Condensed Consolidated Interim Financial Statements
(In Canadian dollars)

# TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Three months ended March 31, 2016 and 2015
(Unaudited)

# TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
(Unaudited)

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| **Assets** | | |
| Non-current assets: | | |
| Investment properties (note 4) | $ 341,588 | $ 342,150 |
| Instalment notes receivable (note 5) | 884 | 956 |
| Deposits | 341 | 341 |
| Total non-current assets | 342,813 | 343,447 |
| Current assets: | | |
| Tenant and other receivables (note 6) | 1,335 | 1,439 |
| Prepaid expenses and other assets | 1,472 | 1,210 |
| Instalment notes receivable (note 5) | 299 | 308 |
| Cash and cash equivalents | 771 | 610 |
| Total current assets | 3,877 | 3,567 |
| Total assets | $ 346,690 | $ 347,014 |
| **Liabilities and Unitholders' Equity** | | |
| Non-current liabilities: | | |
| Mortgages and notes payable (note 7) | $ 193,412 | $ 193,355 |
| Derivative instruments (note 11) | 1,033 | 936 |
| Class B LP Units (note 9) | 24,546 | 21,962 |
| Total non-current liabilities | 218,991 | 216,253 |
| Current liabilities: | | |
| Mortgages and notes payable (note 7) | 4,322 | 6,580 |
| Credit facilities (note 8) | 8,955 | 7,191 |
| Tenant rental deposits and prepayments | 1,280 | 1,550 |
| Accounts payable and accrued liabilities (note 10) | 4,423 | 4,190 |
| Derivative instruments (note 11) | 640 | 698 |
| Total current liabilities | 19,620 | 20,209 |
| Total liabilities | 238,611 | 236,462 |
| Unitholders' equity (note 12) | 108,079 | 110,552 |
| Total liabilities and unitholders' equity | $ 346,690 | $ 347,014 |

See accompanying notes to condensed consolidated interim financial statements.

Approved on behalf of the Board of Trustees on May 4, 2016:

"William J. Biggar" Trustee

"Roland A. Cardy" Trustee

# TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Condensed Consolidated Interim Statements of Income (Loss) and Comprehensive Income (Loss)
(In thousands of Canadian dollars)

Three months ended March 31, 2016 and 2015
(Unaudited)

| | 2016 | 2015 |
|---|---|---|
| Revenue | $ 9,876 | $ 8,890 |
| Expenses: | | |
| Property operating | 2,411 | 2,018 |
| Realty taxes | 1,599 | 1,440 |
| Income before the undernoted | 5,866 | 5,432 |
| Other income (expenses): | | |
| General and administration expenses | (687) | (505) |
| Finance costs (note 14) | (1,880) | (1,817) |
| Distributions on Class B LP Units (note 9) | (639) | (508) |
| Unrealized loss on change in fair value of derivative instruments (note 11) | (39) | (839) |
| Fair value adjustment of Class B LP Units (note 9) | (2,584) | 171 |
| Fair value adjustment of investment properties (note 4) | (637) | 1,069 |
| Net income (loss) and comprehensive income (loss) for the period | $ (600) | $ 3,003 |

See accompanying notes to condensed consolidated interim financial statements.

# TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Condensed Consolidated Interim Statements of Changes in Unitholders' Equity
(In thousands of Canadian dollars)

Three months ended March 31, 2016 and 2015
(Unaudited)

| | Trust Unit capital (note 12(c)) | Cumulative income (loss) | Total |
|---|---|---|---|
| Unitholders' equity, January 1, 2015 | 101,814 | 546 | 102,360 |
| Changes during the period: | | | |
| Units issued and repurchased, net of issue costs | (213) | – | (213) |
| Net income and comprehensive income for the period | – | 3,003 | 3,003 |
| Distributions | – | (2,511) | (2,511) |
| Issue of units under Distribution Reinvestment Plan (“DRIP”) (note 12(e)) | 393 | – | 393 |
| Unitholders' equity, March 31, 2015 | $ 101,994 | $ 1,038 | $ 103,032 |
| Changes during the period: | | | |
| Units issued and repurchased, net of issue costs | 514 | – | 514 |
| Net income and comprehensive income for the period | – | 13,468 | 13,468 |
| Distributions | – | (7,603) | (7,603) |
| Issue of units under DRIP (note 12(e)) | 1,141 | – | 1,141 |
| Unitholders' equity, December 31, 2015 | 103,649 | 6,903 | 110,552 |
| Changes during the period: | | | |
| Units issued and repurchased, net of issue costs | 101 | – | 101 |
| Net loss and comprehensive loss for the period | – | (600) | (600) |
| Distributions | – | (2,569) | (2,569) |
| Issue of units under DRIP (note 12(e)) | 595 | – | 595 |
| Unitholders' equity, March 31, 2016 | $ 104,345 | $ 3,734 | $ 108,079 |

See accompanying notes to condensed consolidated interim financial statements.

# TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Condensed Consolidated Interim Statements of Cash Flows
(In thousands of Canadian dollars)

Three months ended March 31, 2016 and 2015
(Unaudited)

| | 2016 | 2015 |
|---|---|---|
| Operating activities: | | |
| Net income (loss) for the period | $ (600) | $ 3,003 |
| Adjustments for financing activities included in income: | | |
| Finance costs (note 14) | 1,880 | 1,817 |
| Unrealized loss on change in fair value of derivative instruments (note 11) | 39 | 839 |
| Distributions on Class B LP Units (note 9) | 639 | 508 |
| Fair value adjustment of Class B LP Units (note 9) | 2,584 | (171) |
| Adjustments for items not involving cash: | | |
| Fair value adjustment of investment properties (note 4) | 637 | (1,069) |
| Unit-based compensation expense | 86 | 32 |
| Change in other non-cash operating items | 67 | 17 |
| Change in non-cash operating working capital (note 15) | (212) | (752) |
| Cash provided by operating activities | 5,120 | 4,224 |
| Investing activities: | | |
| Acquisitions (note 3) | – | (6,043) |
| Additions to investment properties (note 4) | (119) | (361) |
| Cash used in investing activities | (119) | (6,404) |
| Financing activities: | | |
| Proceeds from credit facilities, net of costs | 1,768 | 3,026 |
| Proceeds from new mortgage financing, net of costs | – | 4,058 |
| Principal payments on mortgages | (1,486) | (1,243) |
| Repayment on vendor take-back mortgage | (765) | – |
| Principal payments on instalment notes receivable (note 5) | 81 | 73 |
| Finance costs paid | (2,288) | (1,983) |
| Proceeds from issuance of Units, net of costs | 7 | (15) |
| Units repurchased and cancelled under normal course issuer bid (“NCIB”) | – | (223) |
| Cash distributions to unitholders | (2,157) | (2,302) |
| Cash provided by (used in) financing activities | (4,840) | 1,391 |
| Increase (decrease) in cash and cash equivalents | 161 | (789) |
| Cash and cash equivalents, beginning of period | 610 | 2,186 |
| Cash and cash equivalents, end of period | $ 771 | $ 1,397 |
| Supplemental cash flow information: | | |
| Units issued under DRIP - unitholders | $ 405 | $ 207 |
| Units issued under DRIP - Class B LP Units | 190 | 186 |

See accompanying notes to condensed consolidated interim financial statements.

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**Organization:**

True North Commercial Real Estate Investment Trust (the “REIT”) is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust amended and restated on May 22, 2014 (“DOT”), and governed by the laws of the Province of Ontario. The REIT incorporated True North Commercial General Partner Corp. (“TNCGP”) on November 16, 2012 and, together with TNCGP, formed True North Commercial Limited Partnership (“TNCLP”) on November 16, 2012.

The REIT is listed on the Toronto Stock Exchange (“TSX”) under the symbol TNT.UN. The registered office of the REIT is 1801 – 3300 Bloor Street West, West Tower, Toronto, Ontario, Canada, M8X 2X2.

**1. Basis of preparation:**

(a) Statement of compliance:

These condensed consolidated interim financial statements of the REIT have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. Selected explanatory notes are included to explain events and transactions significant to understand the changes in financial position and performance of the REIT since the last annual consolidated financial statements as at and for the year ended December 31, 2015. These condensed consolidated interim financial statements do not include all the information required for full financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”).

The condensed consolidated interim financial statements were approved on behalf of the Board of Trustees on May 4, 2016.

(b) Basis of presentation:

The REIT holds its interest in investment property and other assets and liabilities related to the investment property in TNCLP, which is wholly owned by the REIT. All intercompany transactions and balances between the REIT and the subsidiary entities have been eliminated upon consolidation.

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the functional currency of the REIT.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**1. Basis of preparation (continued):**

These condensed consolidated interim financial statements have been prepared on a historical cost basis, except for investment properties, class B limited partnership units of TNCLP ("Class B LP Units"), unit options and derivative instruments, which are stated at their fair values.

(c) Critical judgments and estimates:

In preparing these condensed consolidated interim financial statements, significant judgments made by management in applying accounting policies were the same as those applied to the consolidated financial statements as at and for the year ended December 31, 2015.

**2. Significant accounting policies:**

The accounting policies applied by the REIT in these condensed consolidated interim financial statements are the same as those applied by the REIT in its audited consolidated financial statements as at and for the year ended December 31, 2015.

Future accounting changes:

A number of new standards have been issued but are not effective for the three months ended March 31, 2016 and, accordingly, have not been applied in preparing these consolidated financial statements.

| Standards | Effective date (annual period beginning on or after) |
|---|---|
| IFRS 15, Revenue from Contracts with Customers ("IFRS 15") | January 1, 2018 |
| IFRS 9, Financial Instruments ("IFRS 9") | January 1, 2018 |
| IFRS 16, Leases ("IFRS 16") | January 1, 2019 |

The REIT intends to adopt these standards on their respective effective dates.

## 2. Significant accounting policies (continued):

(a) IFRS 15, Revenue from Contracts with Customers:

IFRS 15 provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standard on leases, insurance contracts and financial instruments. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018, and is to be applied retrospectively. Early adoption is permitted.

The REIT is currently assessing the impact of the new standard.

(b) IFRS 9, Financial Instruments:

On July 24, 2014, the International Accounting Standards Board ("IASB") issued IFRS 9. IFRS 9 was issued as a complete standard including the requirements previously issued and the additional amendments to introduce a new expected loss impairment model and limited changes to the classification and measurement requirements for financial assets and liabilities. This amendment completes the IASB's financial instruments project and the standard is effective for reporting periods beginning on or after January 1, 2018, with early adoption permitted.

The REIT is currently assessing the impact of the new standard.

(c) IFRS 16, Leases:

IFRS 16 supersedes International Accounting Standards ("IAS") 17 Leases, IFRS Interpretations Committee ("IFRIC") 4 Determining whether an Arrangement contains a Lease, Standards Interpretation Committee ("SIC")-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. It eliminates the distinction between operating and finance leases from the perspective of the lessee. All contracts that meet the definition of a lease will be recorded in the statement of financial position with a "right of use" asset and a corresponding liability. The asset is subsequently accounted for as property, plant and equipment or investment property and the liability is unwound using the interest rate inherent in the lease. The accounting requirements from the perspective of the lessor remain largely in line with previous IAS 17 Leases requirements. The effective date for IFRS 16 is January 1, 2019.

The REIT is currently assessing the impact of the new standard.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 3. Acquisitions and dispositions:

The REIT did not acquire or dispose of any investment properties during the three months ended March 31, 2016.

## 4. Investment properties:

The following table summarizes the changes in investment properties for the three months ended March 31, 2016 and 2015:

| | Investment properties |
|---|---|
| Balance, December 31, 2014 | $ 311,480 |
| Acquisitions | 6,077 |
| Additions | 361 |
| Amortization of leasing costs, tenant inducements and straight-line rents | 8 |
| Fair value adjustment | 1,069 |
| Balance, March 31, 2015 | $ 318,995 |
| Acquisitions | 35,048 |
| Additions | 2,156 |
| Dispositions | (15,869) |
| Amortization of leasing costs, tenant inducements and straight-line rents | (42) |
| Fair value adjustment | 1,862 |
| Balance, December 31, 2015 | 342,150 |
| Additions | 119 |
| Amortization of leasing costs, tenant inducements and straight-line rents | (44) |
| Fair value adjustment | (637) |
| Balance, March 31, 2016 | $ 341,588 |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 4. Investment properties (continued):

The REIT determined the fair value of investment properties by developing a range of acceptable values based on the discounted cash flow method and the direct capitalization method, both of which are generally accepted appraisal methodologies. The REIT used the midpoint of this range for all investment properties. The key valuation assumptions for the REIT's investment properties are set out in the following table:

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Terminal and direct capitalization rates - range | 6.00% to 11.50% | 6.00% to 11.50% |
| Terminal and direct capitalization rate - weighted average | 7.13% | 7.14% |
| Discount rates - range | 7.00% to 12.00% | 7.00% to 12.00% |
| Discount rate - weighted average | 7.82% | 7.78% |

The fair values of the REIT's investment properties are sensitive to changes in the key valuation assumptions. Changes in the terminal and direct capitalization rates and discount rates would result in a change to the fair value of the REIT's investment properties as set out in the following table:

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Weighted average terminal and direct capitalization rate: | | |
| 25-basis points increase | $ (9,048) | $ (8,271) |
| 25-basis points decrease | 10,098 | 8,612 |
| Weighted average discount rate: | | |
| 25-basis points increase | (8,707) | (8,295) |
| 25-basis points decrease | 9,805 | 8,781 |

## 5. Instalment notes receivable:

In connection with the acquisition of certain properties in December 2014, the vendors agreed to deliver non-interest bearing instalment notes totalling $2,028 with an initial present value of $1,592 pursuant to which such vendors will provide instalment payments to the REIT to allow the REIT to achieve an effective interest rate of 3.3% per annum on certain assumed mortgages. These instalment notes mature on various dates between April 1, 2017 and April 1, 2027, co-terminously with the assumed mortgages.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 5. Instalment notes receivable (continued):

The following table provides a breakdown of the current and non-current portions of the instalment notes receivable.

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Current | $ 299 | $ 308 |
| Non-current | 884 | 956 |
| Balance | $ 1,183 | $ 1,264 |

## 6. Tenant and other receivables:

The following table presents details of the tenant and other receivables balances.

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Tenant receivables and charge backs | $ 1,168 | $1,273 |
| Other receivables | 167 | 166 |
| | $ 1,335 | $1,439 |

As at March 31, 2016, there is no impairment of tenant and other receivables.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 7. Mortgages and notes payable:

As at March 31, 2016, the REIT had principal balances of mortgages and notes payable outstanding of $198,216 (December 31, 2015 - $200,467). The mortgages and notes payable carry a weighted average fixed interest rate of 3.35% (December 31, 2015 - 3.34%) after giving effect to the instalment note receipts, and a weighted average term to maturity of 3.33 years (December 31, 2015 – 3.57 years). All interest rates are fixed for the term of the respective mortgages except for six (December 31, 2015 – six) of the REIT's mortgages that have utilized interest rate swaps to fix their floating interest rates (note 11). The mortgages are secured by first and second charges on the respective properties.

As at March 31, 2016, mortgages and notes are repayable as follows:

| | Scheduled principal payments | Debt maturing during the period | Total mortgages and notes payable | Scheduled interest payments |
|---|---|---|---|---|
| 2016 – remainder of year | $ 4,533 | $ – | $ 4,533 | $ 5,158 |
| 2017 | 5,903 | 11,499 | 17,402 | 6,399 |
| 2018 | 3,794 | 85,594 | 89,388 | 4,073 |
| 2019 | 2,931 | 20,474 | 23,405 | 2,787 |
| 2020 | 1,634 | 37,361 | 38,995 | 1,495 |
| Thereafter | 3,338 | 21,155 | 24,493 | 2,369 |
| Face value | $ 22,133 | $ 176,083 | $ 198,216 | $ 22,281 |
| Unamortized mark to market mortgage adjustments (2015 - $569) | | | 538 | |
| Unamortized financing costs (2015 – ($1,101)) | | | (1,020) | |
| Total mortgages and notes payable | | | $ 197,734 | |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 7. Mortgages and notes payable (continued):

The following table provides a breakdown of current and non-current portions of mortgages and notes payable:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Current: | | |
| Mortgages and notes payable | $ 4,533 | $ 6,784 |
| Unamortized mark to market mortgage adjustments | 120 | 123 |
| Unamortized financing cost | (331) | (327) |
| | 4,322 | 6,580 |
| Non-current: | | |
| Mortgages and notes payable | 193,683 | 193,683 |
| Unamortized mark to market mortgage adjustments | 418 | 446 |
| Unamortized financing cost | (689) | (774) |
| | 193,412 | 193,355 |
| | $ 197,734 | $ 199,935 |

## 8. Credit facilities:

The REIT has a credit agreement with a Canadian chartered bank for a $5,000 (December 31, 2015 - $5,000) and $12,000 (December 31, 2015 - $10,000) floating rate revolving credit facility (the “Credit Facilities”). The Credit Facilities are secured by two properties and mature on February 12, 2017.

The $5,000 facility bears interest on cash advances above $1,000 at 212.5 basis points per annum over the floating banker's acceptance rate or under $1,000 at 100 basis points over prime rate. The $12,000 facility bears interest on cash advances above $1,000 at 250 basis points per annum over the floating banker's acceptance rate or under $1,000 at 150 basis points over prime rate.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**8. Credit facilities (continued):**

The following table provides a breakdown of the Credit Facilities:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Credit facilities | $ 8,970 | $7,200 |
| Unamortized financing cost | (15) | (9) |
| | $ 8,955 | $7,191 |

**9. Class B LP Units:**

The Class B LP Units are indirectly exchangeable on a one-for-one basis for Units at the option of the holder, under the terms of an exchange agreement and have economic and voting rights equivalent, in all material respects, to Units.

The following table summarizes the changes in Class B LP Units for the three months ended March 31, 2016 and 2015:

| | Class B LP Units | Amount |
|---|---|---|
| Outstanding, December 31, 2014 | 3,422,247 | $ 20,533 |
| Fair value adjustment | – | (171) |
| Outstanding, March 31, 2015 | 3,422,247 | 20,362 |
| Issuance of Class B LP Units | 909,090 | 5,191 |
| Class B LP Units exchanged to Units at fair value | (25,000) | (132) |
| Fair value adjustment | – | (3,459) |
| Outstanding, December 31, 2015 | 4,306,337 | 21,962 |
| Fair value adjustment | – | 2,584 |
| Outstanding, March 31, 2016 | 4,306,337 | $ 24,546 |

During the three months ended March 31, 2016 and 2015, the distributions on Class B LP Units were $639 and $508, respectively.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 10. Accounts payable and accrued liabilities:

The following table presents details of the accounts payable and accrued liabilities balances:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Accounts payable and accrued liabilities | $ 2,505 | $ 2,289 |
| Finance costs payable | 786 | 792 |
| Distributions payable | 859 | 852 |
| Unit based compensation liability | 273 | 257 |
| | $ 4,423 | $ 4,190 |

## 11. Derivative instruments:

The REIT has entered into various interest rate swaps to limit its interest rate exposure from floating to fixed for the terms of mortgages on certain properties. The interest rate swaps expire co-terminously upon the maturity of the corresponding mortgages.

The notional principal amounts of the outstanding interest swap contracts at March 31, 2016 were $72,968 (December 31, 2015 – $73,507). Total unrealized loss on change in the fair value of the derivative instruments for the three months ended March 31, 2016 and 2015 totalled to $39 and $839 respectively.

## 12. Unitholders' equity:

(a) Units:

The REIT is authorized to issue an unlimited number of Units and an unlimited number of special voting units (“Special Voting Units”). Each Unit confers the right to one vote at any meeting of unitholders and to participate pro rata in all distributions by the REIT and, in the event of termination or winding-up of the REIT, in the net assets of the REIT. The unitholders of the REIT have the right to require the REIT to redeem their Units on demand. The Units have no par value.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**12. Unitholders' equity (continued):**

(b) Special Voting Units:

The DOT and the exchange agreement among the REIT, Starlight Investments Ltd ("Starlight") and TNCGP, amongst others, provide for the issuance of the Special Voting Units which have no economic entitlement in the REIT or in the distribution or assets of the REIT, but are used to provide voting rights proportionate to the votes of the Units to holders of securities exchangeable into Units, including the Class B LP Units. Each Special Voting Unit is not transferable separately from the Class B LP Unit to which it is attached and will be automatically redeemed and cancelled upon exchange of the attached Class B LP Unit into a Unit.

(c) Units outstanding:

The following table summarizes the changes in Units for the three months ended March 31, 2016 and 2015:

| | Units | Amount |
|---|---|---|
| Balance, December 31, 2014 | 16,890,286 | $ 101,814 |
| Issue of Units under the Trustee unit issuance plan | 4,094 | 25 |
| Issue of Units under DRIP | 67,645 | 393 |
| Units repurchased and cancelled under NCIB | (37,200) | (223) |
| Issuance and repurchase costs | – | (15) |
| Balance, March 31, 2015 | 16,924,825 | 101,994 |
| Units issued for cash | 45,454 | 300 |
| Issue of Units under the Trustee unit issuance plan | 12,147 | 67 |
| Issue of Units under DRIP | 207,552 | 1,141 |
| Issue of Units from options exercised | 52,084 | 307 |
| Issue of Units from exchange of Class B LP Units | 25,000 | 132 |
| Units repurchased and cancelled under NCIB | (53,400) | (319) |
| Issuance and repurchase costs | – | 27 |
| Balance, December 31, 2015 | 17,213,662 | 103,649 |
| Issue of Units under the Trustee unit issuance plan | 3,978 | 23 |
| Issue of Units under DRIP | 118,698 | 595 |
| Issue of Units from options exercised | 16,667 | 97 |
| Issuance and repurchase costs | – | (19) |
| Balance, March 31, 2016 | 17,353,005 | $ 104,345 |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**12. Unitholders' equity (continued):**

(d) Unit-based compensation plan:

The REIT has adopted a Unit-based compensation plan (the “Plan”). Under the terms of the Plan, the Trustees may, from time to time, at their discretion, and in accordance with TSX requirements, grant certain Trustees and officers of the REIT, employees of Starlight and consultants to the REIT, non-transferable options to purchase Units, exercisable for a period of up to five years from the date of grant. These options vest over a three-year period beginning one year from the date of grant. The total number of Units reserved under the Plan may not exceed 10% of the Units and Class B LP Units outstanding.

For the three months ended March 31, 2016 and 2015, the number of Unit options outstanding changed as follows:

| | Number of Unit options | Weighted average exercise price | Weighted average remaining contractual life (in years) | Number of Unit options exercisable |
|---|---|---|---|---|
| Outstanding, December 31, 2014 | 658,751 | 6.43 | 3.00 | 259,157 |
| Unit options granted | 495,000 | 6.15 | – | – |
| Outstanding, March 31, 2015 | 1,153,751 | 6.31 | 3.62 | 401,653 |
| Unit options exercised | (52,084) | 1.60 | – | – |
| Outstanding, December 31, 2015 | 1,101,667 | 6.53 | 2.93 | 464,159 |
| Unit options exercised | (16,667) | 1.60 | – | – |
| Outstanding, March 31, 2016 | 1,085,000 | 6.61 | 2.69 | 754,996 |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**12. Unitholders' equity (continued):**

For the three months ended March 31, 2016 and 2015, the amount of Unit option compensation liability included in accounts payable and accrued liabilities changed as follows:

| | |
|---|---|
| Balance, December 31, 2014 | 426 |
| Unit options granted | 13 |
| Fair value adjustment | 19 |
| Balance, March 31, 2015 | 458 |
| Balance, December 31, 2015 | 257 |
| Unit options exercised | (70) |
| Fair value adjustment | 86 |
| Balance, March 31, 2016 | 273 |

Compensation expense is included in general and administration expenses. The expense is determined using the Black-Sholes option pricing model.

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Average expected Unit option holding period | 1.73 years | 2.18 years |
| Average expected volatility rate | 19.15% | 20% |
| Average dividend yield | 10.42% | 9.98% |
| Average risk-free interest rate | 0.54% | 0.52% |

Expected volatilities are based on the historical volatility of the Units. The risk free interest rate of return is the yield on zero-coupon Government of Canada bonds of a term consistent with the assumed Unit option life.

**12. Unitholders' equity (continued):**

(e) DRIP

Under the DOT, the total amount of income of the REIT to be distributed to unitholders of the REIT for each calendar month is subject to the discretion of the Trustees, however, the total income distributed shall not be less than the amount necessary to ensure the REIT will not be liable to pay income tax under Part I of the *Tax Act (Canada)* for any year.

For the three months ended March 31, 2016 and 2015, the REIT declared distributions of $2,569 and $2,511, respectively.

Pursuant to the DRIP, unitholders can elect to reinvest cash distributions into additional Units at a 3% discount to the weighted average closing price of the Units on the TSX for the five trading days immediately preceding the applicable date of distribution.

For the three months ended March 31, 2016 and 2015, the REIT issued 118,698 and 67,645 Units under the DRIP for a stated value of $595 and $393, respectively.

**13. Transactions with related parties:**

Starlight is considered a related party to the REIT as Starlight is controlled by the Chairman of the Board and Chief Executive Officer of the REIT, who is also a significant unitholder of the REIT. The REIT has engaged Starlight to perform certain services, as outlined below.

(a) Pursuant to an asset management agreement (the “Asset Management Agreement”), entered into with Starlight on December 14, 2012, Starlight is to perform asset management services for a base annual management fee calculated and payable on a monthly basis in arrears on the first day of each month equal to 0.35% of the sum of: (i) the historical purchase price of the properties; and (ii) the cost of any capital expenditures incurred by the REIT or any of its affiliates in respect of the properties from the effective date.

**13. Transactions with related parties (continued):**

(b) Pursuant to the Asset Management Agreement, Starlight is entitled to receive an acquisition fee in respect of properties announced to be acquired, directly or indirectly, by the REIT as a result of such properties having been presented to the REIT by Starlight calculated as follows:

(i) 1.0% of the purchase price of a property, on the first $100,000 of properties acquired in each fiscal year;

(ii) 0.75% of the purchase price of a property, on the next $100,000 of properties acquired in each fiscal year; and

(i) 0.50% of the purchase price on properties in excess of $200,000 of properties acquired in each fiscal year.

(c) An incentive fee is payable by the REIT for each fiscal year equal to 15% of the REIT's funds from operations ("FFO") per Unit in excess of FFO per Unit for fiscal 2013 plus 50% of the increase in the weighted average consumer price index (or other similar metric, as determined by the Trustees) of the jurisdictions in which the properties are located.

(d) Pursuant to the Asset Management Agreement, Starlight is entitled to a capital expenditure fee equal to 5% of all hard construction costs incurred on each capital project with costs in excess of $1,000, excluding work done on behalf of tenants or any maintenance capital expenditures.

(e) The REIT reimburses Starlight for all reasonable and necessary actual out-of-pocket costs and expenses incurred by Starlight in connection with the performance of the services described in the Asset Management Agreement, including capital expenditures, or such other services which the REIT and Starlight agree in writing are to be provided from time to time.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

## 13. Transactions with related parties (continued):

The following table presents the costs incurred for the three months ended March 31, 2016 and 2015:

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Asset management fees | $ 286 | $ 259 |
| Acquisition fees | – | 59 |
| Other expenses | 31 | – |

Of these amounts, $103 (December 31, 2015 - $104) is included in accounts payable and accrued liabilities.

No incentive fees were earned or capital expenditure fees charged for the three months ended March 31, 2016 and 2015.

## 14. Finance costs:

The following table presents the financing costs incurred for the three months ended March 31, 2016 and 2015:

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Interest on mortgages and notes payable | $ 1,741 | $ 1,692 |
| Other interest expense and standby fees | 92 | 45 |
| Amortization of mortgage discounts | (31) | (33) |
| Amortization of financing costs | 78 | 113 |
| | 1,880 | 1,817 |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

### 15. Change in non-cash operating working capital:

The change in non-cash operating working capital for the three months ended March 31, 2016 and 2015 is as follows:

| | March 31, 2016 | March 31, 2015 |
|---|---|---|
| Deposits | $ – | $ (39) |
| Tenant and other receivables | 104 | (462) |
| Prepaid expenses and other assets | (262) | (338) |
| Tenant rental deposits and prepayments | (270) | (118) |
| Accounts payable and accrued liabilities | 216 | 205 |
| | $ (212) | $ (752) |

### 16. Commitments and contingencies:

As at March 31, 2016, the REIT has entered into commitments at 340 Laurier Avenue West related to its LEED® - EB Gold Certification Retro-Commissioning Project, amounting to $1,461. As at March 31, 2015, the REIT had entered into commitments for building renovations at 340 Laurier Avenue West for $219.

At March 31, 2016 and 2015, the REIT had no commitments for future minimum lease payments under non-cancellable operating leases.

### 17. Segmented disclosure:

All of the REIT's assets and liabilities are in, and its revenue is derived from, Canadian commercial real estate. The REIT’s investment properties are, therefore, considered by management to have similar economic characteristics.

### 18. Capital management:

The REIT’s capital management objectives and policies are consistent with those disclosed in the consolidated financial statements as at and for the year ended December 31, 2015.

The REIT was in compliance with all financial covenants as at March 31, 2016.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**19. Risk management and fair values:**

(a) Risk management:

In the normal course of business, the REIT is exposed to a number of risks that can affect its operating performance. These risks and the actions taken to manage them are as follows:

(i) Interest rate risk:

The REIT is subject to the risks associated with debt financing, including the risk of the interest rate on floating debt may rise before long-term fixed rate debt is arranged and the mortgage will not be able to be refinanced on terms similar to those of the existing indebtedness.

The REIT's objective of managing interest rate risk is to minimize the volatility of earnings.

As at March 31, 2016 and December 31, 2015, the REIT's interest-bearing financial instruments were:

| | Carrying value | |
|---|---|---|
| | March 31, 2016 | December 31, 2015 |
| Fixed-rate instruments: | | |
| Mortgages and notes payable | $ 198,216 | $ 200,467 |
| Variable-rate instruments: | | |
| Credit facilities | $ 8,970 | $ 7,200 |

The REIT is exposed to interest rate risk on its floating-rate debt on certain of its properties which was mitigated by entering into interest rate swaps (note 11).

An increase (decrease) of 100 basis points in interest rates at March 31, 2016 for the variable-rate financial instruments would have increased (decreased) net income for the period by $8 (December 31, 2015 - $5).

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**19. Risk management and fair values (continued):**

(ii) Credit risk:

Credit risk is the risk that: (a) one party to a financial instrument will cause a financial loss for the REIT by failing to discharge its obligations; and (b) the possibility that tenants may experience financial difficulty and be unable to meet their rental obligations.

The REIT is exposed to credit risk on all financial assets and its exposure is generally limited to the carrying amount on the consolidated statement of financial position. The REIT monitors its risk exposure regarding obligations with counterparties through the regular assessment of counterparties' credit positions.

The REIT mitigates the risk of credit loss with respect to tenants by evaluating their creditworthiness, obtaining security deposits, and geographically diversifying its portfolio. The REIT monitors outstanding receivables on a month-to-month basis to ensure a reasonable allowance is provided for all uncollectible amounts.

An aging of billed trade receivables, including billed trade receivables past due but not impaired is as follows:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| 0 to 30 days | $ 578 | $ 34 |
| 31 to 90 days | 27 | 23 |
| Over 90 days | 219 | 632 |
| Total | $ 824 | $ 689 |

As at March 31, 2016, The Federal Government of Canada provides 48% (December 31, 2015 – 49%) of the REIT's rental revenue.

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**19. Risk management and fair values (continued):**

(b) Fair values:

The REIT uses various methods in estimating the fair values recognized in the consolidated financial statements. The fair value hierarchy reflects the significance of inputs used in determining the fair values.

- Level 1 - quoted prices in active markets;
- Level 2 - inputs other than quoted prices in active markets or valuation techniques where significant inputs are based on observable market data; and
- Level 3 - valuation technique for which significant inputs are not based on observable market data.

The tables below presents the REIT's assets and liabilities measured at fair value on the condensed consolidated interim statements of financial position as at March 31, 2016 and 2015:

| March 31, 2016 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Investment properties | $ – | $ – | $ 341,588 | $ 341,588 |
| | $ – | $ – | $ 341,588 | $ 341,588 |
| Liabilities: | | | | |
| Class B LP Units | $ 24,546 | $ – | $ – | $ 24,546 |
| Derivative instruments | – | 1,673 | – | 1,673 |
| | $ 24,546 | $ 1,673 | $ – | $ 26,219 |

(In thousands of Canadian dollars, except Unit and per Unit amounts)

**19. Risk management and fair values (continued):**

| December 31, 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Investment properties | $ – | $ – | $ 342,150 | $ 342,150 |
| | $ – | $ – | $ 342,150 | $ 342,150 |
| Liabilities: | | | | |
| Class B LP Units | 21,962 | – | – | 21,962 |
| Derivative instruments, net | – | 1,634 | – | 1,634 |
| | $ 21,962 | $ 1,634 | $ – | $ 23,596 |

The following summarizes the significant methods and assumptions used in estimating fair values of the REIT's assets and liabilities measured at fair value:

(a) Investment properties:

The REIT determined the fair value of each investment property based on valuation approaches and key assumptions with level 3 inputs as described in note 4.

(b) Class B LP Units:

As allowed under IFRS 13, Fair Value Measurement, if an asset or a liability measured at fair value has a bid and an ask price, the price within the bid-ask spread that is the most representative of fair value in the circumstances shall be used to measure fair value. The REIT has chosen to use closing market price as a practical measure for fair value measurement of its Class B LP Units.

(c) Derivative instruments:

Derivative instruments, such as interest rate swaps, are valued using a valuation technique with level 2 market-observable inputs. The most frequently applied valuation technique includes forward pricing models, using present value calculations. The models incorporate various inputs including forward rates and interest rate curves.

**20. Subsequent event:**

On April 27, 2016, the REIT filed a short form base shelf prospectus (“Prospectus”). The Prospectus was filed with the securities regulatory authorities in each of the provinces and territories of Canada and is valid for a 25 month period, during which time the REIT may issue the following securities: (i) Units; (ii) unsecured debt securities; (iii) subscription receipts exchangeable for Units and/or other securities of the REIT; (iv) warrants exercisable to acquire Units and/or other securities of the REIT; and (v) securities comprised of more than one of Units, debt securities, subscription receipts and/or warrants offered together as a unit, or any combination thereof in amounts, at prices and on terms based on market conditions at the time of sale and set forth in an accompanying prospectus supplement, for an aggregate offering amount of up to $200,000.