

Consolidated Financial Statements of

PARTNERS REAL ESTATE INVESTMENT TRUST

For the years ended December 31, 2018 and 2017



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INDEPENDENT AUDITORS' REPORT

To the Unitholders of Partners Real Estate Investment Trust

We have audited the consolidated financial statements of Partners Real Estate Investment Trust (the Entity), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017
- the consolidated statements of comprehensive income (loss) for the years then ended
- the consolidated statements of unitholders' capital for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies.

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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



Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.



We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion;
- The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit 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;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation;
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit; and
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

A handwritten signature in black ink that reads 'KPMG LLP' in a cursive, slightly slanted font. A horizontal line is drawn underneath the signature.

Chartered Professional Accountants

Vancouver, Canada
March 18, 2019

PARTNERS REAL ESTATE INVESTMENT TRUST

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PARTNERS REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Financial Position

audited (Cdn \$)

As at	December 31, 2018	December 31, 2017
ASSETS		
Non-current assets		
Income producing properties (Note 4)	\$ 98,650,000	\$ 462,928,003
	98,650,000	462,928,003
Current assets		
Other assets (Note 5)	858,377	4,384,057
Accounts receivable (Note 6)	2,894,888	1,068,211
Cash	3,068,578	6,664,907
	6,821,843	12,117,175
Assets held for sale (Note 7)	183,222,326	-
	\$ 288,694,169	\$ 475,045,178
LIABILITIES		
Non-current liabilities		
Mortgages payable (Note 8)	\$ 45,735,092	\$ 228,515,582
	45,735,092	228,515,582
Current liabilities		
Mortgages payable (Note 8)	19,494,289	45,327,618
Convertible debentures (Note 9)	-	7,563,686
Accounts payable and other liabilities	6,961,455	9,333,956
Distributions payable (Note 13)	697,667	956,918
	27,153,411	63,182,178
Liabilities associated with assets held for sale (Note 7)	116,142,244	-
	189,030,747	291,697,760
UNITHOLDERS' EQUITY		
	99,663,422	183,347,418
	\$ 288,694,169	\$ 475,045,178

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST
Consolidated Statements of Comprehensive Income (Loss)

audited (Cdn \$)

	Year ended December 31,	
	2018	2017
Revenues from income producing properties (Note 10)	\$ 48,831,873	\$ 52,904,430
Property operating expenses	(8,041,198)	(8,484,658)
Realty taxes	(11,362,061)	(11,657,490)
Property management fees	(862,904)	(884,402)
	28,565,710	31,877,880
Other expenses:		
Financing costs	\$ 10,687,033	\$ 14,907,403
General and administrative expenses	4,267,658	4,662,349
	14,954,691	19,569,752
Income before other gains/(losses)	13,611,019	12,308,128
Fair value losses (Note 11)	(43,465,060)	(7,945,061)
Gain (loss) on sale of investment property	(3,017,589)	917,110
Comprehensive income (loss)	\$ (32,871,630)	\$ 5,280,177
INCOME (LOSS) PER UNIT (Note 12)		
Basic and diluted	\$ (0.71)	\$ 0.13

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Changes in Unitholders' Equity

audited (Cdn \$)

	Year ended December 31,	
	2018	2017
Trust Units (Note 13)		
BALANCE, BEGINNING OF YEAR	\$ 256,857,960	\$ 220,237,798
Issuance of units under rights offering, net of costs	-	35,181,465
Issuance of units under the dividend reinvestment program, net of costs	679,294	1,437,697
Issuance of units under the optional unit purchase plan, net of costs	-	1,000
BALANCE, END OF YEAR	257,537,254	256,857,960
Contributed Surplus		
BALANCE, BEGINNING OF YEAR	565,080	565,080
BALANCE, END OF YEAR	565,080	565,080
Accumulated Other Comprehensive Loss		
BALANCE, BEGINNING OF YEAR	(74,075,622)	(69,294,498)
Comprehensive income (loss)	(32,871,630)	5,280,177
Distributions to unitholders (Note 13)	(51,491,660)	(10,061,301)
BALANCE, END OF YEAR	(158,438,912)	(74,075,622)
TOTAL UNITHOLDERS' EQUITY	\$ 99,663,422	\$ 183,347,418

The accompanying notes are an integral part of these condensed consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Cash Flows

audited (Cdn \$)

	Year ended December 31,	
	2018	2017
OPERATING ACTIVITIES		
Comprehensive income (loss)	\$ (32,871,630)	\$ 5,280,177
Adjusted for non-cash items:		
Loss (gain) on sale of investment property	3,017,589	(917,110)
Fair value losses (Note 11)	43,465,060	8,044,379
Non-cash unit compensation expense	666,058	595,290
Straight-line rent	66,207	91,762
Tenant incentives and direct leasing costs amortization	974,824	986,622
Financing cost amortization	803,899	1,406,678
Market interest rate adjustment on mortgages	(139,593)	(647,801)
Interest accretion expense	2,406	106,439
Interest expense	10,020,321	14,042,087
Net change in working capital (Note 14)	227,956	(931,464)
Interest paid	(10,237,397)	(14,299,806)
Cash flow provided by operating activities	15,995,700	13,757,253
FINANCING ACTIVITIES		
Proceeds from mortgages	46,190,000	95,680,000
Financing costs of mortgages	(707,254)	(1,330,252)
Repayments of mortgages at maturity	(40,028,730)	(81,640,973)
Repayments of mortgages with property sale	(94,309,015)	(26,686,338)
Regular principal repayments on mortgages	(7,584,459)	(8,667,961)
Convertible debenture repayments	(7,590,000)	(49,910,000)
Credit facility draws	2,000,000	1,000,000
Credit facility repayments	(2,000,000)	(1,000,000)
Proceeds from rights offering	-	35,397,245
Costs to issue units (Note 13)	(66,968)	(231,947)
Distributions to unitholders	(50,926,911)	(8,332,078)
Units purchased under the optional unit purchase plan	-	1,000
Cash flow used by financing activities	(155,023,337)	(45,721,304)
INVESTING ACTIVITIES		
Net proceeds from disposition of income producing properties	139,493,516	38,919,696
Capital improvements, net of recoveries	(3,524,860)	(7,676,128)
Expenditures on tenant incentives and direct leasing costs	(537,348)	(1,748,646)
Cash flow provided (used) by investing activities	135,431,308	29,494,922
NET INCREASE (DECREASE) IN CASH DURING THE YEAR	(3,596,329)	(2,469,129)
CASH, BEGINNING OF YEAR	6,664,907	9,134,036
CASH END OF YEAR	\$ 3,068,578	\$ 6,664,907

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

1. ORGANIZATION OF THE TRUST

Partners Real Estate Investment Trust (“Partners REIT” or the “REIT”) is an unincorporated, open-ended real estate investment trust and was formed pursuant to a Declaration of Trust dated March 27, 2007 and as last amended and restated on December 10, 2018. The address of its registered office and principal place of business is 249 Saunders Road, unit 3, Barrie, Ontario, L4N 9A3. The principal business activity of Partners REIT is operating commercial retail properties. The units of the REIT were originally listed on the Toronto Stock Exchange on April 3, 2012 (the “TSX”) and trade under the symbol “PAR.UN”. Prior to April 3, 2012, the REIT’s units were listed on the TSX Venture Exchange under the same symbol.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies that are used in the preparation of these consolidated financial statements:

(a) *Statement of compliance*

These consolidated financial statements have been prepared under International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) incorporating interpretations issued by the IFRS Interpretations Committee (“IFRICs”).

These consolidated financial statements were approved and authorized for issue by the Board of Trustees on March 18, 2019.

(b) *Basis of presentation*

The financial statements have been prepared on a going concern basis and have been presented in Canadian dollars. The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of income producing properties and certain financial instruments at fair value (as discussed in Note 2(d) and Note 2(g)). The accounting policies set out below have been applied consistently in all material respects. Standards and guidelines not effective for the current accounting period are described in Note 3.

(c) *Basis of consolidation*

The financial statements include the accounts of the REIT and its subsidiaries. Subsidiaries are entities over which the REIT has control, where the REIT has control when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

(d) *Income producing properties*

Income producing properties fall within the definition of investment properties under IAS 40 – *Investment Properties* (“IAS 40”) and consist of commercial retail properties held to earn rental income and properties that are being constructed, developed, or redeveloped for future use as income producing properties.

Management must assess whether the acquisition of property through the purchase of a corporate vehicle, or directly, should be accounted for as an asset purchase or a business combination. Where the acquisition contains significant assets, liabilities or activities in addition to property and related mortgage debt, particularly where there is an integrated set of activities and assets, capable of being conducted and managed for the purpose of providing a return, lower costs or other economic benefits, the transaction is accounted for as a business combination. More specifically, consideration is made of the extent to which significant processes are acquired and, in particular, the extent of ancillary services provided. Where there are no such items the transaction is treated as an asset acquisition.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

Commercial retail properties, developments and redevelopments are measured initially at cost for transactions accounted for as asset acquisitions. Cost includes all amounts relating to the acquisition, including transaction costs (except transaction costs related to a business combination), improvement of the properties and market interest rate adjustments on assumed debt. All costs associated with upgrading and extending the economic life of the existing facilities, other than ordinary repairs and maintenance, are capitalized to income producing properties. Costs that are directly attributable to income producing properties under development or redevelopment are capitalized. These costs include direct development costs, realty taxes and other costs directly attributable to the development.

Subsequent to initial recognition, income producing properties are measured at fair value, determined based on valuations performed by third-party appraisers or available market evidence in accordance with IAS 40. Gains or losses arising from changes in the fair value of income producing properties are included in comprehensive income in the period in which they arise.

The carrying value of income producing properties includes straight-line rent receivable, tenant incentives and direct leasing costs, since these amounts are incorporated in the appraised values of real estate properties.

Income producing properties are reclassified to assets held for sale when criteria set out in IFRS 5 - *Non-Current Assets Held for Sale and Discontinued Operations* are met.

An income producing property is derecognized upon disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

(e) *Income Taxes*

The Income Tax Act (Canada) (the "Tax Act") levies tax on certain trusts and partnerships that are "specified investment flow-through entities" ("SIFTs") in defined circumstances with an exemption for entities that qualify as "real estate investment trusts". A trust that meets prescribed conditions to qualify as a "real estate investment trust" under the Tax Act is not subject to the tax on SIFTs. The REIT's management has determined that the REIT met all the prescribed conditions to qualify as a "real estate investment trust" and as a mutual fund trust ("MFT") under the Tax Act throughout the year. The REIT intends to continue to operate in a manner so as to qualify as a "real estate investment trust" and as an MFT.

The REIT intends to distribute all of its taxable income to unitholders and to deduct such distributions for income tax purposes. Canadian income tax obligations relating to distributions of the REIT are the obligations of the unitholders. Accordingly, no provision has been made for Canadian income taxes under Part I of the Tax Act.

(f) *Revenue recognition*

The REIT has retained substantially all of the risks and benefits of ownership of its income producing properties and therefore, accounts for leases with its tenants as operating leases. Revenue recognition under a lease commences when the tenant has a right to use the leased assets. Generally, this occurs on the lease inception date or, when the REIT is required to make additions to the property in the form of tenant improvements which enhances the value of the property, when substantially complete. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease. A straight-line rent receivable is included in the carrying amount of the income producing property and is recorded for the difference between the rental revenue recorded and the contractual amount received. Deducted from revenues are the amortization of tenant incentives and direct leasing costs.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

Rental revenue also includes percentage participating rents and recoveries of operating expenses, including realty taxes. Percentage participating rents are recognized when tenants' specified sales targets have been met. Operating expense recoveries are recognized in the period that recoverable costs are chargeable to tenants.

(g) *Financial instruments*

(i) Classification and measurement:

Financial assets are classified and measured based on three categories: amortized cost, fair value through other comprehensive income (FVOCI), and fair value through profit and loss (FVTPL). Financial liabilities are classified and measured on two categories: amortized cost or FVTPL. Derivatives embedded in contracts where the host is a financial asset in the scope of IFRS 9 *Financial Instruments* are not separated, but the hybrid financial instrument as a whole is assessed for classification.

Financial assets are not reclassified subsequent to their initial recognition, unless the REIT identifies changes in its business model in managing financial assets and would reassess the classification of financial assets.

All financial liabilities are measured subsequently at amortized cost using the effective interest method or at FVTPL.

The following summarizes the classification and measurement of financial assets and liabilities:

Financial instrument	Classification under IFRS 9
Cash	Amortized cost
Accounts receivable	Amortized cost
Mortgages payable	Amortized cost
Accounts payable and other liabilities	Amortized cost
Fair value of interest rate swap contracts	FVTPL

(ii) Impairment:

An allowance for expected credit losses ("ECL") is recognized at each balance sheet date for all financial assets measured at amortized cost or those measured at fair value through other comprehensive income, except for investments in equity instruments. The ECL model requires considerable judgment, including consideration of how changes in economic factors affect ECLs, which are determined on a probability-weighted basis.

Impairment losses, if incurred, would be recorded as expenses in the consolidated statement of income and comprehensive income with the carrying amount of the financial asset or group of financial assets reduced through the use of impairment allowance accounts. In periods subsequent to the impairment where the impairment loss has decreased, and such decrease can be related objectively to conditions and changes in factors occurring after the impairment was initially recognized, the previously recognized impairment loss would be reversed through the consolidated statement of income and comprehensive income. The impairment reversal would be limited to the lesser of the decrease in impairment or the extent that the carrying amount of the financial asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized, after the reversal.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

(h) *Provisions*

Provisions are recognized when the REIT has a present obligation (legal or constructive) as a result of a past event, it is probable that the REIT will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

(i) *Critical judgment in applying accounting policies*

i. Income producing properties

The REIT's accounting policy relating to income producing properties is described in Note 2(d) above. In applying this policy, judgment is applied in determining the extent and frequency of utilizing independent, third-party appraisals to measure the fair value of the REIT's investment property. Judgment is also applied in determining whether certain costs are additions to the carrying amount of the property and, for property under development, identifying the point at which practical completion of the property occurs and identifying the directly attributable costs to be included in the carrying value of the development property. In addition, judgment is also applied to assess whether the acquisition of property through the purchase of a corporate vehicle or directly should be accounted for as an asset acquisition or a business combination.

ii. Leases

The REIT's policy for property rental revenue recognition is described in Note 2(f) above. Where the REIT is the lessor, the REIT makes judgments in determining whether certain leases, in particular leases to anchor tenants, are considered operating or finance leases. The REIT has determined that all of its leases are operating leases.

(j) *Key accounting estimates and assumptions*

The REIT makes estimates and assumptions that affect carrying amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amount of earnings for the year. Actual results could materially differ from estimates. The estimates and assumptions that are critical to the determination of the amounts reported in the financial statements relate to the following:

i. Income producing properties

The choice of valuation method to determine the fair value of the REIT's income producing properties and the critical estimates and assumptions underlying the fair value determination of its commercial retail properties are set out in Note 4. Significant estimates used in determining the fair value of the REIT's income producing properties includes capitalization rates and stabilized net operating income (which is influenced by inflation rates, vacancy rates, standard costs). A change to any one of these inputs could significantly alter the fair value of an income producing property.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

ii. Financial liabilities at FVTPL

The fair valuation of embedded derivatives employs pricing models. The models require estimates and assumptions to be made with regard to the models' inputs, such as, the underlying asset volatility and risk free rates. Changes in assumptions about these factors could affect the reported fair value of the financial liability. Fair values are most sensitive to change in asset volatility.

(k) Accounting standards implemented in 2018

(i) IFRS 15 Revenue Contracts with customers ("IFRS 15"):

In 2014, the IASB issued IFRS 15 replacing IAS 18 Revenue, IAS 11 Construction Contracts, and related interpretations. IFRS 15 provides a comprehensive framework for the recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the accounting standards on leases, insurance contracts and financial instruments. IFRS 15 is effective for annual periods beginning on or after January 1, 2018.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services.

This is achieved by applying the following five steps:

1. identify the contract with a customer;
2. identify the performance obligations in the contract;
3. determine the transaction price;
4. allocate the transaction price to the performance obligations in the contract; and
5. recognize revenue when (or as) the entity satisfies a performance obligation.

The adoption of IFRS 15 has not had any impact on the revenue recognition policies of the REIT.

(ii) IFRS 9 Financial Instruments ("IFRS 9"):

In 2014, the IASB issued IFRS 9, replacing IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"), and related interpretations. IFRS 9 includes revised guidance on the classification and measurement of financial assets, including impairment and a new general hedge accounting model. IFRS 9 became effective for annual periods beginning on or after January 1, 2018.

The REIT implemented the new requirements for classification and measurement, impairment and general hedging on January 1, 2018 by applying the requirements for classification and measurement, including impairment, retrospectively with no restatement of comparative periods. The REIT also applied related amendments to IFRS 7 *Financial Instruments: Disclosures* ("IFRS 7").

Classification and Measurement

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. Financial assets are classified and measured based on the three categories: amortized cost, fair value through other comprehensive income (FVOCI), and fair value through profit and loss (FVTPL). Financial liabilities are classified and measured on two categories: amortized cost or FVTPL. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are not separated, but the hybrid financial instrument as a whole is assessed for classification.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

Financial assets are not reclassified subsequent to their initial recognition, unless the REIT identifies changes in its business model in managing financial assets and would reassess the classification of financial assets.

The following table summarizes the classification impacts upon adoption of IFRS 9. The adoption of the new classification requirements under IFRS 9 did not result in significant changes in measurement or the carrying amount of financial assets and liabilities.

Financial instrument	Original classification under IAS 39	New classification under IFRS 9
Cash	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Mortgages payable	Other financial liabilities	Amortized cost
Accounts payable and other liabilities	Other financial liabilities	Amortized cost
Fair value of interest rate swap contracts	FVTPL	FVTPL

3. FUTURE ACCOUNTING POLICIES

From time to time, the International Accounting Standards Board (“IASB”) issues new accounting standards and revises existing accounting standards. The following standards, not yet effective as at the date of these consolidated financial statements and accordingly not applied to these consolidated financial statements, may have a future impact:

Leases

IFRS 16 – *Leases* (“IFRS 16”) is a new standard that sets out the principles for the recognition, measurement and disclosure of leases. This new standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. For lessors, IFRS 16 carries forward the lessor accounting requirements in IAS 17, with enhanced disclosure requirements that will provide information to the users of financial statements about a lessor's risk exposure, particularly to residual value risk. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, although earlier application is permitted for entities that apply IFRS 15. The REIT intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019.

The REIT is currently assessing the impact of IFRS 16 and intends to adopt the new standard on the required effective date.

PARTNERS REAL ESTATE INVESTMENT TRUST

Notes to the Consolidated Financial Statements

Years ended December 31, 2018 and 2017

4. INCOME PRODUCING PROPERTIES

As at	December 31, 2018	December 31, 2017
Balance, beginning of year	\$ 462,928,003	\$ 500,989,997
Property disposition at carrying value	(141,911,499)	(38,002,586)
Capital improvements (net of recoveries)	3,524,860	7,676,128
Expenditures on tenant incentives and direct leasing costs	537,348	1,748,646
Amortization of tenant incentives and direct leasing costs	(974,824)	(986,622)
Recognition of straight-line rent	(66,207)	(91,762)
Unrealized fair value losses	(43,622,681)	(8,405,798)
	280,415,000	462,928,003
Properties held for sale (Note 7)	(181,765,000)	-
Balance, end of year	\$ 98,650,000	\$ 462,928,003

Income producing properties, which are classified as investment properties under IFRS, are measured at fair value by management. Management obtains support for the carrying value through consideration of market indicators and by obtaining on a sample basis appraisals from qualified external valuation professionals ("Appraisers") in accordance with IAS 40 – *Investment Properties*. The Appraisers are independent valuation firms, not related to the REIT, that employ valuation professionals who are members of the Appraisal Institute of Canada and the Ordre des évaluateurs agréés du Québec, and who have appropriate qualifications and experience in the valuation of properties in the relevant locations.

For the year ended December 31, 2018 the fair value of the REIT's income producing property portfolio was determined either internally by the REIT using the Direct Capitalization methodology or by obtaining external appraisals.

During 2018, external appraisals were obtained for fifteen of the REIT's properties with an aggregate fair value of \$165.6 million, representing 59.0% of the fair value of the income producing property portfolio. During the year ended December 31, 2017, external appraisals were obtained for twelve of the REIT's properties with an aggregate fair value of \$190.8 million, representing 41.2% of the fair value of the income producing property portfolio as of that date. Properties acquired within the year are valued at the purchase price plus closing costs unless there is evidence of a significant change in the fair value of the property. The value of the remainder of the REIT's income producing property portfolio is determined internally by the REIT by applying significant new information obtained to adjust previous externally prepared appraisals.

The following table outlines the range and weighted average of the capitalization rates applied to the stabilized net operating income in estimating the fair value for the REIT's properties:

As at	December 31, 2018	December 31, 2017
Capitalization rates		
Maximum	12.64%	9.25%
Minimum	6.23%	5.75%
Weighted Average	7.31%	6.63%

At December 31, 2018, a 0.25% increase in capitalization rates for income producing properties would decrease fair value by \$9.5 million (December 31, 2017 - \$17.5 million) and a 0.25% decrease in capitalization rates would increase fair value by \$10.1 million (December 31, 2017 - \$18.9 million).

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The aggregate cost of tenant incentives and direct leasing costs included in income producing properties are recognized as a reduction of rental income over the lease term, on a straight-line basis. As at December 31, 2018, income producing properties included \$4.0 million (December 31, 2017 - \$4.9 million) of net straight-line rent receivables arising from the recognition of rental revenue on a straight-line basis over the lease term in accordance with IAS 17 – *Leases*.

Dispositions of income producing properties

On December 11, 2018, the REIT completed a sale of the Cornwall Square Shopping Centre in Cornwall, Ontario. The selling price of the property totaled \$8.4 million, excluding transaction costs. Using cash on hand and net proceeds from the disposition the \$12.6 million mortgage secured by the property with an interest rate of 6.20% was repaid. The property had a carrying value of \$8.4 million at the time of sale, resulting in a loss on disposition of \$0.7 million after closing costs of approximately \$0.7 million.

On October 24, 2018, the REIT completed the sale of nine properties in Western Canada for gross proceeds of \$94.7 million. A portion of the proceeds from the disposition were used to repay eight mortgages totaling \$56.6 million and bearing a weighted average interest rate of 3.88%. The properties had a carrying value of \$94.6 million at the time of sale resulting in a fair value loss of \$1.6 million after closing costs of approximately \$1.7 million.

On September 6, 2018, the REIT completed the sale of Mariner Square for \$39.0 million. A portion of the proceeds from the disposition were used to repay two mortgages, totaling \$25.1 million. The property had a carrying value of \$39.1 million at the time of sale, resulting in a loss on disposition of \$0.7 million after closing costs of approximately \$0.6 million.

On June 30, 2017 the REIT completed a sale of a retail power centre in Thunder Bay, Ontario. The selling price of the property totaled \$39.75 million, excluding transaction costs. A portion of the proceeds from the disposition were used to repay two mortgages secured by the property, totaling \$26.7 million and bearing a weighted average interest rate of 5.07%. The property had a carrying value of \$38.0 million at the time of sale, resulting in a gain on disposition of \$0.9 million after closing costs of approximately \$0.8 million.

5. OTHER ASSETS

The major components of other assets are as follows:

As at	December 31, 2018	December 31, 2017
Prepaid realty taxes and insurance	\$ 304,399	\$ 1,439,879
Restricted cash - amounts held in escrow	418,193	1,824,618
Prepaid expenses and other	1,081,658	1,087,303
Deferred financing costs on undrawn credit facility	-	32,257
	1,804,250	4,384,057
Other assets associated with properties available for sale	(945,873)	-
Balance, end of year	\$ 858,377	\$ 4,384,057

Cash is considered restricted when it is held in escrow as required under loan agreements and is only available for use for specific purposes. The permitted use of restricted cash is to lease up vacant space and fund certain future capital expenditures for the REIT's income producing property portfolio.

Prepaid expenses and other include general REIT expenses paid in advance and other deferred amounts.

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6. ACCOUNTS RECEIVABLE

As at	December 31, 2018	December 31, 2017
Rents receivable	\$ 341,354	\$ 395,334
Unbilled recoveries	573,383	554,392
Other receivables	2,709,760	396,354
	3,624,497	1,346,080
Allowance for doubtful accounts	(218,156)	(277,869)
	3,406,341	1,068,211
Accounts receivable associated with properties available for sale	(511,453)	-
Balance, end of year	\$ 2,894,888	\$ 1,068,211

The REIT records an allowance for doubtful accounts on tenant rent receivables on a tenant-by-tenant basis, using specific, known facts and circumstances that exist at the time of the analysis. See note 19 for the REIT's exposure to credit risk regarding its receivables, and precautions taken to mitigate these risks.

7. ASSETS HELD FOR SALE

As at December 31, 2018, the REIT classified twelve income producing properties as held for sale that met the criteria required under IFRS 5 *Non-current assets held for sale and discontinued operations*. The properties comprise the following:

Property Name	City and Province	Building Type
Selkirk – SDM	Selkirk, Manitoba	Free standing centre
Gatineau - SDM	Gatineau, Quebec	Free standing centre
Centre Commercial Chateauguay	Montreal, Quebec	Mixed-use Strip Centre
Centre le Village	Nun's Island, Quebec	Enclosed Mall
Plaza de L'Unite	Nun's Island, Quebec	Retail Strip Centre
Marcel-Laurin Shopping Centre	St. Laurent, Quebec	Retail Strip Centre
Mega Centre	Montreal, Quebec	Power Centre
Place Desormeaux	Longueuil, Quebec	Enclosed Mall
Saint-Remi Shopping Centre	St. Remi, Quebec	Retail Strip Centre
Repentigny Shopping Centre	Repentigny, Quebec	Mixed-use Strip Centre
Sorel Shopping Centre	Sorel, Quebec	Retail Strip Centre
Plaza des Seigneurs	Terrebonne, Quebec	Retail Strip Centre

The value of the properties are measured at fair market value as required under IAS 40 – *Investment Property*, which states that when an entity has previously measured an investment property at fair value, it is required to continue measuring the property at fair value until disposal.

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The components of the assets and associated liabilities held for sale are as follows:

As at	December 31, 2018
Assets	
Income producing properties	\$ 181,765,000
Other assets	945,873
Accounts receivable	511,453
Assets held for sale	183,222,326
Liabilities	
Mortgages payable	\$ 113,382,108
Accounts payable and other liabilities	2,760,136
Liabilities associated with assets held for sale	\$ 116,142,244

Subsequent to December 31, 2018, the purchaser of the eleven Quebec properties waived its due diligence condition, but completion of the sale remains subject to a number of closing conditions. The Quebec properties' carrying value and disposition price are \$178 million and this will result in net cash proceeds of approximately \$63 million, after payment of related mortgages and transaction expenses. The REIT anticipates closing the sale during April 2019.

8. MORTGAGES PAYABLE

As at	December 31, 2018	December 31, 2017
Mortgage principal	\$ 180,009,332	\$ 275,741,535
Unamortized above market interest rate adjustments	-	301,992
Unamortized commitment and other fees	(1,397,843)	(2,200,327)
	178,611,489	273,843,200
Mortgages associated with assets held for sale	(113,382,108)	-
	\$ 65,229,381	\$ 273,843,200
Non-current	\$ 45,735,092	\$ 228,515,582
Current	19,494,289	45,327,618
	65,229,381	273,843,200

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Scheduled repayments of mortgage principal are as follows:

	Principal instalments	Principal maturing	Total
2019	5,681,874	17,442,723	23,124,597
2020	4,727,484	22,797,138	27,524,622
2021	3,533,067	52,890,984	56,424,051
2022	2,403,752	16,016,156	18,419,908
2023	1,804,932	20,125,412	21,930,344
Thereafter	5,203,240	27,382,570	32,585,810
Contractual obligations	\$ 23,354,349	\$ 156,654,983	\$ 180,009,332

Mortgages payable are secured by the properties to which they relate with some having recourse to the REIT. The mortgages bear interest at effective rates ranging between 3.14% and 5.53% per annum (December 31, 2017 – 3.03% and 6.04%) and contractual rates ranging between 2.83% and 4.60% (December 31, 2017 – 2.83% and 6.70%). The REIT's weighted average effective interest rate is 3.99% per annum (December 31, 2017 – 4.10%). The total carrying value of the properties pledged as security is \$277.0 million (December 31, 2017 - \$457.9 million).

Included in the mortgages payable at December 31, 2018 are \$18.0 million in mortgages over two properties with an institutional lender (December 31, 2017 - \$81.7 million over seven properties), over which a significant Unitholder of the REIT (with over 20% of the outstanding units on March 18, 2018), has significant influence.

Interest rate swaps are in place to fix the interest rates for three mortgages payable for a notional amount of \$33.1 million between 3.70% and 4.60% until 2021. As at December 31, 2018, the fair value of the interest rate swap is a liability of \$0.2 million (December 31, 2017 – insignificant liability) and is included in accounts payable and accrued liabilities on the statement of financial position. For the year ended December 31, 2018, a fair value loss on the interest rate swaps of \$0.2 million was recorded on the statements of comprehensive income (2017 – fair value gain of \$0.4 million).

During the year ended December 31, 2018, the following mortgages were refinanced or repaid:

In January 2018, the REIT completed a \$13.0 million financing secured on a multi-tenant property in Montreal (Nun's Island), Quebec. The mortgage has a term of three years with an interest rate of 3.76% per annum and an amortization period of 25 years. This financing replaced a maturing mortgage with a principal balance of \$7.8 million and a contractual interest rate of 3.26%.

In March 2018, the REIT completed a \$21.5 million financing secured on a multi-tenant property in Longueuil, Quebec. The mortgage has a term of three years and has an imbedded swap arrangement to fix the interest rate at 4.56% per annum with an amortization period of 25 years. This financing replaced a maturing mortgage with a principal balance of \$21.5 million and a variable rate of interest of 5.45% per annum at the time of repayment.

In June 2018, the REIT completed a \$5.2 million financing secured by a multi-tenant property in Repentigny, Quebec. The mortgage has a term of five years with an interest rate of 4.13% per annum with an amortization period of 25 years. This financing replaced a maturing mortgage with a principal balance of \$4.9 million and a contractual interest rate of 3.34%.

In June 2018, the REIT completed a \$4.64 million bridge loan financing secured by a single tenant property in Winnipeg Manitoba. The REIT pays interest only for the term of six months with an interest rate of prime plus 3% (6.45% at the time of issuance). The financing replaced a mortgage originally set to mature in 2019 with a principal balance of \$1.3 million and a contractual interest rate of 6.70% at the time of maturity.

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In September 2018, with the proceeds from a disposed property in Campbell River, British Columbia, the REIT repaid the \$4.64 million bridge loan financing obtained in June 2018 and a \$20.4 million mortgage secured by the disposed property. The bridge loan carried a variable rate of prime plus 3% (6.70% at the time of repayment) and the mortgage secured by the disposed property carried an interest rate of 3.77%.

In September 2018, the REIT completed a \$1.85 million financing secured by a multi-tenant property in Timmins, Ontario. The mortgage has a term of two years with an interest rate of 4.05% per annum and a 25 year amortization period. This financing replaced a \$4.1 million maturing mortgage with a contractual interest rate of 6.00%.

In October 2018, with the proceeds from nine properties disposed in BC, Alberta and Manitoba, the REIT repaid a total of \$56.6 million over eight mortgages. The eight mortgages carried a weighted average interest rate of 3.88%

In December 2018 with the proceeds of disposition and excess cash on hand, the REIT repaid a \$12.6 million mortgage secured by the Cornwall Square property. The mortgage carried a variable rate of interest of 6.20% at the time of sale.

During the year ended December 31, 2017, the following mortgages were refinanced:

In March 2017, the REIT completed a \$2.6 million financing secured on a multi-tenant property in Terrebonne, Quebec. The mortgage has a term of five years with an interest rate of 3.113% per annum and an amortization period of 25 years. This financing replaced a maturing mortgage with a principal balance of \$1.8 million and a contractual interest rate of 3.50% per annum.

In March 2017, the REIT completed a \$4.4 million financing secured on a single tenant property in Gatineau, Quebec. The mortgage has a term of five years with an interest rate of 3.113% per annum and an amortization period of 22 years. This financing replaced a maturing mortgage with a principal balance of \$3.1 million and a contractual interest rate of 5.93%.

In April 2017, the REIT completed a \$3.0 million financing secured by two free-standing buildings in Edmonton, Alberta. The mortgage has a five-year term, a 25-year amortization period and an interest rate of 3.91%. The mortgage replaced a \$2.1 million mortgage, which carried an interest rate of 4.23%.

In May 2017, the REIT completed a \$13.0 million financing secured by an enclosed mall in Cornwall, Ontario. The mortgage has a three-year term, a 25-year amortization period and an interest rate of prime plus 2.25%, with an interest rate floor of 4.95%. The mortgage replaced a \$16.8 million mortgage, which carried an interest rate of prime plus 2.30%.

In May 2017, the REIT completed a \$27.0 million financing secured by a power centre located in Montreal, Quebec. The mortgage has a ten-year term, a 23-year amortization period and an interest rate of 3.564%. The mortgage replaced a \$23.7 million mortgage, which carried an interest rate of 5.327%.

In August 2017, the REIT completed a \$7.8 million financing secured by a retail strip centre located in Tecumseh, Ontario. The mortgage has a ten-year term, a 25-year amortization period and an interest rate of 3.867%. The mortgage replaced a \$5.1 million mortgage, which carried an interest rate of 4.604%.

In August 2017, the REIT completed a \$5.6 million financing secured by a retail strip centre located in Grand Bend, Ontario. The mortgage has a ten-year term, a 25-year amortization period and an interest rate of 3.898%. The mortgage replaced a \$3.3 million mortgage, which carried an interest rate of 5.118%.

In September 2017 and in December 2017, the REIT extended, for two additional three month periods, a \$21.7 million mortgage secured by an enclosed mall located in Longueuil, Quebec. The mortgage, which will now expire in April 2018. Subsequent to December 31, 2017 the REIT completed a \$21.5 million financing. This new mortgage completed March 23, 2018 has a three-year term, a 25-year amortization and an interest rate of 4.56%.

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In December 2017, the REIT completed a \$20.8 million financing secured by a retail strip centre located in Campbell River, British Columbia. The mortgage has a five-year term, a 25-year amortization period and an interest rate of 3.77%. The mortgage replaced two existing mortgage totaling \$16.3 million, a weighted average rate interest of 5.68%.

In December 2017, the REIT completed an \$11.5 million financing secured by a retail strip centre located in Grand Prairie, Alberta. The mortgage has a five-year term, a 25-year amortization period and an interest rate of 3.70%. The mortgage replaced two existing mortgage totaling \$9.8 million, a weighted average rate interest of 4.77%.

9. CONVERTIBLE DEBENTURES

In March 2013, the REIT issued \$23,000,000 of 5.5% unsecured subordinated convertible debentures (the "Series III Debentures") due March 31, 2018. On August 18, 2017, the REIT repaid 67% of the \$23.0 million Series III Debentures leaving a remaining balance of \$7.6 million outstanding. On January 17, 2018, the REIT repaid the final \$7.6 million of outstanding Series III Debentures plus accrued interest up to that date.

10. REVENUES FROM INCOME PRODUCING PROPERTIES

Revenues recognized from income producing properties for the year ended December 31, 2018 were \$48.8 million (2017 - \$52.9 million). The REIT leases commercial retail properties under operating leases generally with lease terms of between one and fifteen years, and in many cases with options to extend for successive five year periods. Included in revenues from income producing properties are recoveries from tenants for the year ended December 31, 2018 of \$16.7 million (2017 - \$17.6 million), which represents the recovery of common area maintenance costs, realty taxes, insurance, and other permissible recoverable costs. Deducted from revenues are the amortization of tenant incentives and direct leasing costs which for the year ended December 31, 2018 totaled \$1.0 million (2017 - \$1.0 million).

As at December 31, 2018, the REIT is entitled under its non-cancellable tenant operating leases to the following minimum future receipts:

	Within 12 months	2 to 5 years	Beyond 5 years
Operating lease revenue	\$ 23,845,138	\$ 72,034,920	\$ 37,756,584

11. FAIR VALUE GAINS (LOSSES)

The components of fair value gains (losses) are as follows:

	Year ended December 31,	
	2018	2017
Unrealized loss on income producing properties	\$ (43,622,681)	\$ (8,405,798)
Financial liabilities designated as FVTPL:		
Fair value gain (loss) on interest rate swaps	(201,944)	361,419
Fair value gain (loss) on deferred units	359,565	99,318
Total fair value gains (losses)	\$ (43,465,060)	\$ (7,945,061)

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12. INCOME PER UNIT

The table below presents the comprehensive income per unit and weighted average units outstanding calculations. Only dilutive elements have been included in the calculation of diluted per unit amounts.

	Year ended December 31,	
	2018	2017
Numerator		
Comprehensive income (loss) - basic and diluted	\$ (32,871,630)	\$ 5,280,177
Denominator		
Weighted average units outstanding - basic	45,977,087	39,435,646
Weighted average deferred units outstanding	315,243	124,083
Weighted average units outstanding - diluted	46,292,330	39,559,729
Income (loss) per unit - basic and diluted	\$ (0.71)	\$ 0.13

13. UNITHOLDERS' EQUITY

(a) Distributions

For the year ended December 31, 2018 the REIT made monthly cash distributions to unitholders in an amount of \$0.02083 per unit for January to November and \$0.015 per units for December, representing an annualized distribution of approximately \$0.24 per unit. The new monthly distribution of \$0.015, which follows the sale of the REIT's Western Canada portfolio, represents an annualized distribution of \$0.18 per unit. Also following the Western Portfolio sale the REIT paid a special distribution in the amount of \$0.87 per unit, approximately \$40 million, on November 9, 2018.

The amount of the REIT's cash distributions is determined in accordance with the guidelines established from time to time by the Trustees. The Trustees have discretion in declaring distributions. Pursuant to the REIT's Declaration of Trust, it is the intention of the Trustees to make distributions not less than the amount necessary to ensure that the REIT will not be liable to pay income taxes under Part I of the Income Tax Act. As at December 31, 2018, distributions accrued but not yet paid totaled \$0.7 million (December 31, 2017 - \$1.0 million).

(b) Distribution reinvestment and optional unit purchase plan

Prior to the November 2018 distribution payable in December 2018, the REIT had a Distribution Reinvestment and Optional Unit Purchase Plan (the "Plan") to enable Canadian resident unitholders to acquire additional units of the REIT. Effective for the November 2018 distribution, payable in December 2018, the Plan was terminated.

(c) Rights Offering

During May 2017, the REIT announced its intention to raise gross proceeds of \$35.4 million by issuing rights entitling unitholders to subscribe for one additional REIT unit for each three REIT units held as of the record date of June 7, 2017 and with payment of a subscription price of \$3.10 per REIT unit. The Rights Offering closed on July 19, 2017 and the maximum amount available of \$35.4 million, excluding issuance costs of \$0.2 million, was raised and the REIT issued 11,418,466 units.

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(d) Outstanding Units

As at	December 31, 2018		December 31, 2017	
	Units	Dollars	Units	Dollars
Units outstanding, beginning of year	45,831,979	\$ 256,857,960	33,983,594	\$ 220,237,798
Units issued:				
Rights offering	-	-	11,418,466	35,397,245
Distribution reinvestment plan	247,694	746,262	429,640	1,453,864
Optional unit purchase plan	-	-	279	1,000
Unit issue costs	-	(66,968)	-	(231,947)
	46,079,673	\$ 257,537,254	45,831,979	\$ 256,857,960

14. SUPPLEMENTAL CASH FLOW INFORMATION

The following table outlines supplemental cash flow information and the net change in the REIT's working capital:

	Year ended December 31,	
	2018	2017
Net change in working capital		
Net change in accounts receivable	\$ (2,338,130)	\$ 493,981
Net change in other assets	2,547,550	(1,448,364)
Net change in accounts payable and other liabilities	18,536	22,919
	\$ 227,956	\$ (931,464)

15. UNIT-BASED COMPENSATION PLAN

Deferred unit plan ("DUP")

Under the DUP, Trustees have the option to have their fees ("Trustees Fees") and Officers have the option to have annual bonus payments ("Officer Bonus") paid in deferred units of the REIT. The number of units will be equivalent to the cash value of the Trustees Fees or Officer Bonus elected by the Trustee or Officer, as applicable to be paid in units. The maximum number of units reserved for issuance under the DUP is 1% of the issued and outstanding units.

The issue price of the units under the DUP is the volume-weighted average price of the units for the last five trading days preceding the date of issuance. Additional units earned from distributions are issued based on the volume-weighted average price of the units for the last 20 trading days preceding the dividend payment date.

On December 10, 2018 the Board of Trustees cancelled the further issuance of deferred units being earned on Trustees Fees or Officer Bonus.

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The following presents information on the number of deferred units outstanding for the years ended at December 31, 2018 and 2017:

	December 31, 2018		December 31, 2017	
	Deferred Units	Dollars	Deferred Units	Dollars
Opening Balance	204,508	\$ 613,524	-	\$ -
Deferred units issued:				
Officer Bonus	66,225	200,000	81,744	300,000
Trustee Fees	163,435	474,540	116,550	394,226
Distributions on deferred units	26,658	77,775	9,830	31,508
Deferred units redeemed	(29,120)	(86,739)	(3,616)	(12,912)
Special distribution on deferred units	-	(351,084)	-	-
Fair value (gain) / loss on deferred units	-	(8,482)	-	(99,298)
	431,706	\$ 919,534	204,508	\$ 613,524

As at December 31, 2018, the liability related to the DUP was \$0.9 million (December 31, 2017 – \$0.6 million) and is included in accounts payable and other liabilities. The related expense in comprehensive income amounts to \$0.7 million for the year, (2017 - \$0.6 million).

16. INCOME TAXES

All of the REIT's corporate entities that consolidate into the REIT are nominee corporations and do not have any taxable income and therefore do not have any current income tax payable.

Partners REIT qualifies as a REIT for income tax purposes. The REIT intends to distribute all of its taxable income to unitholders and is entitled to deduct such distributions for income tax purposes. Accordingly, a provision for current income taxes payable is not required.

17. CAPITAL MANAGEMENT

The REIT actively manages both its debt capital⁽¹⁾ and its equity capital with the objectives of ensuring that the REIT can continue to grow and operate its business.

The real estate industry is capital intensive by nature. As a result, debt capital is a very important aspect in managing the business. In addition, financial leverage is used to enhance returns from purchased real estate. 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. As well, given the importance of debt capital to real estate entities, the REIT monitors its debt-to-gross book value ratio; a ratio that has become a common industry metric reviewed by analysts, unitholders and others within the industry. The REIT does not have a specific debt-to-gross book value threshold imposed on it in its Declaration of Trust.

The debt-to-gross book value ratio is measured as the REIT's total debt, including mortgages payable, corporate secured debt and debentures, divided by the gross book value of its assets. At December 31, 2018 the REIT's debt-to-gross book value ratio is 61.3% (December 31, 2017 – 59.4%), calculated as follows:

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As at	December 31, 2018	December 31, 2017
Debt⁽¹⁾		
Mortgage principal	\$ 180,009,332	\$ 275,741,535
Debenture principal	-	7,590,000
	\$ 180,009,332	\$ 283,331,535
Gross Book Value of Assets		
Book value of income producing properties (including those held for sale)	\$ 280,415,000	\$ 462,928,003
Book value of all other assets	8,279,169	12,084,917
Unamortized deferred financing fees	1,397,843	2,256,493
	\$ 290,092,012	\$ 477,269,413
Debt-to-Gross Book Value	62.1%	59.4%
Debt-to-Gross Book Value Excluding Debentures	62.1%	57.8%

⁽¹⁾ Debt capital refers to the principal portion of mortgages and debentures. This excludes deferred financing costs, the value of the debentures' convertible feature, and unamortized above market interest rate adjustments.

18. FAIR VALUES

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 fair values of the REIT's assets and liabilities were determined as follows:

(a) *Income producing properties*

The significant assumptions used to determine the fair value of investment properties are disclosed in Note 4.

(b) *Current assets and liabilities*

The carrying amounts for cash, accounts receivable, accounts payable and other liabilities and distributions payable approximate their fair values due to the short-term nature of these items.

(c) *Mortgages payable*

The fair value of secured debt at December 31, 2018 is based on discounted future cash flows, using interest rates ranging between 4.06% and 4.16% that reflect current market conditions for instruments of similar term and risk (December 31, 2017 – rates ranging between 3.88% and 4.24%).

(d) *Interest rate swaps*

The fair value of the interest rate swap contracts is calculated through discounting future expected cash flows using the appropriate BA rate swap curve adjusted for credit risk. Since the BA rate swap curve is an observable input, these financial instruments are considered Level 2.

(e) *Deferred units*

The fair value of deferred units is calculated using the five-day volume weighted average price of the REIT's units as of the date of reporting. Since the five-day volume weighted average price of the REIT's units is an observable input, these financial instruments are considered Level 2.

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Assets and liabilities measured at fair value in the statements of financial position, or where fair value disclosures are required, are classified based on a three-level hierarchy that reflects the significance of the inputs used when determining the fair value as follows:

- Level 1 - determined by reference to quoted prices in active markets for identical assets and liabilities;
- Level 2 - determined by using inputs other than the quoted prices that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - determined using inputs that are not based on observable market data.

The following table classifies assets and liabilities measured at fair value according to the three level hierarchy:

	December 31, 2018			December 31, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets measured at fair value:						
Income producing properties (incl. AFS)	\$ -	\$ -	\$ 280,415,000	\$ -	\$ -	\$ 462,928,003
Liabilities measured at fair value:						
Interest rate swaps	\$ -	\$ 202,032	\$ -	\$ -	\$ 88	\$ -
Deferred units	919,534	-	-	613,524	-	-
Liabilities for which fair values are disclosed:						
Mortgages payable	\$ -	\$ -	\$ 177,693,931	\$ -	\$ -	\$ 272,559,923

The fair value of assets and liabilities is performed on a quarterly basis using the valuation approaches noted above. During the year ended December 31, 2018 there were no transfers between the hierarchy levels.

19. RISK MANAGEMENT

In the normal course of business, the REIT is exposed to a number of risks that can materially affect its operating performance.

(a) Interest rate risk

The REIT is exposed to interest rate risk when funds are drawn under mortgages with floating interest rates. An increase in interest rates would increase the interest cost of these mortgages having an adverse effect on the REIT's comprehensive income and earnings per unit. At December 31, 2018 the REIT has no variable rate debt outstanding, and thus a 1% increase in the prime rate would have no impact on the REIT's annual interest expense (December 31, 2017 – \$0.3 million).

The REIT structures its fixed rate financing to stagger the maturities of its mortgages, thereby minimizing exposure to future interest rate fluctuations.

(b) Credit risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The REIT attempts to mitigate this risk by conducting credit assessments on new lessees, by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant. The maximum credit risk exposure at December 31, 2018 relates to the carrying value of the accounts receivable balance without taking into account any collateral held or other credit enhancements. Collateral held on certain leases are letters of credit or security deposits from the tenants.

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The following table presents an analysis of the age of tenant and other accounts receivable inclusive of amounts for which an allowance has been made.

As at	December 31, 2018	December 31, 2017
Tenant rents receivable		
Less than 30 days past billing date	30,535	244,038
30-60 days past billing date	17,279	59,499
61-90 days past billing date	2,280	1,880
Greater than 90 days past billing date	291,260	89,917
	341,354	395,334
Allowance for doubtful accounts - tenant	(93,156)	(152,869)
Other receivables	2,709,760	396,354
Allowance for doubtful accounts - other	(125,000)	(125,000)
Unbilled recoveries	573,383	554,392
	3,406,341	1,068,211
Accounts receivable associated with properties available for sale	(511,453)	-
	2,894,888	1,068,211

The following table presents a summary of the activity related to the REIT's allowance for doubtful accounts.

	December 31, 2018	December 31, 2017
Opening allowance for doubtful accounts	\$ 277,869	\$ 499,519
Change to allowance for doubtful accounts	43,451	(152,706)
Receivables written-off	(103,164)	(68,944)
Ending allowance for doubtful accounts	\$ 218,156	\$ 277,869

(c) *Liquidity risk*

The REIT's main liquidity requirements arise from on-going working capital requirements, debt servicing and repayment obligations, capital and leasing expenditures and distributions to unitholders, as such distributions may be approved by the Board of Trustees from time to time. All of these liquidity requirements, except for debt repayment obligations, are generally funded from cash flows from operations or from drawing on existing cash (\$3.1 million at December 31, 2018). Property debt repayment obligations are generally funded from obtaining debt re-financing on maturing mortgages.

During 2017 the REIT raised monies from financing and investing activities. On June 30, 2017 the REIT disposed of a property and raised net monies of \$12 million, on July 19, 2017 the REIT closed a Rights Offering that raised net proceeds of approximately \$35 million and resulted in the issuance of 11,418,466 REIT units. These net proceeds plus excess funds generated from the refinancing of maturing mortgages were used to repay the \$35 million Series II Debentures and \$15 million (67%) of the Series III Debentures plus accrued interest. During the year ended December 31, 2018, the REIT re-financed five mortgages generating net monies of \$5 million. These monies plus excess cash from December 31, 2017 were used to fully repay the \$8 million owing on the Series III Debentures.

During 2018 the REIT disposed of 11 properties and after disposition costs and repaying related mortgages generated net cash proceeds of approximately \$45 million. On October 24, 2018 the REIT announced that it would make a \$40 million special distribution to Unitholders and this was paid during November. After the dispositions, to reflect the smaller size of the REIT, the monthly distribution was reduced from the annualized rate of \$0.25 per unit to \$0.18 per unit.

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During 2017 and 2018 the REIT re-financed a total of \$121 million of maturing mortgages with new financings totalling \$142 million generating net monies of \$21 million. Based on these re-financings, the REIT expects that it will continue to be able to refinance property mortgages as they mature. Within the next 12 months the REIT has \$5.7 million in regularly scheduled principal repayments and two maturing mortgages totaling \$17.4 million.

The REIT manages its liquidity risk by:

- staggering the maturities of its maturing mortgages;
- planning capital spending around the availability of cash from operations or debt/equity funding; and
- reviewing the current liquidity position and forecasted cash flows in advance of the approval of the monthly distributions.

The REIT expects to generate sufficient cash from operations, financing(s) and disposition(s) activities that will provide sufficient funds for the REIT to meet its operational requirements, debt obligations, capital spending plans and the distribution to unitholders.

The REIT's financial condition and ability to meet its financial obligations would be adversely affected if it were unable to obtain additional financing either upon refinancing of its maturing obligations or from other financing sources, or if it were unable to meet its other liquidity requirements from on-going operating cash flows. Obtaining replacement capital through new debt financing, new equity raises, the sale of property(s), or any combination of these options will be essential to ensuring the REIT's continued financial flexibility.

The following table shows the contractual cash flows on all of the REIT's non-derivative financial liabilities:

	2019	2020	2021	2022	2023	Thereafter
Mortgages payable						
Interest	\$ 6,411,764	\$ 5,277,428	\$ 3,373,951	\$ 2,225,826	\$ 1,553,634	\$ 2,063,757
Principal payments	5,681,874	4,727,484	3,533,067	2,403,752	1,804,932	5,203,240
Balances due on maturity	17,442,723	22,797,138	52,890,984	16,016,156	20,125,412	27,382,570
Accounts and distributions payable and other liabilities	10,217,226	-	-	-	-	-
Total	\$ 39,753,586	\$ 32,802,050	\$ 59,798,002	\$ 20,645,734	\$ 23,483,978	\$ 34,649,567

(d) Concentration risk

The REIT has one major tenant with 7 locations in the REIT's portfolio providing \$3.1 million in annualized base rents, or 12.9% of the REIT's total annualized base rental revenue.

20. CONTINGENCIES AND COMMITMENTS

(a) Lease commitments – The REIT as lessee

The REIT as lessee is committed under operating leases to renewal periods or notice periods ranging from one year to five years for its three office locations in Barrie, Ontario, Toronto, Ontario and Victoria, British Columbia. In aggregate the leases represent a future commitment to the REIT of approximately \$0.7 million.

(b) Certified class action lawsuit

The REIT was notified that a Statement of Claim dated November 28, 2014 was issued in the Ontario Superior Court seeking certification of a class action on behalf of persons who held units of the REIT on April 1, 2014 against certain parties, including a former Officer and former Trustees of the REIT. The class action was certified on November 8, 2016. In October 2018, the REIT was notified that the parties to these legal proceedings signed minutes of settlement. The Ontario Superior Court of Justice has approved the minutes of settlement and has dismissed the proceedings and all claims made against the REIT's former Trustees and former Officer. The

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REIT was not a defendant in the class action.

21. TRUSTEE AND KEY MANAGEMENT COMPENSATION

The REIT's current independent trustees are Ian Ross, Allan Kimberley, Grant Anthony, Michael Woollcombe and Colin Chapin. Jane Domenico, the REIT's CEO, is also a trustee, but not independent as a result of her position with the REIT. During the year, the REIT's key management personnel include Jane Domenico, Chief Executive Officer and Derrick West, Chief Financial Officer. The remuneration of the REIT's key management personnel and trustees, including estimated amounts accrued and unpaid, was as follows:

	Year ended December 31,		Year ended December 31,	
	2018	2017	2018	2017
	Trustees		Key Management	
Compensation and benefits	\$ 53,610	53,411	\$ 960,176	\$ 1,169,150
Unit-based payments	\$ 474,575	394,589	\$ -	\$ 200,000
	\$ 528,185	\$ 448,000	\$ 960,176	\$ 1,369,150