Consolidated Financial Statements
(In Canadian dollars)

AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Years ended December 31, 2014 and 2013

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INDEPENDENT AUDITORS' REPORT

To the Unitholders of Agellan Commercial Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Agellan Commercial Real Estate Investment Trust, which comprise the consolidated statements of financial position as at December 31, 2014 and 2013, the consolidated statements of income and comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Agellan Commercial Real Estate Investment Trust as at December 31, 2014 and 2013, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

March 6, 2015
Toronto, Canada

AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Financial Position
(In thousands of Canadian dollars)

December 31, 2014 and 2013

	2014	2013
Assets		
Non-current assets:		
Investment properties (note 4)	$ 564,545	$ 524,805
Current assets:		
Assets classified as held for sale (note 6)	8,242	–
Other assets (note 7)	11,143	2,767
Accounts receivable	1,802	1,767
Cash and cash equivalents	11,729	26,219
Total current assets	32,916	30,753
Total assets	$ 597,461	$ 555,558
Liabilities and Unitholders' Equity		
Non-current liabilities:		
Mortgages payable (note 9)	$ 210,059	$ 185,767
Loans payable (note 10)	101,250	114,333
Deferred income tax liability (note 14)	10,040	2,539
Total non-current liabilities	321,349	302,639
Current liabilities:		
Current portion of mortgages payable (note 9)	6,279	3,331
Tenant rental deposits and prepaid rent	4,698	3,881
Derivative instruments (note 13)	1,344	432
Accounts payable and accrued liabilities (note 8)	12,726	9,058
Liabilities classified as held for sale (note 6)	105	–
Distributions payable	1,517	1,502
Finance costs payable	724	682
Total current liabilities	27,393	18,886
Total liabilities	348,742	321,525
Unitholders' equity	248,719	234,033
Subsequent events (note 23)		
Total liabilities and unitholders' equity	$ 597,461	$ 555,558

See accompanying notes to consolidated financial statements.

The consolidated financial statements were approved by the Board on March 6, 2015 and signed on its behalf by:

"Sara Yamotahari" Trustee

"Richard Dansereau" Trustee

AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2014 and 2013

	2014	2013
Revenue:		
Minimum rent	$ 45,486	$ 33,523
Recoveries from tenants	26,998	22,184
Other income	2,477	2,539
	74,961	58,246
Expenses:		
Property operating	20,574	15,267
Property taxes	10,855	4,447
General and administrative	4,022	2,843
Deferred income taxes (note 14)	6,923	2,539
Fair value adjustment on investment properties (note 4)	(530)	(11,160)
IFRIC 21 fair value adjustment on investment properties (note 3)	218	3,842
Loss on sale of investment properties (note 5)	269	–
	42,331	17,778
Income before finance costs	32,630	40,468
Finance costs (note 18)	13,385	9,850
Net income	19,245	30,618
Other comprehensive income:		
Reclassified subsequently to income when specific conditions are met:		
Unrealized gain on translation of U.S. dollar denominated foreign operations	11,601	5,974
Comprehensive income	$ 30,846	$ 36,592

See accompanying notes to consolidated financial statements.

AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2014 and 2013

	Amounts of unit capital (note 11)	Accumulated distributions	Cumulative net income	Other comprehensive income	Total
Unitholders' equity, January 1, 2013	$ –	$ –	$ –	$ –	$ –
Units issued, net of issuance costs	211,634	–	–	–	211,634
Net income	–	–	30,618	–	30,618
Other comprehensive income	–	–	–	5,974	5,974
Distributions	–	(14,790)	–	–	(14,790)
Distribution reinvestment plan	597	–	–	–	597
Unitholders' equity, December 31, 2013	212,231	(14,790)	30,618	5,974	234,033
Net income	–	–	19,245	–	19,245
Other comprehensive income	–	–	–	11,601	11,601
Distributions	–	(18,139)	–	–	(18,139)
Distribution reinvestment plan	1,979	–	–	–	1,979
Unitholders' equity, December 31, 2014	$ 214,210	$ (32,929)	$ 49,863	$ 17,575	$ 248,719

See accompanying notes to consolidated financial statements.

AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2014 and 2013

	2014	2013
Cash flows from (used in) operating activities:		
Net income	$ 19,245	$ 30,618
Adjustments for items not involving cash:		
Straight-line rents adjustment	(2,429)	(2,226)
Amortization of lease incentive	914	71
Fair value adjustment on investment properties	(312)	(7,318)
Finance costs (note 18)	12,776	9,679
Loss on sale of investment properties (note 5)	269	–
Change in non-cash working capital items:		
Other assets	499	330
Accounts receivable	(2)	208
Tenant rental deposits and prepaid rent	674	1,073
Deferred income tax liability	6,923	2,539
Accounts payable and accrued liabilities	2,824	(293)
	41,381	34,681
Cash flows from (used in) financing activities:		
Proceeds from issuance of units, net of issuance costs	–	155,362
Proceeds from mortgages payable	13,388	123,889
Proceeds from loans payable	–	124,030
Financing fees paid	(314)	(2,255)
Principal payments	(3,010)	(2,272)
Repayment of loans payable	(14,282)	(9,704)
Interest paid	(12,097)	(8,820)
Distributions paid	(16,145)	(12,691)
	(32,460)	367,539
Cash flows from (used in) investing activities:		
Acquisition of investment properties (note 3)	(20,615)	(370,155)
Proceeds from disposition on investment properties (note 5)	12,052	–
Additions to investment properties	(7,985)	(6,602)
Change in restricted cash	(8,583)	–
	(25,131)	(376,757)
Effect of exchange rates on cash	1,720	756
Increase (decrease) in cash and cash equivalents	(14,490)	26,219
Cash and cash equivalents, beginning of year	26,219	–
Cash and cash equivalents, end of year	$ 11,729	$ 26,219
Supplemental cash flow information:		
Units issued under distribution reinvestment plan (note 11)	$ 1,979	$ 597
Mortgages assumed on acquisition of investment properties	–	57,008
Units issued as consideration for acquisition of investment properties	–	56,272
Deferred compensation expense (note 12)	50	–

See accompanying notes to consolidated financial statements.

Agellan Commercial Real Estate Investment Trust (the "REIT") is an open-ended real estate investment trust established under, and governed by, the laws of the Province of Ontario, pursuant to a Declaration of Trust dated November 1, 2012, when one trust unit was issued for ten dollars cash. For the period from November 1, 2012 to January 24, 2013, the REIT had no operations or activity other than holding ten dollars in cash and an equivalent amount of equity. The REIT commenced operations on January 25, 2013 when it issued units for cash pursuant to an initial public offering ("IPO") and completed the acquisition of 23 properties located in Canada and the United States.

The units of the REIT ("Units") trade on the Toronto Stock Exchange under the symbol ACR.UN. The registered office of the REIT is 156 Front Street West, Suite 303, Toronto, Ontario, Canada, M5J 2L6.

1. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements of the REIT have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") and using accounting policies described herein.

(b) Basis of consolidation:

The consolidated financial statements include the accounts of the REIT and other entities over which the REIT has control. The REIT controls an entity when it has the power over the entity, has the exposure or rights to variable returns from its involvement with the entity and has the ability to use its power to affect its returns. The REIT evaluates power and assesses control on an ongoing basis.

The REIT's wholly owned subsidiaries are noted in note 17. All intercompany transactions and balances between the REIT and the subsidiary entities have been eliminated upon consolidation. The financial statements of the subsidiaries are prepared for the same reporting year as the REIT, using consistent accounting policies. All intra-group balances, transactions, unrealized gains and losses resulting from intra-group transactions and distributions are eliminated in full.

1. Basis of preparation (continued):

(c) Basis of measurement and foreign currency translation:

The consolidated financial statements have been prepared on the historical cost basis, except for investment properties and derivative instruments, which are stated at fair value.

The functional and presentational currency of the REIT is the Canadian dollar. Assets and liabilities of subsidiaries having a functional currency other than the Canadian dollar are translated at the rates of exchange at the consolidated statement of financial position dates. Revenue and expenses are translated at average rates for the year. The resulting foreign currency translation adjustments are recognized in other comprehensive income.

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the date of the transactions. At the end of each reporting period, foreign currency denominated monetary assets and liabilities are translated to the functional currency using the prevailing rate of exchange at the consolidated statement of financial position dates. Gains and losses on translation of monetary items are recognized in net income, except certain intercompany loans to or from a foreign operation for which settlement is neither planned nor likely to occur in the foreseeable future, are included in other comprehensive income.

(d) Key sources of estimation uncertainty:

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the years. Actual results could differ from those estimates.

1. Basis of preparation (continued):

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are as follows:

Investment properties:

The significant estimates used when determining the fair value of investment properties are capitalization rates and discount rates. The capitalization rates and discount rates applied are reflective of the characteristics of the property, location and market of each investment property noted in note 4.

Management determines fair value internally utilizing internal financial information, external market data, and capitalization rates provided by industry experts and third party appraisals.

(e) Significant judgements:

The following significant judgements made in applying the REIT's accounting policies have the most significant effects on the consolidated financial statements:

(i) Accounting for acquisitions:

The REIT assesses whether an acquisition transaction is an asset acquisition or a business combination.

The REIT accounts for an acquisition as a business combination if the assets acquired and liabilities assumed constitute a business and the REIT obtains control of the business. When the cost of a business combination exceeds the fair value of the identifiable assets acquired or liabilities assumed, such excess is recognized as goodwill. Transaction-related costs are expensed as incurred.

1. Basis of preparation (continued):

If the acquisition does not meet the definition of a business combination, the REIT accounts for the acquisition as an asset acquisition. The investment property acquired is initially measured at the purchase price, including directly attributable costs. Investment properties are carried at fair value.

(ii) Income taxes:

The REIT is a mutual fund trust and a real estate investment trust pursuant to the Income Tax Act (Canada). Under current tax legislation, a real estate investment trust is entitled to deduct distributions of taxable income such that it is not liable to pay income tax, provided that its taxable income is paid or made payable to unitholders during the year. The REIT intends to continue to qualify as a real estate investment trust and to make distributions in the amount necessary to ensure that the REIT will not be liable to pay income taxes on its own activities.

For the Canadian and U.S. corporate subsidiaries of the REIT, income tax expense comprises current and deferred tax. Current and deferred taxes are recognized in net income, except to the extent that it relates to a business combination, or items recognized directly in unitholders' equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the periods, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous period.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investment in subsidiaries and joint arrangements to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

1. Basis of preparation (continued):

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities, but they intend to settle current tax assets and liabilities on a net basis or their tax assets and liabilities will be realized simultaneously.

In determining the amount of current and deferred tax, the REIT takes into account the impact of uncertain tax provisions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the REIT to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the year that such determination is made.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

2. Significant accounting policies:

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements.

(a) Investment properties:

The REIT has selected the fair value method to account for real estate classified as investment property. A property is determined to be an investment property when it is principally held to earn rental income or for capital appreciation or both, but not for sale in the ordinary course of business. All of the REIT's properties are investment properties.

2. Significant accounting policies (continued):

On acquisition, the REIT assesses whether the acquisition transaction is an asset acquisition or a business combination. Investment properties are initially recorded at cost. Subsequent to initial recognition, the REIT uses the fair value model to account for investment properties. Under the fair value model, investment properties are recorded at fair value, determined based on available market evidence, at the consolidated statement of financial position dates. Related fair value gains and losses are recorded in net income in the period in which they arise.

Gains or losses from the disposal of investment properties are determined as the difference between the net disposal proceeds and the carrying amount, and are recognized in net income in the year of disposal.

(b) Derivative instruments:

The REIT holds derivative financial instruments for the purpose of limiting the risks relating to the variability of future earnings and cash flows caused by movements in interest rates and exchange rates. The REIT, in the normal course of business, holds interest rate swaps to manage interest expense on bank debt and forward currency contracts to manage foreign exchange risk. The REIT does not engage in speculative derivative transactions for trading purposes, and the interest rate swaps and forward currency contracts are not designated as hedges. The interest rate swaps and forward currency contracts are marked to fair value at each reporting period, and the change is recognized as finance costs.

(c) Revenue recognition:

The REIT has retained substantially all of the risks and benefits of ownership of its investment properties and, therefore, accounts for its leases with tenants as operating leases.

Revenue from investment properties includes all rental income earned from the properties, including minimum rent earned from tenants under lease agreements, property tax and operating cost recoveries and all other miscellaneous income generally paid by the tenants under the terms of their existing leases. Revenue recognition under a lease commences when a tenant has a right to use the leased asset, and revenue is recognized pursuant to the terms of the lease agreement.

2. Significant accounting policies (continued):

Certain leases call for rental payments that vary significantly over their term due to changes in rates or rent inducements granted to tenants. The rental revenue from these leases is recognized on a straight-line basis, resulting in accruals for rent that are not billable or due until future periods. These straight-line rent amounts are presented as accrued rent receivable and form a component of investment properties.

(d) Finance costs:

Finance costs comprise interest expense on borrowings, realized losses and mark-to-market adjustments of interest rate swaps and forward currency contracts, amortization of financing fees and amortization of mark-to-market adjustment on assumed debt.

Finance costs associated with financial liabilities presented at amortized cost are recognized in net income, using the effective interest method.

(e) Leasing costs:

Leasing costs include commissions paid to external leasing agents and payments to tenants. Leasing costs are included as components of investment properties.

Payments to tenants in connection with a lease, which enhances the value of the leased property, are treated as additions to the investment property. Payments to tenants that are determined to be tenant inducements are recognized as an asset which forms a component of investment properties and is amortized on a straight-line basis over the term of the lease as a reduction of revenue.

2. Significant accounting policies (continued):

(f) Financial instruments:

Financial assets and liabilities are recognized when the REIT becomes a party to the contractual provision of the financial instrument. Financial instruments are classified as one of the following: (i) fair value through profit and loss ("FVTPL"); (ii) loans and receivables; (iii) held-to-maturity; (iv) available-for-sale; or (v) other liabilities. Financial instruments are recognized initially at fair value. Financial assets and liabilities classified at FVTPL are subsequently measured at fair value with gains and losses recognized in profit and loss. Financial instruments classified as held-to-maturity, loans and receivables or other liabilities are subsequently measured at amortized cost. Available-for-sale financial instruments are subsequently measured at fair value and any unrealized gains and losses are recognized through other comprehensive income and presented in the fair value reserve in equity. The REIT derecognizes a financial asset when the contractual rights to the cash flows from the asset expire.

	Classification	Measurement
Financial assets:		
Accounts receivable	Loans and receivables	Amortized cost
Cash and cash equivalents	FVTPL	Fair value
Other receivables	Loans and receivables	Amortized cost
Financial liabilities:		
Mortgages payable	Other liabilities	Amortized cost
Loans payable	Other liabilities	Amortized cost
Tenant rental deposits and prepaid rent	Other liabilities	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Finance costs payable	Other liabilities	Amortized cost
Derivative instruments	FVTPL	Fair value
Distributions payable	Other liabilities	Amortized cost

(g) REIT Units:

Under International Accounting Standard ("IAS") 32, Financial Instruments - Presentation ("IAS 32"), puttable instruments, such as the REIT Units, are generally classified as financial liabilities unless the exemption criteria are met for equity classification. The REIT Units meet the exemption criteria under IAS 32 for equity classification.

2. Significant accounting policies (continued):

(h) Fair value measurements:

The REIT measures fair value under IFRS 13, Fair Value Measurement, which provides a single source of fair value measurement guidance. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The REIT has applied the framework for measuring fair value which requires a fair value hierarchy to be applied to all fair value measurements.

(i) Levies:

The REIT has adopted IFRS Interpretations Committee ("IFRIC") 21, Levies ("IFRIC 21"), with a date of initial application of January 1, 2014. IFRIC 21 provides guidance on accounting for levies in accordance with the requirements of IAS 37, Provisions, Contingent Liabilities, and Contingent Assets. IFRIC 21 is to be applied retrospectively. As a result of the adoption of IFRIC 21, the REIT has reassessed the timing of when to accrue annual property taxes imposed by specific legislation in the jurisdictions where it owns the properties. The adoption of IFRIC 21 requires the REIT to recognize the full amount of annual U.S. property tax liabilities at the point in time the property tax obligation is imposed.

The REIT previously accrued for U.S. property taxes evenly over the year. In accordance with IFRIC 21, the REIT has determined that the liability to pay the U.S. property taxes should be recognized in full at a point in time, when the obligating event as stated in the legislation occurs. The impact was to recognize the annual U.S. realty tax accrual and corresponding U.S. expense in full on January 1, 2014. The REIT has retrospectively applied the change in accounting policy resulting in a $3,842 decrease in property taxes for the year ended December 31, 2013 with an equal and offsetting fair value adjustment on investment properties.

2. Significant accounting policies (continued):

(j) Unit-based compensation:

The REIT has a deferred unit plan, which provides holders with the right to receive REIT Units which are puttable. The REIT estimates the fair value of the deferred units on issuance and amortizes this unit-based compensation expense over the vesting period. The deferred units are fair-valued on the basis of the unit price at each reporting period and the change in fair value of the amortized unit-based compensation expense is recognized as unit-based compensation expense.

(k) Future accounting standards:

A number of new standards, amendments to standards and interpretations have been issued but are not yet effective for the year ended December 31, 2014 and, accordingly, have not been applied in preparing these consolidated financial statements.

In May 2014, the International Accounting Standards Board ("IASB") issued IFRS 15, Revenue from Contracts with Customers ("IFRS 15"). The new standard 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, 2017, and is to be applied retrospectively. Early adoption is permitted. The REIT is currently assessing the impact of the new standard on its consolidated financial statements.

In July 2014, the IASB issued IFRS 9, Financial Instruments ("IFRS 9"), replacing IAS 39, Financial Instruments - Recognition and Measurement. The project has three main phases: classification and measurement, impairment and general hedging. The standard 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 on its consolidated financial statements.

In December 2014, the IASB issued amendments to IAS 1, Presentation of Financial Statements. The amendments are effective for annual periods beginning on or after January 1, 2016 with early adoption permitted. The REIT intends to adopt these amendments in its financial statements for the annual period beginning January 1, 2016 and is currently assessing the impact of these amendments on its consolidated financial statements.

(In thousands of Canadian dollars, except per unit amounts)

3. Acquisitions:

On January 10, 2014, the REIT acquired a 100% interest in a property located at 10130 Perimeter Parkway, in Charlotte, North Carolina for a total purchase price of $20,709 (including acquisition costs and closing adjustments of $123). The REIT assumed a net working capital liability of $94 related to tenant rental deposits and prepaid rent of $45, accounts payable and accrued liabilities of $87, net of other assets of $38. The transaction has been recognized as an asset acquisition. The acquisition was funded by cash received on the loan payable.

Net assets acquired:	
Investment properties, including acquisition costs and closing adjustments of ($123)[i]	$ 20,709
Working capital assumed	(94)
Net assets acquired	$ 20,615
Consideration paid	$ 20,615

[i]IFRIC 21 adjustment of $218 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.

On November 12, 2013, the REIT acquired a 100% interest in two properties located at 10900 Corporate Centre Drive and 4920 Westway, in Houston, Texas for a total purchase price of $47,347 (including acquisition costs and closing adjustments of $128). The REIT assumed working capital of $1,494 related to prepaid rent of $324, accounts payable and accrued liabilities of $1,209, net of other assets of $39. The transaction has been recognized as an asset acquisition. The acquisition was funded by a mortgage of $26,703 (net of financing costs of $211), and the balance of the purchase price was paid in cash from proceeds from the offering.

(In thousands of Canadian dollars, except per unit amounts)

3. Acquisitions (continued):

On June 12, 2013, the REIT acquired a 100% interest in 11000 Corporate Centre Drive, Houston, Texas for a purchase price of $18,475 (including acquisition costs and closing adjustments of ($143)). The REIT assumed working capital of $304 related to prepaid rent of $136, accounts payable and accrued liabilities of $176, net of other assets of $8. This transaction has been recognized as an asset acquisition. The acquisition was funded by new financing of $10,163 (net of financing costs of $141) and a drawdown on the revolving credit facility of $7,410. The balance of the purchase price was funded with cash on hand.

Net assets acquired:	
Investment properties, including acquisition costs and closing adjustments of ($15)[ii]	$ 65,822
Working capital assumed	(1,798)
Net assets acquired	$ 64,024
Consideration paid funded by:	
New financing, net of financing costs of $352	$ 36,866
Draw on revolving credit facility	7,410
Cash (proceeds from unit issuance and cash on hand)	19,748
	$ 64,024

[ii]IFRIC 21 adjustment of $371 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.

On January 25, 2013, the REIT indirectly acquired a 100% interest in a portfolio of investment properties for a purchase price of $422,984 from the vendors of the properties, a related party (the "Vendors"), adjusted for closing adjustments and acquisitions costs. This transaction has been accounted for as an asset acquisition.

(In thousands of Canadian dollars, except per unit amounts)

3. Acquisitions (continued):

The following table summarizes the allocation of the purchase price to estimated fair value of the assets acquired and liabilities assumed:

Net assets acquired:	
Investment properties[iii]	$ 424,547
Assumed mortgages, including mark-to-market adjustment of $3,777	(60,571)
Working capital assumed	(1,147)
Net assets acquired	$ 362,829
Consideration paid:	
Units to Vendors	$ 51,603
Units to Agellan Capital Partners Inc. ("ACPI") principals	4,669
Cash paid out by the REIT:	
Proceeds used from offering, net of costs	121,047
Proceeds used from new financing, net of financing costs	185,084
Due to ACPI	2,375
Due from Vendors	(1,949)
	$ 362,829

[iii] IFRIC 21 adjustment of $3,471 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.

The working capital assumed included other assets of $2,962, net of accounts payable and accrued liabilities of $1,857, tenant rental deposits of $1,320 and prepaid rent of $932. The REIT raised excess cash of $945 from the offering.

Included in assumed mortgages is a U.S. dollar-denominated mortgage of U.S. $54,114 (Cdn. $54,547) and financing costs of U.S. $212 (Cdn. $214). Included in proceeds used from new financing are U.S. dollar-denominated mortgages of U.S. $86,000 (Cdn. $86,688).

(In thousands of Canadian dollars, except per unit amounts)

4. Investment properties:

	2014	2013
Balance, beginning of year	$ 524,805	$ –
Acquisition of investment properties - IPO	–	424,547
Acquisition of investment properties (note 3)	20,709	65,822
Additions - capital expenditures and leasing costs	7,081	6,602
Straight-line rents adjustment	2,429	2,226
Fair value adjustment	530	11,160
Foreign exchange impact on translation of U.S. operations	29,869	14,448
Transfer of investment properties to assets held for sale (note 6)	(8,200)	–
Disposition of investment properties	(12,678)	–
Balance, end of year	$ 564,545	$ 524,805

Investment properties are stated at fair value. The fair value was determined by a combination of valuations made by independent external appraisers having appropriate professional qualifications and internal management valuations primarily using a discounted cash flow model.

(a) External appraisals:

The REIT regularly obtains appraisals to supplement internal management valuations and to support fair market value.

The aggregate appraised value of properties externally appraised during the year ended December 31, 2014, including appraisals obtained in conjunction with acquisitions totalled U.S. $41,450.

(In thousands of Canadian dollars, except per unit amounts)

4. Investment properties (continued):

(b) Internal valuations:

Fair value of each property was primarily determined by using the discounted cash flow method. The discounted cash flow method discounts the expected future cash flows, generally over a term of 10 years, including a terminal value based on the application of a capitalization rate to estimated year 11 cash flows.

The discounted cash flows reflect rental income from current leases and assumptions about rental income from future leases reflecting market conditions at the reporting date, less future cash outflows in respect of such leases.

The key valuation assumptions for the REIT's investment properties reflect Level 3 inputs and are set out in the following table:

2014	Canada	United States
Discount rates - range	7.40% - 8.25%	7.25% - 9.50%
Discount rate - weighted average	7.43%	8.61%
Terminal capitalization rates - range	7.00% - 7.50%	6.50% - 8.75%
Terminal capitalization rate - weighted average	7.25%	8.00%

2013	Canada	United States
Discount rates - range	7.50% - 8.25%	7.75% - 9.75%
Discount rate - weighted average	7.53%	8.78%
Terminal capitalization rates - range	7.00% - 7.50%	7.50% - 9.00%
Terminal capitalization rate - weighted average	7.25%	8.15%

(In thousands of Canadian dollars, except per unit amounts)

4. Investment properties (continued):

The fair values of the REIT's investment properties are sensitive to changes in the key valuation assumptions. Changes in the terminal 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:

	2014	2013
Weighted average terminal capitalization rate:		
25-basis points increase	$ (9,859)	$ (8,331)
25-basis points decrease	10,524	8,893
Weighted average discount rate:		
25-basis points increase	(10,015)	(8,163)
25-basis points decrease	10,348	8,348

5. Disposition:

On August 13, 2014, the REIT disposed of one investment property for fair value of $12,678. Selling costs incurred on the transaction were $269 and are recognized as a loss on sale of investment properties. The proceeds received net of working capital adjustments were $12,052.

The mortgage payable previously secured by the property remains with the REIT and has now been secured by cash held in escrow of $8,312. Subsequent to year end, this mortgage was transferred to five of the six properties acquired in Atlanta, Georgia (note 23), and the cash held in escrow was released.

(In thousands of Canadian dollars, except per unit amounts)

6. Assets and liabilities classified as held for sale:

The REIT has classified one property as held for sale at December 31, 2014 (2013 - nil).

The following table sets forth the consolidated statements of financial position items associated with the investment property classified as held for sale:

	December 31, 2014
Assets:	
Investment properties	$ 8,200
Other assets	7
Accounts receivable	35
	$ 8,242
Liabilities:	
Tenant rental deposits and prepaid rent	$ 62
Accounts payable and accrued liabilities	43
	$ 105

7. Other assets:

	2014	2013
Prepaid expenses	$ 1,255	$ 1,144
Restricted cash	8,709	–
Deposits in escrow	1,054	1,110
Deposits on acquisitions	–	425
Other receivables	125	88
	$ 11,143	$ 2,767

(In thousands of Canadian dollars, except per unit amounts)

7. Other assets (continued):

Restricted cash can only be used for specified purposes. The REIT's restricted cash represents cash held in escrow by lenders pursuant to certain lender agreements, and cash held in escrow on securing the mortgage on an investment property sold during the year (note 5).

8. Accounts payable and accrued liabilities:

	2014	2013
Trade payable	$ 517	$ 649
Realty tax payable	5,580	4,441
Other payables and accruals	6,629	3,968
	$ 12,726	$ 9,058

9. Mortgages payable:

	2014	2013
Current:		
Mortgages payable	$ 5,722	$ 2,825
Unamortized mark-to-market premium	825	739
Unamortized financing fees	(268)	(233)
	6,279	3,331
Non-current:		
Mortgages payable	209,267	184,348
Unamortized mark-to-market premium	1,991	2,583
Unamortized financing fees	(1,199)	(1,164)
	210,059	185,767
	$ 216,338	$ 189,098

(In thousands of Canadian dollars, except per unit amounts)

9. Mortgages payable (continued):

The mortgages payable are secured by charges on 23 investment properties. Mortgages payable include financing fees and mark-to-market premium which are amortized into finance costs over the terms of the related mortgages, using the effective interest rate method. At December 31, 2014, the consolidated statements of financial position included financing fees of $1,903 (2013 - $1,565) and accumulated amortization of $436 (2013 - $168). The mortgages carry a weighted average interest rate of 4.22%. Included in mortgages payable are U.S. dollar denominated mortgages of U.S. $183,302 (Cdn. $212,649) (2013 - U.S. $173,719 (Cdn. $184,767)).

Future principal repayments at December 31, 2014 are as follows:

	Scheduled principal payments	Debt maturing during the period	Total mortgages payable	Scheduled interest payments	Total debt service	Weighted average interest rate of debt maturing
2015	$ 3,410	$ 2,312	$ 5,722	$ 8,571	$ 14,293	3.95%
2016	3,547	–	3,547	8,397	11,944	–%
2017	3,715	–	3,715	8,236	11,951	–%
2018	3,286	98,696	101,982	6,285	108,267	4.50%
2019	2,806	–	2,806	3,704	6,510	–%
Thereafter	6,511	90,706	97,217	7,703	104,920	3.94%
Face value	$ 23,275	$ 191,714	214,989	$ 42,896	$ 257,885	
Unamortized mark-to-market premium			2,816			
Unamortized financing fees			(1,467)			
			$ 216,338			

(In thousands of Canadian dollars, except per unit amounts)

10. Loans payable:

The REIT has a revolving credit facility, secured by charges on three Canadian properties. The maximum amount available to the REIT under these facilities is $120,000, and the facility matures on January 25, 2017. Amounts can be drawn under the facility in both United States and Canadian dollars. The facility bears interest at bankers' acceptance/LIBOR plus 2.00% or prime/U.S. base rate plus 1.00%. As at December 31, 2014, the amount drawn on the facility was $101,557 (2013 - $114,818). Included in loans payable balance at December 31, 2014 are U.S. dollar denominated loans of U.S. $6,600 (Cdn. $7,657) (2013 - U.S. $16,000 (Cdn. $17,018)). The interest rate on $60,000 drawn on the facility has been economically fixed at 3.40% using an interest rate swap (note 13).

Financing fees of $863 (2013 - $736) were incurred to obtain the revolving credit facility and are being amortized over the remaining term. As at December 31, 2014, the unamortized financing fees totalled $307 (2013 - $485).

11. Unitholders' equity:

	2014		2013	
	Units	Amount	Units	Amount
Unitholders' equity January 1	23,269,796	$ 212,231	–	$ –
IPO Units, net of issuance costs of $12,627	–	–	19,089,206	178,264
Units issued under IPO over-allotment option, net of issuance costs of $954	–	–	313,097	2,177
Units issued, net of issuance costs of $1,824	–	–	3,795,000	31,193
Additional shares issued under the DRIP program	224,891	1,979	72,493	597
	23,494,687	$ 214,210	23,269,796	$ 212,231

(a) Units:

The REIT is authorized to issue an unlimited number of Units. On January 25, 2013, the REIT issued 13,461,943 Units at $10 per Unit for total proceeds of $134,619. Costs relating to the IPO, including underwriters' fees, were $12,627 and have been charged directly to unitholders' equity.

11. Unitholders' equity (continued):

In addition, the REIT issued $51,603 of Units to Vendors and $4,669 of Units to ACPI.

On February 27, 2013, the REIT issued an additional 313,097 Units under the over-allotment option for total of $3,131. Costs relating to this over-allotment were $954. As part of overallotment option, the Vendors exchanged a portion of their Units to bring their ownership to 19.3%.

On August 6, 2013, the REIT filed a short-form base shelf prospectus ("Prospectus") allowing for the issuance, from time to time, of Units and debt securities or any combination thereof, having an aggregate offering price of up to $500,000. The Prospectus is valid for a 25-month period.

On October 9, 2013, the REIT issued 3,450,000 units at a price of $8.70 per Unit. On November 4, 2013, an additional 345,000 units were issued through the underwriters' over-allotment option under the same terms for total proceeds of $33,017. Costs relating to the offering were $1,824 and have been charged directly to unitholders' equity.

The unitholders have the right to require the REIT to redeem their units on demand not to exceed $50 per calendar month. Upon receipt of the redemption notice by the REIT, all rights to and under the Units tendered for redemption shall be surrendered and the holder thereof shall be entitled to receive a price per unit ("Redemption Price"), as determined by a market formula. The Redemption Price will be paid in accordance with the conditions provided for in the Declaration of Trust.

(b) Distribution Reinvestment Plan ("DRIP"):

The REIT adopted a DRIP on May 18, 2013. Unitholders can elect to reinvest cash distributions into trust units of the REIT, including a "bonus distribution" of units equal in value to 3% of each distribution. For the year ended December 31, 2014, the REIT issued 224,891 (2013 - 72,493) Units under the DRIP for a stated average value of $8.80 (2013 - $8.24) per Unit.

The REIT may initially issue up to 954,461 Units of the REIT under the DRIP. The REIT may increase the number of Units available to be issued under the DRIP at any time at its discretion subject to (i) the approval of the REIT's board of trustees; (ii) the approval of any stock exchange upon which the Units trade; and (iii) public disclosure of such increase.

(In thousands of Canadian dollars, except per unit amounts)

12. Deferred Unit Incentive Plan:

On January 25, 2013, the REIT authorized a Deferred Unit Incentive Plan ("DUIP") that provides for the granting of deferred trust units ("DTUs") to trustees, officers, directors, employees, consultants and service providers, as well as employees of such service providers. DTUs are defined as notional units that are tied to the REIT's financial and REIT Unit trading performance. The maximum number of REIT Units reserved for issuance under the DUIP is 5% of the total number of REIT Units issued and outstanding from time to time. Vested DTUs may be redeemed in whole or in part of units of the REIT issued from treasury. Whenever cash distributions are paid to REIT unitholders, additional DTUs are credited to the participant's outstanding DTU balance based on the 5-day volume-weighted average price on the grant date. These additional units vest on the same schedule as their corresponding DTUs.

On August 11, 2014, the plan was amended so that all members of the Board of Trustees will be able to receive their annual retainer and meeting fees for the fiscal year in the form of DTUs. DTUs issued to Trustees in lieu of their annual retainer and meeting fees will vest immediately. However, in no event shall the exercise of the Trustees' DTUs issued in lieu of their annual retainer and meeting fees occur prior to the third anniversary of the grant date, except in the instance of termination of service.

For the year ended December 31, 2014, 5,597 DTUs were granted to Trustees for services rendered (2013 - nil).

The movement of the DUIP balance was as follows:

As at January 1, 2014	$	–
Compensation expense		50
As at December 31, 2014	$	50

Total compensation expense recognized for the year ended December 31, 2014 was $50 (2013 - nil). These amounts are recognized in accounts payable and accrued liabilities and general and administrative expenses.

13. Derivative instruments:

The REIT has entered into interest rate swap agreements and a foreign currency forward lock contract agreement.

(a) Under the revolving credit facility's interest rate swap agreement, the REIT has agreed to exchange, at specified intervals, the difference between the fixed and variable interest amounts calculated by reference to a notional amount of $60,000 maturing January 27, 2017 as outlined in note 10. The valuation of this interest rate swap contract was computed using Level 2 inputs, as outlined in note 22.

The REIT also entered into additional swap agreements to fix mortgages payable of U.S. $10,100 and U.S. $25,650 at 3.04% and 3.35%, respectively, for five years each.

The REIT recognized an unrealized loss of $430 (2013 - unrealized gain of $100) for the year ended December 31, 2014, which has been recorded as finance costs.

(b) Under the terms of the foreign currency forward lock contract agreement, the REIT will be exchanging a fixed amount of U.S. dollars for Canadian dollars each month. The valuation of the foreign currency forward lock contract agreement was computed using Level 2 inputs, as outlined in note 22.

The total notional value of the forward contracts outstanding as of December 31, 2014 is U.S. $12,473 and have a weighted average forward exchange rate of 1.09 Canadian dollars per United States dollar.

The REIT recognized an unrealized loss of $488 (2013 - unrealized loss of $532) for the year ended December 31, 2014, which has been recorded as finance costs. The contract expires on December 30, 2016.

14. Income taxes:

The REIT has certain subsidiaries in Canada and the United States that are subject to tax on their taxable income. The effective tax rate for the year differs from the expected statutory tax rate in Canada of nil applicable to the REIT as a significant portion of the consolidated net income is earned by the U.S. subsidiary and, accordingly, a deferred tax expense of $6,923 has been recorded (2013 - $2,539).

(In thousands of Canadian dollars, except per unit amounts)

14. Income taxes (continued):

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	2014	2013
Deferred tax assets:		
Net operating losses and deferred interest deductions	$ 1,061	$ 813
Deferred tax liabilities:		
Investment properties	9,851	2,093
Other assets	1,250	1,259
	11,101	3,352
Deferred tax liability	$ 10,040	$ 2,539

At December 31, 2014, the REIT's U.S. subsidiary had accumulated net operating losses and deferred interest deductions available for carryforward for U.S. income tax purposes of $2,882 (2013 - $2,033).

The net operating losses will expire between 2033 and 2034. The deferred interest deductions and the deductible temporary differences do not generally expire under current tax legislation.

During 2014, $223 (2013 - $47) of withholding taxes with respect to distributions from the U.S. subsidiary have been recorded in general and administrative expenses.

During 2014, $144 (2013 - $74) of U.S. state franchise taxes incurred by the U.S. subsidiary have been recorded in property operating expenses, as these taxes are recoverable from tenants.

During 2014, $91 (2013 - nil) of U.S. state franchise taxes incurred by the U.S. subsidiary have been recorded in general and administrative expenses, as these taxes are not recoverable from tenants.

15. Capital management:

The REIT's objectives when managing capital are to ensure sufficient liquidity to pursue its organic growth combined with strategic acquisitions, and to maintain a flexible capital structure that optimizes the cost of capital at acceptable risk and preserves the ability to meet financial obligations.

The capital structure of the REIT consists of cash, debt and unitholders' equity. In managing its capital structure, the REIT monitors performance throughout the year and makes adjustments to its capital based on its investment strategies and changes to economic conditions. In order to maintain or adjust its capital structure, the REIT may issue equity or new debt, issue new debt to replace existing debt (with different characteristics), or reduce the amount of existing debt.

Part of the REIT's objectives in securing mortgages for its properties and managing its long-term debt is to stagger the maturities in order to mitigate short-term volatilities in the debt markets. The REIT's Declaration of Trust stipulates that the REIT shall not incur indebtedness greater than 60% of gross book value or 65%, including convertible debentures.

The REIT is required under the terms of its credit facility to meet certain financial covenants, including:

(a) a Debt to Gross Book Value ratio of not more than 65%;

(b) a Debt Service Coverage Ratio of not less than 1.50; and

(c) a minimum equity of not less than the aggregate of: (i) $150,000; and (ii) 75% of net proceeds received in connection with any future equity offerings.

In addition, the REIT is required under certain property mortgage terms to meet financial covenant ratios.

The REIT complied with all financial covenants as at December 31, 2014.

(In thousands of Canadian dollars, except per unit amounts)

16. Segmented disclosure:

Identifiable non-current assets and revenue by geographic region are outlined below. Investment properties are attributable to countries based on the location of the properties.

Non-current assets:

	2014	2013
Canada	$ 198,145	$ 207,916
United States	366,400	316,889
	$ 564,545	$ 524,805

Revenue:

	2014	2013
Canada	$ 28,693	$ 26,270
United States	46,268	31,976
	$ 74,961	$ 58,246

The REIT has one tenant in its Canadian portfolio that accounts for 12.43% (2013 - 14.77%) of its total revenue. The tenant's lease will expire in 2020.

17. Transactions with related parties:

The REIT is the ultimate Canadian parent entity.

The consolidated financial statements include the accounts of the REIT and all its subsidiaries. The subsidiaries of the REIT are listed below:

- Agellan Commercial REIT Holdings Inc.
- Agellan Commercial REIT U.S. Inc.

17. Transactions with related parties (continued):

- Agellan Commercial REIT U.S. G.P., Inc.
- Agellan Commercial REIT U.S. L.P.
- Agellan Warrenville G.P., Inc.
- Agellan Warrenville L.P.

Related parties include the Vendors, by virtue of their ownership interest in REIT Units, and ACPI, who are related due to their ownership of REIT Units, as well as due to certain common ownership interests in ACPI and the REIT.

Except as disclosed elsewhere in the consolidated financial statements, the related party transactions include the following:

(a) The REIT engaged ACPI or its related parties to perform asset management services for a fee of 0.4% of the gross book value, as defined in the asset management agreement (the "External Management Agreement") between the REIT and ACPI. The costs of these services, aggregating $2,311 (2013 - $1,763) for the year ended December 31, 2014, were charged to general and administrative expenses.

(b) ACPI is also entitled to a Unit Price Performance Fee five years following the IPO or upon termination of the External Management Agreement, which shall be equal to the product of: (i) the Unit price on the date that is five years following the IPO based on the 20-day volume weighted average price of the Units on the stock exchange on which the Units are then listed, less $13.00; and (ii) one million. The Unit Price Performance Fee shall not be payable to ACPI in the event the REIT terminates ACPI for cause or ACPI terminates the External Management Agreement. The Unit Price Performance Fee, calculated using the Black-Scholes pricing model, was nil (2013 - $12) for the year ended December 31, 2014 and is accrued in general and administrative expenses.

17. Transactions with related parties (continued):

(c) ACPI shall be paid an incentive fee annually, for each term of the External Management Agreement, equal to the product of: (i) 15% of any excess adjusted funds from operation ("AFFO") per unit as derived by the REIT for each fiscal year greater than 103% of forecast AFFO per unit; and (ii) the weighted average number of issued and outstanding units over the applicable fiscal year. The incentive fee will be measured and paid in units, unless payment in units triggers a taxable event in ACPI. The incentive target will increase annually by 50% of the increase in Canadian and the U.S. consumer price indices. No amount has been accrued for the year ended December 31, 2014 (2013 - nil).

(d) The REIT engaged ACPI or its related parties to perform property management services for fees as defined in the property management agreements. The costs of these services, aggregating $614 (2013 - $547) for the year ended December 31, 2014, were charged to property operating expenses.

(e) Included in accounts payable and accrued liabilities is $199 (2013 - $174) payable to ACPI for asset management fees and $51 (2013 - $49) payable to ACPI or its related parties for property management fees.

(f) The REIT has entered into lease agreements whereby certain Vendor lease space in properties for terms of approximately five years. Rental revenue from these leases was $2,204 (2013 - $3,201) for the year ended December 31, 2014 for minimum rent and recoveries revenue. Included in accounts receivable is $96 from these leases.

(g) Vendors of certain investment properties have an option to purchase certain vacant development land owned by the REIT, comprising 5.9 acres for $12,000, subject to certain conditions. The option expires July 24, 2015.

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(In thousands of Canadian dollars, except per unit amounts)

17. Transactions with related parties (continued):

The compensation of Trustees and key management personnel is set out in the following table:

	2014	2013
Trustee fees	$ 202	$ 193
Salaries and benefits	211	199
	$ 413	$ 392

18. Finance costs:

	2014	2013
Interest:		
Loan facility	$ 3,638	$ 2,998
Mortgages payable	8,442	6,480
Amortization of financing fees	547	413
Amortization of mark-to-market premium	(769)	(644)
Unrealized loss (gain) on derivative instrument - interest rate swap	430	(100)
Unrealized loss on derivative instrument - foreign currency exchange hedge	488	532
	12,776	9,679
Realized loss on foreign currency exchange hedge	609	171
	$ 13,385	$ 9,850

(In thousands of Canadian dollars, except per unit amounts)

19. Property operations:

The REIT generally leases investment properties under operating leases with lease terms between 1 and 10 years, with options to extend up to a further 10 years.

Future minimum base rent lease payments on tenant operating leases are as follows:

2015	$ 45,105
2016 - 2019	126,066
2020 and thereafter	56,724
	$ 227,895

20. Commitments and contingencies:

(a) The REIT has entered into a long-term lease agreement with a tenant dated November 19, 2014, whereby the REIT is obligated to construct a built to suit automobile dealership and office space on existing lands at one of REIT's properties located in Canada. The lease can be terminated by either the tenant or the landlord if certain development requirements are not met in the time period agreed to between the REIT and the tenant, such as required governmental approvals for site development.

(b) The REIT had no commitments for future minimum lease payments under non-cancellable operating leases.

(c) The REIT is involved in litigation and claims in relation to the investment properties that arise from time to time in the normal course of business. In the opinion of management, none of these, individually or in aggregate, would result in the recognition of a liability that would have a significant adverse effect on the consolidated statements of financial position of the REIT.

21. 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:

(a) Market risk:

Market risk is the risk that changes in market prices, such as interest rates, will affect the REIT's financial instruments.

The REIT is subject to the risks associated with debt financing, including the risk that the interest rate on floating rate debt may rise before long-term fixed rate debt is arranged and that the mortgages payable 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. The REIT staggers the maturities of its fixed rate mortgages in order to minimize the exposure to future interest rate fluctuations. The REIT has $41,556 (2013 - $54,818) of floating rate debt at December 31, 2014. A 1% change in interest rates will change the annual finance costs by $416 (2013 - $548).

(b) Credit risk:

Credit risk is the risk that: (i) one party to a financial instrument will cause a financial loss for the REIT by failing to discharge its obligations; and (ii) 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 statements of financial position. The REIT monitors its risk exposure regarding obligations with counterparties through the regular assessment of counterparties' credit positions.

The REIT attempts to mitigate the risk of credit loss with respect to tenants by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant. Thorough credit assessments are conducted in respect of new leasing and tenant deposits are obtained when warranted.

21. Risk management (continued):

The REIT monitors its collection process on a month-to-month basis to ensure that a stringent policy is adopted to provide for all past due amounts. All receivables not expected to be collected are provided for as bad debt expense in the consolidated statements of income and comprehensive income.

(c) Liquidity risk:

Liquidity risk is the risk that the REIT may encounter difficulty in meeting its financial obligations when they come due. Management's strategy to managing liquidity risk is to ensure, to the extent possible, that it always has sufficient financial assets to meet its financial liabilities when they come due, by forecasting cash flows from operations and anticipated investing and financing activities. To mitigate the risk associated with the refinancing of maturing debt, the REIT staggers the maturity dates of its portfolio over a number of years.

(d) Foreign currency risk:

A significant portion of the REIT's operations are conducted in the United States and the financial position and results for these operations are denominated in U.S. dollars. The REIT's functional and reporting currency is the Canadian dollar. Accordingly, the revenue and expenses of the U.S. operations are translated at average rates of exchange in effect during the year. Assets and liabilities are translated at the exchange rates in effect at the consolidated statement of financial position dates. As a result, the REIT is subject to foreign currency fluctuation risk on the U.S. operations, which could adversely impact its operating results and its cash flows. In addition, because the distributions to unitholders are denominated in Canadian dollars, the cash available for distribution could be adversely impacted.

At December 31, 2014, a one-cent change in the exchange rate will have approximately a $1,296 (2013 - $1,195) impact on net assets with an offsetting adjustment to other comprehensive income and an approximate $206 (2013 - $73) impact on net income.

22. Fair value measurement:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The REIT uses various methods in estimating the fair values of assets and liabilities that are measured at fair value on recurring or non-recurring basis in the consolidated statements of financial position. The fair value hierarchy reflects the significance of inputs used in determining the fair values.

- Level 1 - fair value is based on unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - fair value is based on models using significant market-observable inputs other than quoted prices for the assets or liabilities; and
- Level 3 - fair value is based on models using significant inputs that are not based on observable market data (unobservable inputs).

Determination of fair value and resulting hierarchy requires the use of observable market data whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value.

The fair value of investment properties is outlined in note 4.

Derivative instruments valued using a valuation technique with market-observable inputs (Level 2) include foreign currency exchange contracts and interest rate swaps. The most frequently applied valuation technique includes forward pricing models, using present value calculations. The models incorporate various inputs including foreign exchange spot and forward rates and interest rate curves.

The fair value of the REIT's mortgages payable and loans payable are determined using present value calculations based on market-observable interest rates for mortgages and loans with similar terms and conditions (Level 2). The fair value of the REIT's mortgages payable at December 31, 2014 is $223,265 (2013 - $188,697).

(In thousands of Canadian dollars, except per unit amounts)

22. Fair value measurement (continued):

The carrying values of the REIT's financial assets, which include accounts receivable, other assets, assets classified as held for sale and cash and cash equivalents, as well as financial liabilities, which include accounts payable and accrued liabilities, liabilities classified as held for sale and tenant rental deposits and prepaid rent, approximate their recorded fair values due to their short-term nature.

The table below presents the REIT's assets and liabilities recognized at fair value as at December 31:

2014	Level 1	Level 2	Level 3	Total
Assets:				
Investment properties	$ –	$ –	$ 564,545	$ 564,545
Liabilities:				
Derivative instruments	$ –	$ 1,344	$ –	$ 1,344

2013	Level 1	Level 2	Level 3	Total
Assets:				
Investment properties	$ –	$ –	$ 524,805	$ 524,805
Liabilities:				
Derivative instruments	$ –	$ 432	$ –	$ 432

23. Subsequent events:

The REIT declared distributions of $0.06458 per Unit on January 21, 2015 and February 18, 2015 to unitholders of record as at January 30, 2015 and February 27, 2015, respectively.

On February 5, 2015, the REIT disposed of one Canadian property for a gross purchase price of $8,200.

On February 9, 2015, the REIT completed the acquisition of six industrial properties located in Atlanta, Georgia for an aggregate purchase price of U.S. $12,900.

On March 2, 2015, the REIT obtained additional financing on three office properties located in Houston, Texas totaling U.S. $10,000.