Condensed Consolidated Interim Financial Statements
(In Canadian dollars)

TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

Three months ended March 31, 2020 and 2019
(Unaudited)

TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

		March 31, 2020		December 31, 2019
Assets				
Non-current assets:				
Investment properties (note 4)	$	1,372,342	$	1,362,517
Instalment notes receivable (note 5)		298		317
Deposits		1,173		593
Total non-current assets		1,373,813		1,363,427
Current assets:				
Derivative instruments (note 11)		—		14
Tenant and other receivables (note 6)		4,036		3,161
Prepaid expenses and deposits		4,272		3,202
Instalment notes receivable (note 5)		80		83
Cash and cash equivalents		22,264		5,669
Total current assets		30,652		12,129
Total assets	$	1,404,465	$	1,375,556
Liabilities and Unitholders' Equity				
Non-current liabilities:				
Mortgages payable (note 7)	$	767,103	$	681,349
Derivative instruments (note 11)		4,022		122
Class B LP Units (note 8)		18,741		28,111
Total non-current liabilities		789,866		709,582
Current liabilities:				
Mortgages payable (note 7)		45,868		111,234
Tenant rental deposits and prepayments		6,861		5,275
Accounts payable and accrued liabilities (note 10)		26,250		22,135
Derivative instruments (note 11)		1,180		—
Total current liabilities		80,159		138,644
Total liabilities		870,025		848,226
Unitholders' equity (note 12)		534,440		527,330
Total liabilities and unitholders' equity	$	1,404,465	$	1,375,556

Subsequent event (note 21)

See accompanying notes to condensed consolidated interim financial statements.

Approved on behalf of the Board of Trustees on May 5, 2020.

"William J. Biggar" Trustee

"Roland A. Cardy" Trustee

TRUE NORTH COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Three months ended March 31, 2020 and 2019
(Unaudited)

	2020	2019
Revenue (note 14)	$ 35,329	$ 25,767
Expenses:		
Property operating	8,775	6,745
Realty taxes	5,445	4,202
Income before the undernoted	21,109	14,820
Other income (expenses):		
General and administration expenses	(1,196)	(1,608)
Finance costs (note 15)	(7,182)	(5,100)
Distributions on Class B LP Units (note 8)	(573)	(634)
Fair value adjustment of Class B LP Units (note 8)	9,370	(4,226)
Fair value adjustment of investment properties (note 4)	1,176	(1,620)
Unrealized loss on change in fair value of derivative instruments (note 11)	(5,094)	(280)
Net income and comprehensive income	$ 17,610	$ 1,352

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, 2020 and 2019
(Unaudited)

	Trust Unit capital	Cumulative income and distributions	Total
	(note 12(c))		
Unitholders' equity, January 1, 2019	$ 341,041	$ 22,049	$ 363,090
Changes during the period:			
Units issued, net of costs	21	—	21
Net income and comprehensive income for the period	—	1,352	1,352
Distributions	—	(8,518)	(8,518)
Issue of units under DRIP (note 12(e))	1,319	—	1,319
Unitholders' equity, March 31, 2019	342,381	14,883	357,264
Changes during the period:			
Units issued, net of costs	172,285	—	172,285
Net income and comprehensive income for the period	—	22,826	22,826
Distributions	—	(29,576)	(29,576)
Issue of units under DRIP (note 12(e))	4,531	—	4,531
Unitholders' equity, December 31, 2019	519,197	8,133	527,330
Changes during the period:			
Units issued, net of costs	188	—	188
Net income and comprehensive income for the period	—	17,610	17,610
Distributions	—	(12,615)	(12,615)
Issue of units under DRIP (note 12(e))	1,927	—	1,927
Unitholders' equity, March 31, 2020	$ 521,312	$ 13,128	$ 534,440

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, 2020 and 2019
(Unaudited)

	2020	2019
Operating activities:		
Net income and comprehensive income for the period	$ 17,610	$ 1,352
Adjustments for financing activities included in income:		
Finance costs (note 15)	7,182	5,100
Unrealized loss on change in fair value of derivative instruments (note 11)	5,094	280
Distributions on Class B LP Units (note 8)	573	634
Fair value adjustment of Class B LP Units (note 8)	(9,370)	4,226
Adjustments for items not involving cash:		
Fair value adjustment of investment properties (note 4)	(1,176)	1,620
Unit-based compensation expense	(476)	465
Change in other non-cash operating items	262	289
Change in non-cash operating working capital (note 16)	3,751	(762)
Cash provided by operating activities	23,450	13,204
Investing activities:		
Acquisitions (note 3)	—	(24,474)
Additions to investment properties (note 4)	(8,873)	(4,478)
Cash used in investing activities	(8,873)	(28,952)
Financing activities:		
Proceeds from credit facilities	—	3,800
Proceeds from mortgage refinancing, net of costs	92,894	27,565
Repayments of mortgage refinancing	(67,641)	—
Principal payments on mortgages	(5,135)	(3,873)
Payments received on instalment notes receivable (note 5)	22	35
Finance costs paid	(7,247)	(5,284)
Unit issuance costs	(83)	(2)
Cash distributions to unitholders	(10,792)	(7,317)
Cash provided by financing activities	2,018	14,924
Increase (decrease) in cash and cash equivalents	16,595	(824)
Cash and cash equivalents, beginning of period	5,669	2,492
Cash and cash equivalents, end of period	$ 22,264	$ 1,668
Supplemental cash flow information:		
Units issued under DRIP – unitholders	$ 1,808	$ 1,190
Units issued under DRIP – Class B LP Units	119	129

See accompanying notes to condensed consolidated interim financial statements.

Organization:

True North Commercial Real Estate Investment Trust (the “REIT”) is an unincorporated, open-ended real estate investment trust established pursuant to the second amended and restated declaration of trust made as of 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 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 1400 - 3280 Bloor Street West, Centre Tower, Toronto, Ontario, Canada, M8X 2X3.

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 (“IAS”) 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 audited annual consolidated financial statements as at and for the year ended December 31, 2019. Certain information and note disclosures normally included in the annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) have been omitted or condensed.

The condensed consolidated interim financial statements were approved on behalf of the Board of Trustees on May 5, 2020.

(b) Basis of presentation:

The REIT holds its interest in investment properties and other assets and liabilities related to the investment properties 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.

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”), trust unit (“Unit”) options, incentive units and derivative instruments, which are stated at their fair values.

1. Basis of preparation (continued):

(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 audited consolidated financial statements as at and for the year ended December 31, 2019.

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, 2019 except for the new accounting standards applied on January 1, 2020 as noted below:

Amendments to IFRS 3: Definition of a Business

The amendment to IFRS 3 clarifies to be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs. Also, it clarifies a business can exist without including all of the inputs and processes needed to create outputs.

These amendments have no impact on the condensed consolidated interim financial statements of the REIT.

3. Acquisitions and dispositions:

The REIT did not acquire or dispose of any investment properties during the three months ended March 31, 2020.

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

4. Investment properties:

The following table summarizes the changes in investment properties for the three months ended March 31, 2020 and 2019:

	Investment properties
Balance, December 31, 2018	$ 928,137
Acquisitions	25,342
Additions	4,478
Amortization of leasing costs, tenant inducements and straight-line rents	(266)
Fair value adjustment	(1,620)
Balance, March 31, 2019	956,071
Acquisitions	405,452
Additions	9,963
Dispositions	(8,700)
Amortization of leasing costs, tenant inducements and straight-line rents	(1,274)
Fair value adjustment	1,005
Balance, December 31, 2019	1,362,517
Additions	8,873
Amortization of leasing costs, tenant inducements and straight-line rents	(224)
Fair value adjustment	1,176
Balance, March 31, 2020	$ 1,372,342

The REIT determines 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 key valuation assumptions for the REIT's investment properties are set out in the following table:

	March 31, 2020	March 31, 2019
Terminal and direct capitalization rates - range	4.75% to 10.25%	4.75% to 10.25%
Terminal and direct capitalization rate - weighted average	6.28%	6.44%
Discount rates - range	5.75% to 10.25%	5.75% to 10.25%
Discount rate - weighted average	7.13%	7.21%

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

4. Investment properties (continued):

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

	March 31, 2020	March 31, 2019
Weighted average terminal and direct capitalization rate:		
25-basis points increase	$ (43,230)	$ (29,134)
25-basis points decrease	46,884	30,410
Weighted average discount rate:		
25-basis points increase	(40,905)	(27,303)
25-basis points decrease	43,614	28,392

Refer to Note 21, Subsequent Events for discussion of the impact of COVID-19 on the REIT's business and operations, including the valuation of investment properties.

5. Instalment note receivable:

The REIT received non-interest bearing instalment notes from the vendor of certain properties acquired in December 2014. The instalment payments 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 co-terminously with the assumed mortgages.

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

	March 31, 2020	December 31, 2019
Current	$ 80	$ 83
Non-current	298	317
	$ 378	$ 400

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

6. Tenant and other receivables:

The following table presents details of tenant and other receivables:

	March 31, 2020	December 31, 2019
Tenant receivables	$ 3,294	$ 2,294
Other receivables	742	867
	$ 4,036	$ 3,161

As at March 31, 2020 and 2019, there was no impairment of tenant and other receivables.

7. Mortgages payable:

As at March 31, 2020, the REIT had $816,579 (December 31, 2019 – $795,856) of principal balances of mortgages outstanding. The mortgages carry a weighted average fixed interest rate of 3.38% (December 31, 2019 – 3.38%) after giving effect to the instalment note receipts, and a weighted average term to maturity of 4.47 years (December 31, 2019 – 3.87 years). All interest rates are fixed for the term of the respective mortgages except for six (December 31, 2019 – seven) 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, 2020, mortgages are repayable as follows:

	Scheduled principal payments	Debt maturing during the period	Total mortgages payable	Scheduled interest payments
2020 - remainder of year	$ 16,771	$ 24,502	$ 41,273	$ 20,157
2021	22,570	23,247	45,817	25,707
2022	20,684	155,434	176,118	22,968
2023	14,647	141,596	156,243	15,758
2024	12,995	79,399	92,394	12,698
Thereafter	20,669	284,065	304,734	16,628
Face value	$ 108,336	$ 708,243	$ 816,579	$ 113,916
Unamortized mark to market mortgage adjustments			246	
Unamortized financing costs			(3,854)	
Total mortgages payable			$ 812,971	

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

7. Mortgages payable (continued):

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

		March 31, 2020		December 31, 2019
Current:				
Mortgages payable	$	46,918	$	112,240
Unamortized mark to market mortgage adjustments		21		22
Unamortized financing cost		(1,071)		(1,028)
		45,868		111,234
Non-current:				
Mortgages payable		769,661		683,616
Unamortized mark to market mortgage adjustments		225		230
Unamortized financing cost		(2,783)		(2,497)
		767,103		681,349
	$	812,971	$	792,583

8. Class B LP Units:

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

The following table summarizes the changes in Class B LP Units for the three months ended March 31, 2020 and 2019:

	Class B LP Units		Amount
Outstanding, January 1, 2019	4,268,837	$	24,162
Fair value adjustment	—		4,226
Outstanding, March 31, 2019	4,268,837		28,388
Class B LP Units exchanged to Units	(412,655)		(2,984)
Fair value adjustment			2,707
Outstanding, December 31, 2019	3,856,182		28,111
Fair value adjustment	–		(9,370)
Outstanding, March 31, 2020	3,856,182	$	18,741

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

8. Class B LP Units (continued):

During the three months ended March 31, 2020 and 2019, distributions on Class B LP Units were $573 and $634, respectively, and have been recorded as an expense in the condensed consolidated interim statements of income and comprehensive income.

9. Credit facility:

The REIT has a credit agreement with a Canadian chartered bank for a $20,000 (December 31, 2019 - $20,000) unsecured floating rate revolving credit facility. The facility bears interest on cash advances at 225 basis points per annum above the prime rate or 325 basis points per annum over the floating banker's acceptance rate and matures on December 1, 2020. This facility was undrawn as at March 31, 2020 and December 31, 2019.

10. Accounts payable and accrued liabilities:

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

	March 31, 2020	December 31, 2019
Accounts payable and accrued liabilities	$ 19,967	$ 15,276
Finance costs payable	1,870	1,751
Distributions payable	4,211	4,196
Unit-based compensation liability (note 12(c))	202	912
	$ 26,250	$ 22,135

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 certain mortgages. 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, 2020 were $101,385 (December 31, 2019 – $129,488). Total unrealized loss on change in the fair value of the derivative instruments for the three months ended March 31, 2020 and 2019 was $5,094 and $280, respectively.

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

12. Unitholders' equity:

(a) Units:

The REIT is authorized to issue an unlimited number of Units and an unlimited number of 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.

(b) Units outstanding:

The following table summarizes the changes in Units for the three months ended March 31, 2020 and 2019:

	Units	Amount
Balance, December 31, 2018	57,216,643	$ 341,041
Issue of Units – non-executive Trustee Unit issuance plan	3,427	23
Issue of Units – DRIP	215,419	1,319
Issue of Units – options exercised	2,000	13
Issuance costs	—	(15)
Balance, March 31, 2019	57,437,489	342,381
Issue of Units for cash – public offering	23,839,500	161,065
Issue of Units – acquisition of investment property	2,148,904	15,000
Issue of Units – exchange of Class BLP Units (note 8)	412,655	2,984
Issue of Units – DRIP	686,006	4,531
Issue of Units – options exercised	237,875	1,708
Issuance costs	—	(8,472)
Balance, December 31, 2019	84,762,429	519,197
Issue of Units – DRIP	279,802	1,927
Issue of Units – options exercised	35,112	271
Issuance costs	—	(83)
Balance, March 31, 2020	85,077,343	$ 521,312

12. Unitholders' equity (continued):

(c) Unit-based compensation plans:

(i) Incentive Unit Plan:

On June 10, 2019, the REIT established an incentive trust unit plan (the "Incentive Unit Plan") to replace the non-executive trustee unit issuance plan and the Unit-based compensation plan (collectively, the "Plans"). The previous Plans granted Units and options respectively. The Incentive Unit Plan issues two types of units: (i) deferred Units; and (ii) restricted Units, collectively ("Incentive Units").

Deferred Units are granted to the non-executive Trustees as part of a Trustee's annual board retainer and meeting fees and vest immediately.

The Trustees may, at their discretion, grant restricted Units to certain Trustees, officers of the REIT and its subsidiaries and certain eligible service providers, subject to such restrictions (i.e vesting requirements) that the Trustees may impose. The Trustees may not extend any vesting conditions beyond November 30 of the third calender year from grant date.

Incentive Units granted under the Incentive Unit Plan are comparable to that of the previous Plans and will continue to be classified as liabilities within the REIT's statement of financial position. Unit-based compensation expense is recognized in general and administration expenses over the vesting period of the Incentive Units. Fair value adjustments are made upon the revaluation of the Incentive Units at each reporting period and recorded in general and administration expenses.

For the three months ended March 31, 2020, the REIT issued 8,432 Incentive Units (March 31, 2019 - 0) with a fair value of $41. Total Incentive Units outstanding at March 31, 2020 was 25,409 (December 31, 2019 - 16,977).

(ii) Unit Options:

Prior to June 10, 2019, the Trustees granted certain Trustees, officers of the REIT and its subsidiaries and certain eligible service providers, non-transferable options to purchase Units pursuant to the REIT's Unit-based compensation plan.

On June 10, 2019 the non-executive trustee unit issuance plan was terminated and the Unit-based compensation plan was suspended and no further options will be granted. Options that have or will vest are eligible to be exercised prior to the applicable expiry dates.

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

12. Unitholders' equity (continued):

The following table summarizes the changes in Unit based options outstanding for the three months ended March 31, 2020 and 2019:

	Number of Unit options	Weighted average exercise price	Weighted average remaining contractual life (in years)	Number of Unit options exercisable
Outstanding, December 31, 2018	2,160,500	$ 6.32	3.15	970,474
Unit options exercised	(2,000)	6.43	—	—
Outstanding, March 31, 2019	2,158,500	6.32	2.90	1,075,968
Unit options exercised	(743,327)	6.19	—	—
Outstanding, December 31, 2019	1,415,173	6.38	2.83	785,313
Unit options exercised	(254,998)	6.29	—	—
Outstanding, March 31, 2020	1,160,175	6.41	2.67	637,813

Options outstanding as of March 31, 2020 consist of the following:

Exercise price	Unit Options Outstanding	Unit Options exercisable	Expiry Date
$6.04	85,000	85,000	August 5, 2021
$6.28	124,168	124,168	November 14, 2021
$6.17	180,003	86,663	August 11, 2022
$6.44	206,168	103,994	November 16, 2022
$6.43	267,502	159,994	March 9, 2023
$6.66	297,334	77,994	September 20, 2023
	1,160,175	637,813	

Unit option expense is determined using the Black-Scholes option pricing model.

	March 31, 2020	March 31, 2019
Average expected Unit option holding period	1.46 years	1.73 years
Average expected volatility rate	29.91%	14.65%
Average dividend yield	12.22%	8.93%
Average risk-free interest rate	0.38%	1.60%

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

12. Unitholders' equity (continued):

Expected volatilities are based on the historical volatility of the Units. The risk free interest rate return is the yield on a Government of Canada bond with a term consistent with the expected Unit option holding period.

(iii) For the three months ended March 31, 2020 and 2019, the amount of Unit based compensation liability included in accounts payable and accrued liabilities (note 10) is as follows:

Balance, December 31, 2018	$	63
Unit options expense		23
Fair value adjustment		441
Balance, March 31, 2019	$	527
Unit options expense		47
Unit options exercised		(703)
Deferred units granted		117
Fair value adjustment		924
Balance, December 31, 2019	$	912
Unit options expense		9
Unit options exercised		(367)
Deferred units granted		37
Fair value adjustment		(389)
Balance, March 31, 2020	$	202

Unit based compensation expense is included in general and administrative expenses.

(d) Distributions:

Under the DOT, the total amount of income to be distributed to unitholders for each calendar month is at 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.

The REIT currently pays a monthly distribution of $0.0495 per Unit or $0.594 per Unit on an annualized basis.

For the three months ended March 31, 2020 and 2019, the REIT declared distributions of $12,615 and $8,518, respectively.

12. Unitholders' equity (continued):

(e) Dividend reinvestment plan ("DRIP"):

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, 2020 and 2019, the REIT issued 279,802 and 215,419 Units under the DRIP for a stated value of $1,927 and $1,319, respectively.

13. Transactions with related parties:

Starlight Group Properties Holdings Inc. ("Starlight") is considered a related party of the REIT as Starlight is controlled by the Chairman of the Board, President and Chief Executive Officer of the REIT, who is also a significant unitholder of the REIT. The REIT has engaged Starlight or an affiliate of Starlight to perform certain services, as outlined below.

(a) Pursuant to an asset management agreement (the "Asset Management Agreement"), 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.

(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 and 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

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

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

13. Transactions with related parties (continued):

(c) An annual incentive fee is payable by the REIT 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 annual 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 out-of-pocket 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.

The following table presents the expenses incurred for the three months ended March 31, 2020 and 2019:

		March 31, 2020		March 31, 2019
Asset management fees	$	1,128	$	773
Acquisition fees		—		245
Other expenses		28		24

At March 31, 2020, $399 (December 31, 2019 - $370) 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, 2020 and 2019.

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

14. Revenue:

The components of the REIT's revenues for the three months ended March 31, 2020 and 2019 are as follows:

		2020		2019
Base rent	$	19,929	$	14,067
Operating costs and realty tax recoveries		14,436		10,828
Parking and other		994		872
	$	35,359	$	25,767

15. Finance costs:

The following table presents the financing costs incurred for the three months ended March 31, 2020 and 2019:

		2020		2019
Interest on mortgages payable	$	6,847	$	4,672
Other interest expense and standby fees		65		184
Amortization of mortgage discounts (premiums)		(6)		(9)
Amortization of financing costs		276		253
	$	7,182	$	5,100

16. Change in non-cash operating working capital:

The change in non-cash operating working capital for the three months ended March 31, 2020 and 2019 are as follows:

		2020		2019
Deposits	$	(580)	$	—
Tenant and other receivables		(875)		320
Prepaid expenses and deposits		(1,070)		(596)
Tenant rental deposits and prepayments		1,586		(132)
Accounts payable and accrued liabilities		4,690		(354)
	$	3,751	$	(762)

17. Commitments and contingencies:

As at March 31, 2020, the REIT has entered into commitments for building renovations totaling $798 (December 31, 2019 - $1,347).

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

18. 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.

19. Capital management:

The REIT's capital management objectives and policies are consistent with those disclosed in the audited consolidated financial statements as at and for the year ended December 31, 2019.

The REIT was in compliance with all financial covenants as at March 31, 2020.

20. 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 interest rates on floating-rate debt rising before long-term fixed rate debt is arranged and existing mortgages may not be able to be refinanced on terms similar or more favourable than those currently in place.

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

As at March 31, 2020 and December 31, 2019, the REIT's interest-bearing financial instruments were:

	Carrying value	
	March 31, 2020	December 31, 2019
Fixed-rate instruments:		
Mortgages payable	$ 816,579	$ 795,856
Variable-rate instruments:		
Credit facilities	$ —	$ —

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

20. Risk management and fair values (continued):

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

An increase (decrease) of 100 basis points in interest rates at March 31, 2020 for the REIT's variable-rate financial instruments would have no impact on net income and comprehensive income.

(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 financial assets and its exposure is generally limited to the carrying amount on the condensed consolidated interim statements 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 monthly basis to ensure a reasonable allowance is provided for all uncollectible amounts. The REIT reviewed all outstanding receivables and assessed the risk of uncollectibility to be low.

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

	March 31, 2020	December 31, 2019
0 to 30 days	$ 1,361	$ 1,068
31 to 90 days	308	227
Over 90 days	165	76
Total	$ 1,834	$ 1,371

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

20. Risk management and fair values (continued):

(b) Fair values:

The fair values of the REIT's financial assets and liabilities, except as noted below, approximate their carrying values due to their short-term nature.

The REIT uses various methods in estimating the fair values of its financial instruments and investment properties. 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 or disclosed at fair value:

March 31, 2020	Level 1	Level 2	Level 3	Total
Assets:				
Investment properties	$ —	$ —	$ 1,372,342	$ 1,372,342
Instalment notes receivable	—	559	—	559
	$ —	$ 559	$ 1,372,342	$ 1,372,901
Liabilities:				
Mortgages payable	$ —	$ 829,400	$ —	$ 829,400
Class B LP Units	18,741	—	—	18,741
Derivative instruments, net	—	5,202	—	5,202
Unit-based compensation	—	—	202	202
	$ 18,741	$ 834,602	$ 202	$ 853,545

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

20. Risk management and fair values (continued):

December 31, 2019	Level 1	Level 2	Level 3	Total
Assets:				
Investment properties	$ —	$ —	$ 1,362,517	$ 1,362,517
Instalment notes receivable	—	591	—	591
	$ —	$ 591	$ 1,362,517	$ 1,363,108
Liabilities:				
Mortgages payable	$ —	$ 795,700	$ —	$ 795,700
Class B LP Units	28,111	—	—	28,111
Derivative instruments, net	—	108	—	108
Unit-based compensation	—	—	912	912
	$ 28,111	$ 795,808	$ 912	$ 824,831

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

(i) Investment properties:

The REIT determines 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 key valuation assumptions of the REIT's investment properties are described in note 4.

(ii) Instalment notes receivable:

The fair value of instalment notes receivable is estimated based on the present value of future receipts, discounted at the yield on a Government of Canada bond with the nearest maturity date to the underlying instalment note, plus an estimated credit spread at the reporting date for a comparable financial instrument. The estimated fair value of instalment notes receivable at March 31, 2020 was approximately $559 (December 31, 2019 - $591).

(iii) Mortgages payable:

The fair value of mortgages payable is estimated based on Level 2 inputs which take into account the present value of future payments, discounted at the yield on a Government of Canada bond with the nearest maturity date to the underlying mortgage, plus an estimated credit spread at the reporting date for a comparable mortgage. The estimated fair value of mortgages payable at March 31, 2020 was approximately $829,400 (December 31, 2019 - $795,700).

20. Risk management and fair values (continued):

(iv) Class B LP Units:

Pursuant to 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 the closing market price of Units as a practical measure for fair value measurement of its Class B LP Units.

(v) Unit-based compensation:

Incentive Units granted are carried at fair value, the REIT has chosen to use the closing market price of Units as a practical measure for fair value measurement of its Incentive Units.

Unit options granted are carried at fair value, estimated using the Black-Scholes option pricing model for option valuation using level 3 inputs as described in note 12(c).

(vi) 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.

21. Subsequent events:

On March 11, 2020, the World Health Organization declared that the outbreak of COVID-19 was a global pandemic which has resulted in the federal and provincial governments enacting a series of public health and emergency measures to combat the spread of the virus impacting business operations both nationally and internationally and have lead to an economic downturn.

The duration and impact of COVID-19 is currently unknown and the Canadian governments have enacted subsidies and other stimulus in an attempt to stabilize economic conditions. As of May 5, 2020, the REIT has received approximately 99% of April contractual rents and is working with its smaller tenants, which may require assistance. While it is too early to determine if the REIT will be able to maintain its collection efforts in the months ahead, the REIT's tenant base is comprised primarily of government and credit rated tenants and the average occupancy rate for the REIT's portfolio is 97%.

21. Subsequent events (continued):

Capitalization rates used in the valuation of investment properties as at March 31, 2020 are based on current market data available and have not been adjusted to reflect the future market uncertainty related to COVID-19 as there is to date little actual evidence of material capitalization rate expansion. Given the uncertainty around the duration of the pandemic and the potential negative impact it may have on the real estate industry, it is not possible to predict such impact on capitalization rates at this time.

The future cash flows of an investment property are based upon rental income from current leases and assumptions about occupancy rates and market rents from future leases, less future cash outflows relating to such current and future leases. The economic impact of COVID-19 could adversely impact tenants' ability to meet rental obligations. The REIT has assessed rent collectability when determining future cash flows and has determined the risk of default to be low given the quality of the REIT's tenant base being largely made up of government and credit rated tenants. Leasing assumptions of near-term vacancies at certain properties were revised to reflect current market conditions.

The REIT is continuing to review its cash flow projections and the fair value of its real estate portfolio in these challenging times. Capitalization rates could change materially as additional market data becomes available in the months ahead and significant changes in assumptions concerning rental income, occupancy rates, tenant inducements and future market rents could negatively impact future valuations of the real estate portfolio and the REIT's overall operations as the pandemic continues.

Subsequent to quarter end, the REIT refinanced two properties with mortgages totaling $31,230 with a weighted average fixed average interest rate of 2.95% for five and ten year terms resulting in additional cash on hand of approximately $13,600, net of costs.

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