trust expense during the first quarter of 2007.

In future periods, unit-based compensation expense, for the options that were issued in July 2006, is expected to decline by a significant amount, as follows:

<u>Period</u>	<u>Projected Unit-Based Compensation</u>
2007	\$ 256,668
2008	134,800
2009	68,314
2010	<u>22,139</u>
	<u>\$ 481,921</u>

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

### Summary of Trust Units Issued

The following is a summary of the units which have been issued by LREIT, as of March 31, 2007, since its inception date as a publicly listed entity:

<u>Issue Date</u>	<u>Description</u>	<u>Units Issued</u>	<u>Equity Raised</u>
August 30, 2002	Initial units issued on creation of LREIT	775,000	\$ 500,000
Units outstanding, December 31, 2002		775,000	500,000
August 28, 2003	First closing of private offering	502,463	2,009,852
August 29, 2003	Units issued on conversion of debentures	14,500	-
December 8, 2003	Second closing of private offering	70,750	283,000
December 22, 2003	Private placement	1,250,000	5,000,000
Units outstanding, December 31, 2003		2,612,713	7,792,852
April 15, 2004	Private placement on the acquisition of Greenwood Gardens	20,000	-
December 23, 2004	First closing of private placement	3,828,500	19,142,500
Units outstanding, December 31, 2004		6,461,213	26,935,352
January 27, 2005	Second closing of private placement	1,171,500	5,857,500
February 2, 2005	Private placement	200,000	1,000,000
September 29, 2005	Exercise of unit options	10,000	40,000
December 14, 2005	Private placement	6,297,240	32,115,924
January to December 31, 2005	Units issued on conversion of debentures	2,715,333	-
Units outstanding, December 31, 2005		16,855,286	65,948,776
November 1, 2006	Units issued on exchange of Class B units of Village West LP	100,000	-
November and December 2006	Units issued under DRIP	2,439	13,250
January to December 31, 2006	Units issued on conversion of debentures	434,510	-
Units outstanding, December 31, 2006		17,392,235	\$ 65,962,026
January to March 31, 2007	Units issued under DRIP	17,273	100,748
January to March 31, 2007	Units issued on conversion of debentures	17,366	-
Units outstanding, March 31, 2007		17,426,874	\$ 66,062,774

### 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 quarter of 2007, LREIT declared distributions of \$0.14 per unit, or \$0.56 on an annualized basis. Distributions are comprised of the following components:

	<u>Trust Units</u>	<u>LP Units</u>	<u>Total</u>
Cash distributions paid for January and February, 2007	\$ 1,517,168	\$ 33,284	\$ 1,550,452
Cash distributions paid for March 2007	<u>761,321</u>	<u>16,642</u>	<u>777,963</u>
	2,278,489	49,926	2,328,415
Value of units issued under DRIP	<u>148,334</u>	-	<u>148,334</u>
Distributions declared, per Statement of Equity	<u>\$ 2,426,823</u>	<u>\$ 49,926</u>	<u>\$ 2,476,749</u>

## 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 March 31, 2007, since its inception date as a publicly listed entity:

### Summary of Debenture Offerings

<u>Issue Date/Maturity Date</u>	<u>Series</u>	<u>Interest Rate</u>	<u>Amount Issued</u>	<u>Units Conversions</u>		<u>Net Amount Outstanding March 31 2007</u>
				<u>Three Months Ended March 31 2007</u>	<u>As of December 31 2006</u>	
Aug. 30/02/Aug. 30/07	A	10.0 %	\$ 3,000,000	\$ (13,000)	\$ (1,310,000)	\$ 1,677,000
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	(76,000)	(2,251,000)	1,673,000
Feb. 17/05/Feb. 17/10	E	8.0 %	12,000,000	-	-	12,000,000
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>
			<u>\$ 69,543,000</u>	<u>\$ (89,000)</u>	<u>\$ (14,692,000)</u>	54,762,000
Net accumulated accretion						<u>2,267,485</u>
Book value, March 31, 2007						<u>\$ 57,029,485</u>
Allocation of book value						
Debt component						\$ 43,282,822
Equity component						<u>13,746,663</u>
						<u>\$ 57,029,485</u>

## Mortgage Loans Payable

March 31, 2007           \$239,803,971  
December 31, 2006       \$171,255,511

### Summary of Mortgage Loans Payable

Year of Maturity	Weighted Average Interest Rate	Amount March 31, 2007	Percentage of Total
Fixed rate			
2007	10.1 %	\$ 8,615,466	3.6 %
2008	9.4 %	26,870,412	11.2 %
2009	5.4 %	31,198,271	13.1 %
2011	8.5 %	7,409,223	3.1 %
2013	5.9 %	26,944,977	11.3 %
2014	5.5 %	17,637,978	7.4 %
2015	5.7 %	37,819,201	15.8 %
2016	5.2 %	<u>44,070,571</u>	<u>18.4 %</u>
		200,566,099	83.9 %
Demand/floating rate			
	7.4 %	<u>38,420,529</u>	<u>16.1 %</u>
		238,986,628	<u>100.0 %</u>
Difference between contractual and market interest rates on mortgage loans assumed		<u>817,343</u>	
		<u>\$ 239,803,971</u>	
Amount pertaining to:			
Income properties		\$ 191,216,628	
Properties under development		<u>48,587,343</u>	
		<u>\$ 239,803,971</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 quarter of 2007, the balance of mortgage loans payable increased by \$68,548,460, comprised of the following amounts:

Mortgage loans assumed/arranged for first quarter property acquisitions	\$ 50,407,160
Refinancing of mortgage loans for properties acquired prior to January 1, 2007	18,258,978
Principal repayments	(935,021)
Difference between contractual and market interest rates on mortgage loans assumed	<u>817,343</u>
	<u>\$ 68,548,460</u>

As of March 31, 2007, the weighted average interest rate of the fixed rate mortgage loans is 6.0%, compared to 5.6% as of December 31, 2006. The weighted average interest rate for floating rate mortgage loans decreased from 7% at December 31, 2006 to 6.9% as of March 31, 2007.



Excluding properties under development, the ratio of mortgage loans payable, relative to the total acquisition cost of the entire portfolio of income-producing properties, increased from 70% as of December 31, 2006 to 84% as of March 31, 2007. The increase reflects the additional financing which was obtained for properties acquired prior to 2007. On a weighted average basis, the ratio of mortgage loans payable increased from 70% for the three months ended March 31, 2006 to 74% for the three months ended March 31, 2007.

The ratio of mortgage loans payable, relative to the estimated current value of the property portfolio, was approximately 61.8%, as of December 31, 2006, compared to 60% at March 31, 2007. The cumulative construction and land costs for Park View Apartments and the related mortgage loan indebtedness are excluded from the debt ratio calculation as Park View is under construction.

### Vendor Take-Back Mortgages

The vendor take-back mortgage loan balance of \$6,486,475 consists of the \$250,000 interest-free vendor take-back mortgage loan that was obtained on the acquisition of the properties in Prince Albert, Saskatchewan in February 2005, less amounts owed to LREIT from the vendor. The loan for the Prince Albert properties matured on July 1, 2006 and will be repaid on demand. In addition, a \$6,250,000 vendor take-back mortgage, due on June 30, 2007, was obtained upon the purchase of Woodland Park in March 2007.

### BALANCE SHEET ITEMS

	<u>March 31, 2007</u>	<u>December 31, 2006</u>
Total assets	<u>\$ 364,095,144</u>	<u>\$ 294,222,201</u>
Mortgage loans payable	\$ 239,803,971	\$ 171,255,511
Convertible debentures (face value)	<u>54,762,000</u>	<u>54,851,000</u>
	<u>\$ 294,565,971</u>	<u>\$ 226,106,511</u>

### Total Assets

As of March 31, 2007, the total assets of LREIT amounted to \$364,095,144, compared to \$294,222,201 at the end of 2006, representing an increase of approximately \$70 Million or 24%. The increase in total assets is mainly due to an increase in "Income Properties" and "Properties Under Development" and reflects the acquisition of three additional properties since December 31, 2006.

### Long-Term Financial Liabilities

As of March 31, 2007, mortgage loans payable and the face value of convertible debenture debt amounted to approximately 74.1% of the estimated current value of the total property portfolio of LREIT, compared to approximately 73.4% as of December 31, 2006.

### Other Balance Sheet Items

#### Deferred Financing Costs

March 31, 2007	\$4,709,707
December 31, 2006	\$4,451,849

Deferred financing costs, net of amortization, increased by \$257,858 during the first quarter of 2007.

The increase in the unamortized balance of deferred financing costs during the first quarter of 2007 mainly reflects the capitalization of costs relating to additional financing which was obtained during the three months ended March 31, 2007.

**Other Assets**

March 31, 2007	\$7,851,180
December 31, 2006	\$18,444,089

Other assets decreased by \$10,592,909 since December 31, 2006. The decrease mainly reflects the application of \$13,000,000 of deposits on Woodland Park upon closing of the purchase in March 2007, offset by increases due to the increase in the property portfolio of the Trust.

**Accounts Payable and Accrued Liabilities**

March 31, 2007	\$12,137,471
December 31, 2006	\$8,294,598

As disclosed in note 11 of the financial statements, "Accounts Payable and Accrued Liabilities" increased by \$3,842,873 since December 31, 2006. The increase mainly reflects amounts due in regard to the construction costs of properties under development and an increase in trade accounts payable, mortgage interest payable and tenant security deposits as a result of the growth in LREIT's portfolio of properties.

**Future Income Taxes**

March 31, 2007	\$3,507,133
December 31, 2006	\$3,277,025

The liability for "future income taxes", as disclosed on the Consolidated Balance Sheet of LREIT mainly represents the income tax liability associated with the acquisition of Riverside Terrace.

In 2005, LREIT acquired Riverside Terrace by purchasing all of the issued and outstanding shares of its wholly owned operating subsidiary, Riverside Terrace Inc., resulting in a potential income tax liability of approximately \$4 Million. The income tax liability is also reflected in the recorded cost of the property. The income tax liability pertains to a difference between the tax and book value of the assets and will decline as the difference between the tax and book value of the assets decreases over time.

**Non-controlling Interest**

As previously disclosed, the acquisition of the Village West Townhouses, encompassed the issuance of 456,617 Class B Limited Partnership Units. The net income or loss associated with the operations of the Village West Townhouses accrues to the holder of the limited partnership units until such time as the limited partnership units are converted to trust units. On November 1, 2006, 100,000 of the limited partnership units were converted to trust units.

The "non-controlling interest" amount of \$1,851,662 on the balance sheet of LREIT, represents the cumulative interest of the holder of the limited partnership units of the LREIT Village West Limited Partnership. As of March 31, 2007, the cumulative interest consists of the original value of the limited partnership units of \$2,739,704, minus the operating loss attributable to the limited partnership units of \$98,288, the deemed value of the converted units of \$600,000 and the cumulative cash distributions of \$189,754 which have been paid to the holder of the limited partnership units. Please refer to note 13 of the financial statements. As reflected on the Consolidated Statements of Operations, the allocation of the loss of \$98,288 serves to decrease the loss of LREIT.

Original value of limited partnership units	\$ 2,739,704
Cumulative share of loss of Village West Townhouses	(98,288)
Cumulative distributions on LP Units of Village West LP	(189,754)
Exchange of 100,000 LP Units for Units of the Trust	<u>(600,000)</u>
Non-controlling interest	<u>\$ 1,851,662</u>

## RESULTS OF OPERATIONS

### Impact of Changes in Accounting Policy

#### Improvements to Income Properties

Effective January 1, 2007, LREIT adopted a new accounting policy in regard to the treatment of costs associated with the upgrading of existing income properties to more accurately reflect improvements to the income properties. The new accounting policy is being applied on a retroactive basis.

The new policy is described in Note 2 of the first quarter financial statements. The adoption of the accounting policy by LREIT resulted in a decrease in prior years operating expenses of \$1,100,474, an increase in prior years amortization expense of \$80,456 and an increase in original cost of income properties of \$989,495. Accordingly, for comparative purposes, the net loss for the first quarter of 2006 is \$100,196 lower than was previously reported.

The new accounting policy does not impact the treatment of costs incurred in regard to major in-suite renovations or properties under development as the Trust has previously adopted accounting policies which provide for the capitalization of costs incurred in regard to in-suite renovations and properties under development.

#### Balance Sheet Classification of Deferred Charges and Intangibles

Effective January 1, 2007, LREIT adopted a new presentation of certain assets relating to income properties.

Prior to January 1, 2007, tenant improvements recorded on the acquisition of income properties, as well as tenant inducements and leasing expenses in regard to ongoing leasing activity, were recorded as deferred charges and disclosed as a separate line item on the consolidated balance sheet of the Trust (deferred financing costs were also included in deferred charges). Similarly, intangible assets recorded on the acquisition of income properties, including lease origination costs, tenant relationships and above market in-place leases were recorded as intangible assets and disclosed as a separate line item on the consolidated balance sheet.

In accordance with the new presentation, the components of acquisition costs which were previously recorded as deferred charges (except for deferred financing costs) and the components which pertain to lease origination costs and tenant relationships, are now presented as components of income properties. The component of the acquisition costs which pertains to above market in-place leases is now classified as a component of other assets.

## Analysis of Income/Loss

### General

At the end of 2006, the expectation for 2007 was that LREIT would achieve a significant increase in operating income, operating cash flow and net income, excluding amortization expense, while continuing to incur a net loss and operate with a cash distribution payout ratio which exceeded operating cash flows.

Overall, operating results for the first quarter of 2007 were generally in accordance with expectations, with LREIT achieving a 45.3% increase in operating income, compared to the first quarter of 2006 and a 114% increase in cash from operating activities. The first quarter loss of LREIT increased by 82% in 2007, compared to 2006.

### Loss for the Period

#### Analysis of Loss

	Three Months Ended Year Ended March 31		Increase (Decrease)
	2007	2006 (restated)	
Operating income - rental properties	\$ 4,570,037	\$ 3,010,545	\$ 1,559,492
Interest income - Trust	314,693	351,842	(37,149)
Operating income	<u>4,884,730</u>	<u>3,362,387</u>	<u>1,522,343</u>
Financing expense			
Mortgage loans	2,551,404	1,689,472	861,932
Debentures	<u>1,592,003</u>	<u>813,823</u>	<u>778,180</u>
	<u>4,143,407</u>	<u>2,503,295</u>	<u>1,640,112</u>
Operating income, net of financing expense*	741,323	859,092	(117,769)
Trust expense	<u>458,323</u>	<u>202,385</u>	<u>255,938</u>
Income, before amortization, future income tax recovery and non-controlling interest*	283,000	656,707	(373,707)
Amortization	2,156,036	1,637,369	518,667
Future income tax recovery	(79,874)	(8,676)	(71,198)
Non-controlling interest	<u>(23,927)</u>	<u>-</u>	<u>(23,927)</u>
Loss for the period	<u>\$ (1,769,235)</u>	<u>\$ (971,986)</u>	<u>\$ (797,249)</u>

The analysis of loss for the year represents the re-formatting of balances from the Consolidated Statement of Loss in order to provide a more detailed assessment of the financial performance of the Trust. The components of operating income and financing expense, as disclosed in the analysis, agree to the segmented financial information in the notes to the financial statements, while all other line items agree to the Consolidated Statement of Loss. Accordingly, the analysis consists entirely of GAAP measurements, aside from two sub-totals (see asterisks).

**Income, Excluding Amortization Expense, Future Income Tax Recovery and Non-Controlling Interest**

During the first quarter of 2007, the income of LREIT, before amortization expense, future income tax recovery and non-controlling interest, decreased by \$373,707 or 57%, compared to the first quarter of 2006. The decrease in income reflects an increase in financing expense of approximately \$1.6 Million and an increase in Trust expense of approximately \$0.3 Million, largely offset by an increase in operating income of approximately \$1.5 Million.

The increase in operating income is almost entirely due to an increase in operating income from rental properties. The increase reflects the incremental income from properties which were acquired between April 1, 2006 and December 31, 2006, as well as a significant improvement in the operating income of the 22 properties which have been in the LREIT portfolio since January 1, 2006.

The increase in financing expense is comprised of an increase in financing expense pertaining to mortgage loans and an increase in financing expense in regard to convertible debentures.

The increase in Trust expense reflects an increase in unit based compensation expense, service fees and stock exchange listing fees.

**Loss For the Period**

After considering amortization expense, future income tax recovery and non-controlling interest, LREIT incurred a loss of \$1,769,235 during the first quarter of 2007, compared to a loss of \$971,986 in the first quarter of 2006. The loss reflects total amortization charges of approximately \$2.2 Million, compared to approximately \$1.6 Million in the first quarter of 2006.

**Financing Expense - Mortgage Loans**

Financing expense on mortgage loans increased by \$861,932 or 51.0% during the first quarter of 2007 and as a percentage of operating income, increased from 50.3% in the first quarter of 2006 to 52.2% in the first quarter of 2007. The increase mainly reflects the incremental interest expense on the additional mortgage loans which were arranged for properties acquired prior to 2007. Virtually all of interest expense for mortgage loans which were arranged or assumed for properties acquired during the first quarter of 2007, was capitalized.

**Financing Expense - Debentures**

During the first quarter of 2007, financing expense on convertible debentures increased by \$778,180 or 96%, compared to the first quarter of 2006. The increase mainly reflects the incremental financing expense which resulted from the issuance of the \$13.68 Million Series F convertible debentures in March 2006 and the \$25.73 Million Series G convertible debentures in December 2006.

As a percentage of operating income, financing expense on debentures increased from 24% in 2006 to 33% in the first quarter of 2007. The increase in the ratio of debenture financing expense, relative to operating income, reflects the following factors:

- an increase in the relative amount of debenture capital due to a change in the overall capital structure of the Trust. As of March 31, 2007, the ratio of convertible debenture debt, at face value, compared to the unit component of the total equity of the Trust was 41%. As of March 31, 2006, the convertible debenture debt ratio was 29%; and

- a lag in the return on the investment of the proceeds of the December 2006 Series G convertible debenture offering. The proceeds from the Series G convertible debenture offering were primarily invested in properties which did not contribute to operating income during the first quarter of 2007 as the properties were either under development or acquired at the end of the quarter. Conversely, financing expense for the Series G convertible debentures is reflected in the operating results for the first quarter of 2007, for a full three month period.

### **Amortization Expense**

During the first quarter of 2007, total amortization expense increased by \$518,667 or 32%, compared to the first quarter of 2006. The increase mainly reflects the growth in the portfolio of income-producing properties since March 31, 2006.

During the first quarter of 2007, the ratio of amortization expense to operating income was 44%, compared to 49% in 2006. The decrease in the ratio of amortization expense, relative to operating income mainly reflects a proportionately lower allocation of a portion of the purchase price to intangible assets for properties which were acquired subsequent to March 31, 2006 and the fact that intangible assets are amortized over a shorter time frame than other components of the acquisition cost.

### **Trust Expense**

Trust expense increased by \$255,938 during the first quarter of 2007, compared to the first quarter of 2006. The increase in Trust expense is mainly due to the following factors:

- the charge to unit-based compensation expense of \$80,824 in regard to the unit options which were issued by the Trust in July 2006;
- an increase in the monthly 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. The asset management for the three months ended March 31, 2007 was \$226,102, compared to \$129,159 for the three months ended March 31, 2006.

Please refer to "Related Party Transactions" on page 33 of this report 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

- an increase in fees associated with being listed on the TSX in 2007 as opposed to the Venture Exchange in 2006.

### **Operating Income**

During the first quarter of 2007, the operating income of LREIT increased by approximately \$1.5 Million or 45%, compared to the first quarter of 2006. The increase in the operating income is mainly due to the increase in the number of properties in the portfolio of LREIT.

During the first quarter of 2006, 23 properties, with a total acquisition cost of \$177 Million, contributed to the operating income of LREIT, including two properties which were acquired in January 2007. During the first quarter of 2007, 33 properties, with a total acquisition cost of \$234 Million, contributed to operating income, representing the property portfolio of the Trust as of December 31, 2006. The three properties which were acquired during the first quarter of 2007 did not have any meaningful impact on operating income, as two of the properties were under development (Woodland Park and The Clarington) and the third property (Nova Court) was acquired at the end of the quarter, on March 23, 2007.

## Overall Portfolio Analysis

### Analysis of Operating Income

	Percentage of Total Operating Income	
	Three Months Ended March 31	
	2007	2006
Residential	81 %	70 %
Commercial	13 %	20 %
Total - Income Properties	94 %	90 %
Trust	6 %	10 %
Total	100 %	100 %

The operations of LREIT encompass the acquisition and management of a growing portfolio of income-producing properties. The portfolio of Income Properties includes commercial and residential properties in rental markets across western Canada and in Ontario and the Northwest Territories. For financial reporting purposes, the operating results of the Income Properties are segmented geographically and by property type, while operating results pertaining to overall asset management and administrative activities are categorized under the heading of "Trust".

The operating income from "Trust" operations consists almost exclusively of interest income on mortgage loans receivable and excess cash reserves. The portfolio of Income Properties is the primary source of operating income accounting for 94% and 90% of the total operating of income of LREIT in the first quarter of 2007 and 2006, respectively.

The following discussion focuses on an analysis of the Income Properties of LREIT, with a more detailed review of the residential property portfolio, given the ongoing increase in the amount of residential properties.

## Revenues

### Total Rental Revenues

#### Analysis of Rental Revenues by Property Sector

	Percentage of Total Rental Revenue	
	Three Months Ended March 31	
	2007	2006
Residential	87 %	81 %
Commercial	13 %	19 %
	100 %	100 %

Although the residential property component of LREIT is gradually accounting for a higher percentage of operating income, the commercial and light industrial properties of LREIT continue to generate excellent yields and provide a strong foundation for the Trust in terms of cash flows and asset values. The two light industrial properties in the LREIT portfolio are 100% leased to single tenants under long-term lease agreements, while the three commercial properties, Mclvor Mall, the Kenaston Property and Nova Court, were 98%, 97% and 100% leased respectively, as of March 31, 2007.

## Revenue from Residential Properties

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

	Percentage of Total Rental Revenue	
	Three Months Ended March 31	
	2007	2006
Alberta	43 %	40 %
Saskatchewan	32 %	34 %
Northwest Territories	10 %	13 %
Manitoba	5 %	8 %
British Columbia	5 %	5 %
Ontario	5 %	N/A %
	<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 three months ended March 31, 2007, LREIT expanded into Bowmanville, Ontario. Additional new property acquisitions occurred in Alberta and the Northwest Territories, with the highest concentration of property acquisitions centred in Fort McMurray, Alberta.

The relative ranking of revenues by geographic market segment has not changed significantly since the first quarter of 2006, as the property acquisitions of LREIT, subsequent to March 31, 2006, were mainly located in Alberta and Saskatchewan. In June 2006, LREIT also acquired its first property in Ontario, resulting in a modest decrease in the revenue percentages for Manitoba and the Northwest Territories.

The continued geographic diversification of LREIT will serve to mitigate the general economic risks which are associated with real property ownership, such as the risk of increased competition or reduced demand in a local real estate market.

## Operating Costs

### Total Operating Costs

#### Analysis of Operating Cost Ratio by Property Sector

	Operating Cost Ratio	
	Three Months Ended March 31	
	2007	2006
Residential	48 %	53 %
Commercial	42 %	42 %
Total portfolio	48 %	51 %

The operating cost ratio for the entire portfolio of LREIT properties decreased from 51% in the first quarter of 2006 to 48% in the first quarter of 2007, primarily due to a decrease in the operating cost ratio of the residential property portfolio.

### Operating Costs for Commercial Properties

During the first quarter of 2007, the operating cost ratio remained relatively constant at 42%, compared to the first quarter of 2006.



*Same Property Analysis*

All of the commercial properties in the LREIT portfolio were acquired prior to 2006 and, as such, the properties completed a full quarter of operation in the first quarter of 2006 and 2007. As disclosed in the following chart, the total revenues and operating income of the commercial properties decreased by a modest amount during the first quarter of 2007, compared to the first quarter of 2006. The modest decrease mainly reflects a higher level of non-recoverable costs at the Kenaston Property, largely offset by an improvement in the operating results of the McIvor Mall. The change in revenues and operating income did not affect the overall operating cost ratio of the commercial properties.

	Three Months Ended March 31		Decrease	
	2007	2006	Amount	%
Total revenue	\$ 1,120,056	\$ 1,169,397	\$ (49,341)	(4.2)%
Operating income	\$ 646,307	\$ 673,159	\$ (26,852)	(4.0)%

**Operating Costs for Residential Properties***Overall Residential Portfolio***Geographic Analysis of Operating Cost Ratio - Multi-Family Properties**

	Three Months Ended March 31			
	2007		2006	
	Operating Cost Ratio	Vacancy Loss	Operating Cost Ratio	Vacancy Loss
Alberta	36 %	4 %	42 %	1 %
Northwest Territories	43 %	1 %	51 %	9 %
Manitoba	55 %	23 %	58 %	25 %
Saskatchewan	60 %	10 %	57 %	13 %
British Columbia	63 %	2 %	97 %	26 %
Ontario	67 %	7 %	N/A	N/A
Total residential portfolio	48 %	7 %	53 %	10 %

During the first quarter of 2007, there was a significant improvement in the operating cost ratio of the residential property portfolio, with the ratio decreasing from 53% during the first quarter of 2006 to 48% during the first quarter of 2007.

The operating results for the Alberta portfolio has the most significant impact of the overall ratio, given the relative size of the Alberta portfolio, compared to other provinces. For the Alberta portfolio, the operating cost ratio decreased from 42% in the first quarter of 2006 to 36% in the first quarter of 2007. The decrease in ratio reflects the acquisition of six properties in Fort McMurray, Alberta, subsequent to March 31, 2006 and the comparatively high profit margin associated with the six properties.

The province with the most significant change in operating cost ratio was British Columbia, with the operating cost ratio decreasing from 97% in 2006 to 63% in 2007. The lower operating cost ratio mainly reflects the improvement in the vacancy rate at Greenwood Gardens, the sole property in the LREIT portfolio in British Columbia.

Overall, the residential portfolio continued to generate a favourable return in 2006 as the high operating cost ratios are primarily occurring in the smaller properties which, in total, comprise a relatively low percentage of the overall property portfolio.

*Same Property Analysis*

As of January 1, 2006, there were 18 residential properties in the LREIT portfolio.

As disclosed in the following analysis, the combined revenue of the 18 properties increased by 12.2% in the first quarter of 2007, compared to the first quarter of 2006, while operating income increased by 23.2% during the same period. The improvement in operating results is mainly attributable to Greenwood Gardens and Nelson Ridge Estates. For Greenwood Gardens, the improvement mainly reflects a significant reduction in the vacancy loss and in bad debt expense. For Nelson Ridge Estates, the improvement is mainly attributable to rental rate increases.

	Three Months ended March 31		Increase (Decrease)	
	2007	2006	Amount	%
Total revenue	<u>\$ 5,379,751</u>	<u>\$ 4,796,870</u>	<u>\$ 582,881</u>	<u>12.2 %</u>
Operating income	<u>\$ 2,826,202</u>	<u>\$ 2,293,275</u>	<u>\$ 532,927</u>	<u>23.2 %</u>

**Revenue/Income and Other Commitments****Lakewood Manor**

As disclosed on page 9, the acquisition of Lakewood Manor is expected to close on July 1, 2007. A multi-year lease agreement with a major oil sands company has been arranged for all of the apartment suites and townhouses at the property.

The lease is for a three year term, with a two year renewal option, and will result in absolute net operating income for Lakewood Manor of \$4,743,000 per annum. The agreement also provides 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 \$25,593,600 for 2007; \$26,297,600 for 2008; and \$27,091,200 for 2009.

The lease agreement will ensure a 100% occupancy for Lakewood Manor for a minimum of three years. The lease agreement is also expected to result in a reduction in the cost of fixed rate mortgage financing for the property.

**Elgin Lodge**

LREIT has retained Kingsway Arms Management Services Inc. ("Kingsway") to manage Elgin Lodge for a ten year term. 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, totalling 850 suites located across Ontario.

As disclosed on page 10, the construction of the 59 suite expansion of Elgin Lodge commenced in December 2006. 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, if any, by which the appraised value of the expanded property exceeds the total cost to LREIT, including the expansion cost. The one-time payment is net of a 12% return on equity.

### The Clarington Seniors Residence

LREIT has also retained Kingsway to manage The Clarington Seniors Residence for a ten-year term. During the five year period after the "lease-up" date, Kingsway is entitled to a one-time payment equal to 50% of the amount, if any, by which the appraised value of the property exceeds the original acquisition cost to LREIT. The one-time payment is net of an 8% return on equity.

### Park View Apartments

LREIT has entered into a Development Agreement with Shelter Canadian Properties Limited in regard to the construction of Park View Apartments. Details of the Development Agreement are disclosed on page 9 of this report.

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

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

During the first quarter of 2007, FFO decreased by \$710,679 compared to the first quarter of 2006, while AFFO decreased by \$303,674. On a per unit basis, FFO decreased by \$.042 per unit, while AFFO decreased by \$.019 per unit.

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

	Three Months Ended March 31	
	2007	2006 (restated)
Loss for the period	\$ (1,769,235)	\$ (971,986)
Add (Deduct):		
Total amortization expense	2,156,036	1,637,369
Amortization of deferred financing costs	(440,869)	(103,897)
Future income tax recovery	(79,874)	(8,676)
Non-controlling interest	(23,927)	-
<b>Funds from operations</b>	<b>(157,869)</b>	<b>552,810</b>
Add (Deduct):		
Straight-line rent adjustment	(21,970)	(10,310)
Net amortization of above/below market in-place lease	399	26
Accretion of debt component of convertible debentures	1,592,003	813,823
Interest expense on convertible debentures	(1,054,539)	(614,061)
Unit based compensation	83,671	3,989
Tenant inducement and leasing expenses	(64,484)	(46,622)
Improvements to income properties	(92,292)	(111,062)
<b>Adjusted funds from operations</b>	<b>\$ 284,919</b>	<b>\$ 588,593</b>
FFO per unit		
- basic	\$ (0.009)	\$ 0.033
- diluted	\$ (0.009)	\$ 0.033
AFFO per unit		
- basic	\$ 0.016	\$ 0.035
- diluted	\$ 0.016	\$ 0.035

\* 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.

## Comparison to Preceding Quarter

### Comparison to 2006 Fourth Quarter

	Three Months Ended		Increase (Decrease)
	March 31, 2007	December 31, 2006 (restated)	
Operating income - rental properties	\$ 4,570,037	\$ 4,536,197	\$ 33,840
Interest income - Trust	314,693	260,417	54,276
Operating income	<u>4,884,730</u>	<u>4,796,614</u>	<u>88,116</u>
Financing expense			
Mortgage loans	2,551,404	2,321,147	230,257
Debentures	<u>1,592,003</u>	<u>1,059,541</u>	<u>532,462</u>
	<u>4,143,407</u>	<u>3,380,688</u>	<u>762,719</u>
Operating income, net of financing expense	741,323	1,415,926	(674,603)
Trust expense	<u>458,323</u>	<u>518,494</u>	<u>(60,171)</u>
Income, before amortization, future income tax recovery and non-controlling interest	283,000	897,432	(614,432)
Amortization	2,156,036	1,969,156	186,880
Future income tax recovery	(79,874)	(455,245)	375,371
Non-controlling interest	<u>(23,927)</u>	<u>(52,898)</u>	<u>28,971</u>
Loss for the period	<u>\$ (1,769,235)</u>	<u>\$ (563,581)</u>	<u>\$ (1,205,654)</u>

### Analysis of Incremental Loss

During the first quarter of 2007, LREIT incurred a loss of \$1,769,235, compared to a loss of \$563,581 during the fourth quarter of 2006. The increase in the loss reflects the following factors:

- an increase in operating income of \$88,116. As previously disclosed, the three properties which were acquired by LREIT during the first quarter of 2007 did not have any meaningful impact on operating income as two of the properties were under development throughout the first quarter, while the third property was acquired at the end of the quarter, on March 23, 2007. In addition, LREIT did not complete any new property acquisitions during the fourth quarter of 2006. Accordingly, the increase in operating income in the first quarter of 2007 reflects an improvement in the operating results of the property portfolio which has been in place since the beginning of the fourth quarter of 2006.
- an increase in mortgage loan financing expense of \$230,257 or 10%. The increase reflects the additional mortgage financing which was obtained for pre-2007 property acquisitions during the first quarter of 2007;
- an increase in debenture financing expenses of \$532,462. The increase is mainly due to the issuance of the Series G debentures in the fourth quarter of 2006 ; and
- a decrease in Trust expense of \$60,171. The decrease mainly reflects the fact that Trust expense was comparatively high during the fourth quarter of 2006 due to the initial listing costs which were associated with the move from the TSX Venture to the TSX.
- an increase in amortization expense of \$186,880 due to the increase in amortization on deferred financing costs as a result of additional refinancings.
- a decrease in income tax recovery of \$375,371 as a result of a decrease in the effective tax rate during 2006 resulting in an increase in the income tax recovery in the fourth quarter of 2006.

## Summary of Quarterly Results

### Quarterly Analysis

	2007		2006	
	Q1	Q4 (restated)	Q3 (restated)	Q2 (restated)
Total revenue	\$ 9,051,765	\$ 8,835,557	\$ 8,370,252	\$ 6,891,004
Operating income	\$ 4,884,730	\$ 4,796,613	\$ 4,912,506	\$ 4,025,854
Loss for the period	\$ (1,769,235)	\$ (563,581)	\$ (829,956)	\$ (776,734)

### PER UNIT

Operating income				
- basic	\$ 0.281	\$ 0.278	\$ 0.284	\$ 0.235
- diluted	\$ 0.255	\$ 0.267	\$ 0.266	\$ 0.222
Loss for the period				
- basic	\$ (0.102)	\$ (0.033)	\$ (0.048)	\$ (0.045)
- diluted	\$ (0.102)	\$ (0.033)	\$ (0.048)	\$ (0.045)

### Quarterly Analysis

	2006		2005	
	Q1 (restated)	Q4 (restated)	Q3 (restated)	Q2 (restated)
Total revenue	\$ 6,442,035	\$ 5,579,894	\$ 4,846,417	\$ 4,300,018
Operating income	\$ 3,362,387	\$ 2,876,420	\$ 2,819,604	\$ 2,485,136
Loss for the period	\$ (971,986)	\$ (437,352)	\$ (299,935)	\$ (713,757)

### PER UNIT

Operating income				
- basic	\$ 0.200	\$ 0.288	\$ 0.282	\$ 0.306
- diluted	\$ 0.187	\$ 0.227	\$ 0.241	\$ 0.213
Loss for the period				
- basic	\$ (0.058)	\$ (0.043)	\$ (0.030)	\$ (0.090)
- diluted	\$ (0.058)	\$ (0.043)	\$ (0.030)	\$ (0.090)

## CAPITAL RESOURCES AND LIQUIDITY

### Cash from Operating Activities

During the first quarter of 2007, LREIT generated cash from operating activities of \$1,136,446, compared to \$531,138 during the first quarter of 2006, representing an increase of approximately \$600,000. The increase reflects the following variables:

- an increase in "cash from operations" of approximately \$47,283 during the first quarter of 2007. Cash from operations is a non-GAAP measurement which reflects the net loss of the Trust, after adjusting for non-cash expenses, including amortization, unit-based compensation and the non-cash component of debenture financing expense.
- an increase in cash flow from non-cash operating items of approximately \$576,000 during the first quarter of 2007. The increased cash flow primarily reflects the extent to which the increase in operating accounts payable exceeded the increase in operating accounts receivable during the first quarter of 2007.
- an increase in tenant inducements and leasing expenses of approximately \$18,000. Tenant inducements and leasing expenses, excluding amounts recorded on property acquisitions, amounted to \$64,484 during the first quarter of 2007 and consisted entirely of leasehold improvements at the Kenaston Property and the Mclvor Mall.

### Funding of Cash Distributions

#### Distributable Income

The stated policy of LREIT is to distribute cash to the Unitholders, on a quarterly 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 non-GAAP measurement which differs from "cash from operating activities", as disclosed in the Consolidated Statement of Cash Flows in the financial statements. 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 March 31	
	2007	2006 (restated)
Cash provided by operating activities, per Statement of Cash Flow	\$ 1,136,446	\$ 531,138
Add (deduct):		
Interest paid on convertible debentures	1,146,824	721,239
Interest expense on convertible debentures	(1,054,539)	(614,061)
Changes in non-cash operating items	(410,651)	165,236
Tenant inducement and leasing expenses	64,484	46,622
Distributable income	<u>\$ 882,564</u>	<u>\$ 850,174</u>
Per unit		
- Basic	\$ 0.051	\$ 0.050
- Diluted	\$ 0.050	\$ 0.050

As disclosed in the following summary, the total distributions of LREIT for 2007 exceeded distributable income by \$1,594,185 and cash from operating activities by \$1,340,303.

	Three Months Ended March 31	
	2007	2006 (restated)
Total distributions	\$ 2,476,749	\$ 2,364,800
Distributable income	\$ 882,564	\$ 850,174
Excess of distributions over distributable income	\$ (1,594,185)	\$ (1,514,626)
Cash provided by operating activities	\$ 1,136,446	\$ 531,138
Excess of distributions over cash provided by operating activities	\$ (1,340,303)	\$ (1,833,662)

### Distribution Shortfall

The shortfall between total distributions and cash from operating activities effectively represents a return of capital to the Unitholders and serves to reduce the investment total capacity of the Trust, thereby contributing to the variance between the operating cash flows and total distributions.

As additional properties are acquired and operations stabilize, it is anticipated that the shortfall between the total distributions and operating cash flows will be reduced over time.

### Financing/Investment Activities

The chart on page 32 provides a summary of the cash flow activities of the Trust.

As disclosed in the chart, the net cash used in investment activities exceeded the net cash provided by financing activities, excluding cash distributions, by \$1,899,845 during the first quarter of 2007. Financing activities consisted almost exclusively of transactions related to mortgage loan financing while investment activities consisted primarily of cash outflows associated with the acquisition and development of new properties. Included in investment activities are asset additions of \$1,213,774, the details of which are provided in note 2 of the chart.

After providing for the cash inflows from operating activities and the cash outflow in regard to cash distributions, the net cash increase for the first quarter of 2007 was \$1,485,839, or \$724,518 after deducting the March 2007 cash distribution of \$761,321 which was paid on April 15, 2007. After accounting for the opening cash balance of \$1,588,271, LREIT completed the first quarter of 2007 with a cash balance of \$3,074,110.

**Cash Flow Analysis (Note 1)**

	Three Months Ended March 31, 2007
<b>Cash, beginning of period</b>	\$ 1,588,271
<b>Financing Activities:</b>	
Mortgage proceeds	49,508,978
Mortgage principal payments	(935,021)
Mortgage loan refinancing	(2,500,000)
Financing costs	<u>(713,894)</u>
Total financing	<u>45,360,063</u>
<b>Investing Activities:</b>	
Property acquisitions	(34,578,953)
Asset additions (Note 2)	(1,213,774)
Property under development	(5,253,628)
Deposits	(134,025)
Restricted cash	<u>(2,279,838)</u>
Total investing	<u>(43,460,218)</u>
<b>Net cash inflow of investment capital</b>	1,899,845
Operating activities	<u>1,136,446</u>
Cash before distributions	3,036,291
Cash distributions	<u>(1,550,452)</u>
<b>Net cash inflow</b>	1,485,839
<b>Cash, beginning of period</b>	<u>1,588,271</u>
<b>Cash, ending of period</b>	<u>\$ 3,074,110</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 inflow of investment capital". Aside from the exclusion of cash distributions from financing activities and the subtotal entitled "net inflow" of investment capital, the analysis consists entirely of GAAP measurements.

**Note 2 - Asset Additions**

Renovation costs for Highland Tower	\$ 1,465,578
Improvements to Income Properties	<u>92,292</u>
	1,557,870
Asset additions included in accounts payable	<u>(344,096)</u>
Cash outlay - asset additions	<u>\$ 1,213,774</u>



## Working Capital Requirements

### General

On an annual basis, LREIT is generating sufficient cash from operating activities to fully fund operating costs and mortgage loan debt service costs for its entire portfolio of income-producing properties, as well as interest payable on convertible debentures and trust expenses.

LREIT requires other sources of capital in order to fund property acquisitions, capital improvements and a portion of the monthly cash distributions.

### Capital Commitments

The following chart provides a summary of the projected capital commitments of LREIT in regard to property acquisitions and capital improvements, subsequent to March 31, 2007.

Property	Approximate Amount	Description
Borden Place (closed on May 1, 2007)	\$1.2 Million	- represents the \$5.6 Million purchase price net of the mortgage loans of \$4.2 Million and deposits of \$200,000.
Highland Tower Apartment Project (expected to be substantially complete in June 2007)	(\$2.4 Million)	- represents the cost to complete the renovation program, net of projected financing of \$3,100,000. *
Lakewood Manor (projected closing in July 2007)	\$3.3 Million	- represents the \$59,835,825 purchase price, net of the projected financing of \$48 Million, less the mortgage loan receivable of \$8.5 Million.
Park View Apartments (ongoing funding - projected closing date in November 2007)	(\$1.1 Million)	- represents the total maximum construction costs of \$57.75 Million, net of the projected financing of \$45 Million, less the cash outlay to March 31, 2007 of approximately \$14 Million. *
Elgin Lodge (ongoing funding)	\$0.8 Million	- represents the projected construction costs of \$9.5 Million, less the mortgage financing of approximately \$6.9 Million, less the cash outlay to December 31, 2006 of approximately \$1.8 Million. *
Millennium Village (Projected closing in August, October and November 2007)	\$3.2 Million	- represents the \$25,150,000 purchase price, net of the mortgage financing of \$16,954,000, less the mortgage loan receivable of \$4 Million and deposit of \$1 Million
	<u>\$5.0 Million</u>	

\* adjusted for accounts payable

As indicated in the preceding chart, LREIT requires approximately \$5.0 Million during the last three quarters of 2007 in order to fund its existing capital expenditure commitments.

## Sources of Capital

### Short-term

As of March 31, 2007, the cash balance of LREIT was \$3,074,110, while the working capital deficiency balance was \$1,241,443.

The refinancing of under-leveraged properties is expected to serve as the primary source of additional capital during the remainder of 2007. Since March 31, 2007, LREIT has received a mortgage loan advance of approximately \$1.7 Million in regard to prior period property acquisitions and financing proposals for additional of \$17.5 Million are under negotiation with lenders.

The proceeds from the refinancing of existing properties are expected to be sufficient to enable LREIT to fulfill all of its funding commitments for the immediate future in regard to property acquisitions, capital improvements and cash distributions.

### Longer Term

Since its inception, LREIT has demonstrated an ongoing ability to raise additional capital to fund new property acquisitions and it is anticipated that any future debenture or trust unit offerings will be well received by the marketplace and will also serve as a source of investment capital. LREIT may also exchange trust units for real property acquisitions. Secondary financing sources, such as a revolving line of credit, may also be considered by LREIT as a source of interim investment capital.

The ability of LREIT to raise additional capital and, in turn, proceed with the acquisition of the properties which are under contract 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

The financial results for the remainder of 2007 are expected to be similar to the first quarter results with LREIT achieving significant increases in operating income and cash from operating activities, while continuing to incur a net loss and operate with a cash distribution payout ratio which exceeds operating cash flows.

## 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.

For 2006, the Committee approved a monthly service fee equal to 0.3% of the net book value of the total assets of the Trust, excluding cash and accumulated amortization, as of the date of the most recently issued financial statements. For 2007, the 0.3% fee has been extended to August 31, 2007. Payment of the fee occurs on a monthly basis, on the last day of each month.

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.

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 Park View Apartments**

As disclosed in the section of this report entitled "Investment Activities", the Park View apartment complex is being constructed pursuant to a development agreement with Shelter Canadian. Pursuant to the development agreement, Shelter Canadian has 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. In consideration for its services under the development agreement, Shelter will earn a development fee from LREIT in the maximum amount of \$1,000,000, 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.

### **CHANGES IN ACCOUNTING POLICY**

Effective January 1, 2007, LREIT adopted the new GAAP accounting policies for "Financial Instruments, Recognition and Measurement" (Handbook Section 3855), for "Comprehensive Income and Equity" (Handbook Sections 1530 and 3251) and for "Hedges" (Handbook Section 3865).

This new policy for Financial Instruments, Recognition and Measurement establishes standards for the recognition and measurement of all financial instruments, provides a character-based definition of a derivative financial instrument and provides criteria to be used to determine when a financial instrument should be recognized and when a financial instrument is to be extinguished.

The new policy for Comprehensive Income and Equity establishes standards for the presentation of equity and changes in equity during the reporting period.

## **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.

### **Fluctuations in 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 continue to pay distributions which are 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 March 31, 2007, there were 36 properties in the real estate portfolio of LREIT, including four commercial properties and 32 residential properties, comprising 2,607 rental units. Eight of the residential properties, comprising a total of 505 suites are located in Fort McMurray. The eight properties have an aggregate acquisition price of \$110.6 Million, which represents approximately 19.4% of the total aggregate purchase price of the real estate portfolio. In addition, LREIT has acquired or is committed to acquire two additional multi-family residential properties in Fort McMurray and is currently developing a third multi-family residential property in Fort McMurray. The three properties comprise a total of 433 suites and have an aggregate acquisition price/development cost of approximately \$142.7 Million. Assuming the completion of the committed acquisitions and the property under development, LREIT will have a total of 11 multi-family residential properties in Fort McMurray, comprising a total of 938 suites, with an aggregate acquisition price/development cost to LREIT of approximately \$253.3 Million. The 11 Fort McMurray properties will represent approximately 30.9% of the total multi-family residential suites and approximately 56.1% of the total aggregate acquisition price/development cost to LREIT of its real estate portfolio.

### **Proposed 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. Except for the subsidiaries of LREIT which own and operate seniors housing complexes, no provision for income taxes is required under the current Canadian income tax legislation.

On March 29, 2007, the Minister of Finance Canada tabled in the House of Commons a Bill that contained legislation to implement a previously announced proposal for the federal income taxation of publicly traded trusts, including income trusts (the "Bill"). With respect to publicly traded trusts which existed prior to November 1, 2006, the Bill would apply starting with taxation years ending in or after 2011, except for those existing trusts that qualify for the real estate investment trust ("Qualifying REIT") exception included in the legislation. In addition, there are certain exceptions where an existing trust (including a Qualifying REIT) may lose its relief in the interim periods prior to 2011 where it undergoes "undue expansion".

Canadian real estate investment trusts which have operating subsidiaries, such as LREIT, do not currently qualify as a Qualifying REIT under the Bill as proposed. It is possible that changes will be made to the Bill prior to its enactment that will enable LREIT to qualify as a Qualifying REIT. Alternatively, if the proposals are not changed, LREIT will consider its alternatives, including restructuring its affairs to qualify as a Qualifying REIT. However, it is not possible at this preliminary juncture to provide any assurances 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.

### **Relationship with Shelter Canadian**

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.

## **TAXATION**

### **Taxation of LREIT**

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 intend to 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.

### **Taxation of Unitholders**

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. 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. 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. Distributions in excess of the taxable income of LREIT are allocated to the Unitholder for the year and will not be included in computing the taxable income of the Unitholder. The adjusted cost base of the units which are held by the Unitholder will, however, be reduced by the amount of distributions not included in income.

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.

All of the distributions which have been paid by LREIT from September 2002 to March 31, 2007 have represented a reduction in adjusted cost base of the units.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

No changes were made to the design of the internal controls over financial reporting during the three months ended March 31, 2007 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 March 31, 2007 Quarterly 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  
May 7, 2007