LANESBOROUGH REIT

2012 ANNUAL REPORT

TABLE OF CONTENTS

Unitholder Returns

	Year Ended December 31, 2012 (Per unit)	Year Ended December 31, 2011 (Per unit)
Opening price	$0.42	$0.44
Closing price	$0.65	$0.42

Lanesborough Real Estate Investment Trust ("LREIT") units are listed on the Toronto Stock Exchange under the symbol "LRT.UN". The Series G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G". The 5 year 9% second mortgage bonds and two series of warrants are listed on the Toronto Stock Exchange under the symbols "LRT.NT.A", "LRT.WT" and "LRT.WT.A", respectively.

CHIEF EXECUTIVE OFFICER'S MESSAGE
2012 Annual Report

Total Operations

Overall, the comprehensive income of LREIT, including taxes, increased by $15,063,077 in 2012, compared to 2011.

Income from Operations

Continuing Operations

LREIT completed 2012 with income before taxes and discontinued operations of $601,545, compared to $2,382,662 in 2011, representing a decrease of $1,781,117. The decrease in income before taxes and discontinued operations mainly reflects a decrease in fair value gains, almost entirely offset by other factors, as follows:

- **Fair value gains/adjustments:** valuation gains/adjustments related to the fair market value of investment properties, including Parsons Landing, decreased by approximately $4.8 Million during 2012, compared to 2011. The decrease is mainly due to a $3.5 Million reduction in the fair value of Parsons Landing**.**

- **Insurance proceeds:** the income of LREIT for 2012 includes insurance proceeds of $925,355 related to the settlement of the claim for furniture and equipment losses in regard to the fire at Parsons Landing.

- **Forgiveness of debt:** the refinancing of mortgage loan debt in 2012 encompassed the forgiveness of $859,561 of debt by one of the lenders. The debt forgiveness is included in income.

- **Interest Income:** interest income increased by $641,462 during 2012. The increase in interest income mainly reflects interest earned on mortgage loans receivable.

- **Profit on sale of investment properties:** during 2012, the profit on sale of investment properties increased by $428,436, compared to 2011.

During 2012, the net operating income of LREIT decreased by $3,300,162; however, the decrease in net operating income was almost entirely offset by a $3,278,987 income recovery on Parsons Landing. The decrease in net operating income is mainly due to elimination of two investment properties in Fort McMurray from the revenue stream (Sienna (was divested) and Parsons Landing (destroyed by fire)) partially offset by an increase in net operating income from the Fort McMurray property portfolio.

Discontinued Operations

LREIT completed 2012 with net income from discontinued operations of $19.5 Million, representing an increase in income from discontinued operations of $16.8 Million, compared to 2011. The increase in income mainly reflects the profit on the sale of two seniors' housing complexes.

Cash Outflow from Operating Activities

During 2012, the cash outflow from operating activities, excluding working capital adjustments, amounted to $2.1 Million compared to a cash outflow of $2.6 Million during 2011, representing a decrease in the cash outflow of $0.5 Million. The decrease in the cash outflow, excluding working capital adjustments, mainly reflects insurance proceeds of $0.9 Million, a decrease in interest "paid" of $0.8 Million, an increase in interest received of $0.3 Million and a $0.3 Million decrease in the cash component of trust expense, largely offset by a $1.9 Million increase in income tax expense.

Including working capital adjustments, LREIT completed 2012 with a cash outflow from operating activities of $4.5 Million, compared to a cash outflow from operating activities of $1.6 Million during 2011.

Mortgage Financing

During 2012, LREIT obtained $105.6 Million of new mortgage loan financing. The new financing, combined with the release of $6.9 Million of mortgage loan escrow deposits, was primarily used to repay, or pay-down, existing mortgage loan debt. The new financing enabled LREIT to resolve a number of debt covenant issues and also served as a source of interim capital, pending the completion of property sales.

After considering the mortgage loan debt which was eliminated on property sales, "regular" payments of principal and the net decrease in mortgage loan debt from other financing activities, the total mortgage loan debt of LREIT decreased by $76.5 Million in 2012. The ratio of total debt to carrying value of all properties, excluding Parsons Landing, was 68% as at December 31, 2012, compared to 74% as at December 31, 2011

Mortgage Loan Covenants

During 2012, LREIT eliminated covenant breaches on $67.2 Million of mortgage loan debt, encumbered against eight properties, including seven properties in Fort McMurray, Alberta.

As of December 31, 2012, LREIT has $97.3 Million of mortgage loan debt with covenant breaches, comprised of four mortgage loans. It is anticipated that the covenant breach for three of the loans in Fort McMurray, all of which are over-holding past maturity with the consent of the lenders, will be eliminated in 2013 as a result of the refinancing of the loans.

The other mortgage loan in Fort McMurray has a maturity date of May 1, 2018 and was paid-down by $4,287,000 in 2012. The covenant breach is expected to be eliminated through modified loan terms.

Divestiture Program

In 2009, LREIT initiated a multi-year asset divestiture program with the objective of reducing debt levels.

During 2012, LREIT sold two senior housing complexes under its divestiture program, as well as one investment property and nine condominium units at Lakewood Townhomes. In total, the property sales in 2012 resulted in net sale proceeds of $21.9 Million. The net sale proceeds enabled LREIT to meet all of its ongoing funding commitments and substantially reduce the extent of its working capital deficiency. As of December 31, 2012, LREIT has a working capital deficiency of approximately $4.5 Million, representing a decrease of approximately $9.0 Million, compared to the working capital deficiency as of December 31, 2011.

Parsons Landing

The reconstruction of Parsons Landing is expected to be completed during the fourth quarter of 2013. Following an estimated lease-up period of 90 days, the property will be reclassified as a revenue-generating investment property. The loss of $3.5 Million that LREIT recognized in 2012 in regard to the reduction in the fair value of Parsons Landing is expected to be substantially recovered in 2013.

Qualification for REIT Exception

Management believes that LREIT will qualify for the REIT Exception for income tax purposes for 2013. As a result, LREIT will once again be in a position to reduce its taxable income from capital gains or otherwise through the payment of cash or "special" distributions. The reduction of taxable income will have a beneficial impact on the cash position of LREIT.

Outlook

In 2013, LREIT will continue to focus on the following initiatives:

- The refinancing of mortgage loan debt, including upward refinancing, in order to resolve the remaining covenant breaches and reduce interest rates. During the first two months of 2013, LREIT has replaced $20.4 Million of 12% mortgage loan financing with a new 5.0% first mortgage loan of $21 Million; collected $3.2 Million of mortgage loan receivables and reduced the outstanding balance of a 12% blanket second mortgage loan from $9.5 Million to $7.5 Million. In addition, a 7% first mortgage loan of $22.7 Million and a 12% second mortgage loan of $16.3 Million are expected to be replaced with a 3.7% five year first mortage loan of $42 Million by March 31, 2013.

- The sale of the two remaining seniors' housing complexes under the divestiture program and the sale of additional condominium units at Lakewood Townhomes.

- The improvement of net operating income by maximizing rental rates and controlling operating costs.

The net proceeds from upward refinancing and property sales, combined with the draws on the revolving loan commitment from 2668921 Manitoba Ltd., as required, are expected to be sufficient to enable LREIT to meet all of its ongoing funding obligations during 2013.

ARNI C. THORSTEINSON, CFA
Chief Executive Officer
March 13, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("MD&A") of Lanesborough Real Estate Investment Trust ("LREIT" or the "Trust") should be read in conjunction with the condensed consolidated financial statements ("Financial Statements") of LREIT for the year ended December 31, 2012 and with reference to the quarterly reports for 2012.

Forward-Looking Information

Certain statements contained in this MD&A and in certain documents incorporated by reference herein are "forward-looking statements" that reflect the expectations of management regarding the future growth, results of operations, performance, prospects and opportunities of LREIT. Readers are cautioned not to place undue reliance on forward-looking information. All statements other than statements of historical fact contained or incorporated by reference herein are forward-looking statements including, without limitation, statements regarding the timing and amount of distributions and the future financial position, business strategy, potential acquisitions, plans and objectives of LREIT. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in forward-looking statements including risks associated with breaches of covenants under financing agreements, risks associated with delayed acquisition of properties, debt financing, availability of cash for distributions, the taxation of trusts, public markets, real property ownership, liquidity, interest and financing risk, credit risk, concentration of portfolio in one market, future property acquisitions, dependence on natural resources industries, reliance on single or anchor tenants, availability of suitable investments, land leases, general uninsured losses, interest rate fluctuations, Unitholder liability, potential conflicts of interest, changes in legislation and investment eligibility, multi-family residential sector risk, environmental risks, other tax-related risk factors, supply risk, utility and property tax risk, government regulation, nature of Units, dilution, competition, general economic conditions, current economic conditions, relationship with the property manager, reliance on key personnel, reliance on Shelter Canadian Properties Limited ("Shelter Canadian") or its parent company 2668921 Manitoba Ltd. for interim funding and additional risks associated with debentures. Although the forward-looking statements contained or incorporated by reference herein are based upon what management believes to be reasonable assumptions, LREIT cannot assure investors that actual results will be consistent with these forward-looking statements.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. Forward-looking statements are made as of the date hereof, or such other date specified in such statements, and neither LREIT nor any other person assumes any obligation to update or revise such forward-looking statements to reflect new information, events or circumstances, except as expressly required by applicable securities law.

Purchase Price Information

All purchase prices set forth herein are disclosed prior to closing costs, other adjustments on closing and GST, where applicable.

Divestiture Program

During 2012, LREIT sold one investment property (Siena Apartments) and two seniors' housing complexes (Clarington Seniors' Residence and Riverside Terrace) under its divestiture program, as well as 9 condominium units at Lakewood Townhomes. The sale of Siena Apartments occurred on May 1, 2012. The sale of Clarington Seniors' Residence occurred on May 9, 2012 and the sale of Riverside Terrace occurred on December 6, 2012. Property sales in 2011 consisted of the sale of four condominium units at Lakewood Townhomes during the fourth quarter of the year.

FINANCIAL SUMMARY

	December 31		
	2012	2011	2010
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION			
Total assets	$ 481,552,578	$ 555,220,070	$ 547,829,176
Total long-term financial liabilities **(1)**	$ 323,026,417	$ 399,176,274	$ 402,006,221

	Year Ended December 31		
	2012	2011	2010
DISTRIBUTIONS			
Distributions paid in units	$ -	$ -	$ 8,814,286
Per unit	$ -	$ -	$ 0.49
KEY FINANCIAL PERFORMANCE INDICATORS (2)			
Operating Results			
Rentals from investment properties	$ 38,410,992	$ 41,852,726	$ 39,902,688
Net operating income *	$ 22,429,229	$ 25,729,391	$ 23,361,318
Income (loss), before taxes and discontinued operations *	$ 601,545	$ 2,382,662	$ (11,496,252)
Income (loss) and comprehensive income (loss)	$ 20,098,308	$ 5,035,231	$ (9,323,543)
Cash Flows			
Cash flow from operating activities	$ (4,538,612)	$ (1,566,188)	$ (1,565,119)
Funds from Operations (FFO) *	$ (6,927,383)	$ (6,993,506)	$ (10,333,671)
Adjusted Funds from Operations (AFFO) *	$ (9,997,160)	$ (8,483,052)	$ (9,670,113)
Distributable loss *	$ (5,091,215)	$ (5,002,715)	$ (5,652,477)
Per Unit			
Net operating income *			
- basic	$ 1.204	$ 1.394	$ 1.279
- diluted	$ 1.197	$ 1.391	$ 1.279
Income (loss), before taxes and discontinued operations*			
- basic	$ 0.032	$ 0.129	$ (0.629)
- diluted	$ 0.032	$ 0.129	$ (0.629)
Income (loss) and comprehensive income (loss)			
- basic	$ 1.079	$ 0.273	$ (0.510)
- diluted	$ 1.073	$ 0.272	$ (0.510)
Cash flow from operating activities			
- basic and diluted	$ (0.244)	$ (0.085)	$ (0.086)
Funds from Operations (FFO) *			
- basic and diluted	$ (0.372)	$ (0.379)	$ (0.566)
Adjusted Funds from Operations (AFFO) *			
- basic and diluted	$ (0.537)	$ (0.460)	$ (0.529)
Distributable loss *			
- basic and diluted	$ (0.273)	$ (0.271)	$ (0.309)

(1) Long-Term Financial Liabilities

Long-term financial liabilities consist of mortgage loans, a swap mortgage loan, debentures, defeased liability and mortgage bonds. The swap mortgage loan and mortgage bonds are included at face value.

(2) Non-IFRS Measurements

Items marked with an asterisk represent measurements which are not calculated or presented in accordance with International Financial Reporting Standards (IFRS) or which do not have a standardized meaning as prescribed by IFRS. The non-IFRS measurements may not be comparable to the measurements which are provided by other entities and should not be used as an alternative to the measurements which are determined in accordance with IFRS for purposes of assessing the performance of LREIT. LREIT believes, however, that the non-IFRS measurements are useful in supplementing the reader's understanding of the performance of the Trust. Details regarding the calculation of the non-IFRS measurements and a reconciliation to IFRS measurements, where applicable, are provided in the report.

EXECUTIVE SUMMARY

Core Business and Strategy

LREIT was established in order to create a portfolio of income-producing real estate investments. The core business activities of LREIT include investment, development, management and divestiture activities which are focused on maximizing the return on the real estate portfolio.

Prior to 2009, the primary business strategy of LREIT was to achieve growth through the acquisition of new properties. As of December 31, 2008, the real estate portfolio of LREIT consisted of 45 properties with an acquisition cost of approximately $597 Million, including 14 properties located in Fort McMurray, Alberta.

In 2009, the slow down of economic activity in Fort McMurray resulted in a significant reduction in the operating income and operating cash flows of LREIT. Recessionary influences, combined with the reduced operating cash flows, negatively impacted the overall financing capabilities of LREIT. In response, LREIT initiated a divestiture strategy in 2009 with the objective of generating $250 Million of gross proceeds from property sales in order to create funds for the pay down of mortgage loan and convertible debenture debt and to restore working capital. In October 2011, the divestiture program was expanded to include a condominium sales program for the Lakewood Townhomes property in Fort McMurray, Alberta.

As of December 31, 2012, 21 properties and 13 condominium units have been sold under the divestiture program for gross proceeds of $236 Million. The property portfolio of LREIT, as of December 31, 2012 consists of the remaining 24 properties, comprised of 22 investment properties (including the unsold condominium units at Lakewood Townhomes) and two seniors' housing complexes. The operating results for the two seniors' housing complexes are classified under discontinued operations.

A more detailed description of the operations and business strategy of LREIT is provided in the section of the MD&A titled, "Overview of Operations and Investment Strategy".

Qualification for REIT Exception

Management believes that LREIT will qualify for the REIT Exception for income tax purposes for 2013. As a result, LREIT will once again be in a position to reduce its taxable income from capital gains or otherwise through the payment of cash or "special" distributions. The reduction of taxable income will have a beneficial impact on the cash position of LREIT.

It will be necessary for LREIT to meet certain "tests" or conditions on an ongoing basis to retain its status as a Qualifying REIT.

Highlights of 2012 Results and Key Issues/Events

1. Background Information

The revenues and expenses for the seniors' housing complexes are disclosed under one line item titled "Income from Discontinued Operations" in the Condensed Consolidated Statements of Comprehensive Income ("Statement of Comprehensive Income"). The following analysis of revenues and expenses does not include the revenues and expenses of the seniors' housing complexes, including the gain on the sale of the Clarington Seniors' Residence and Riverside Terrace. After considering the sale of the Clarington Seniors' Residence and Riverside Terrace, the portfolio of seniors' housing complexes consists of two properties as of December 31, 2012.

The revenues and expenses disclosed in the analysis reflect the revenues and expenses of investment properties. There were not any changes to the number of properties in the property portfolio between January 1, 2011 and March 31, 2012. During the second quarter of 2012, LREIT sold one of the investment properties (Siena Apartments). Siena Apartments is disclosed as "Properties Sold" in the analyses throughout this report. In addition, 13 condominium units have been sold at the Lakewood Townhomes, comprised of the sale of four condominium units in the fourth quarter of 2011, and 9 condominium units in 2012. The fire at Parsons Landing also resulted in the temporary removal of 160 suites from rental operations at the beginning of February 2012. Parsons Landing is disclosed as an "Impaired Property" in the analyses throughout this report.

Cash flow from operating activities includes net operating income, less interest and trust expenses incurred, on a cash basis, from the investment properties and the seniors' housing complexes in discontinued operations.

2. Operations

	Year Ended December 31	
	2012	2011
Average occupancy level		
Fort McMurray	90%	82%
Other investment properties	97%	98%
Properties sold *	n/a	100%
Impaired Property **	n/a	86%
Total	92%	88%
Average rental rate		
Fort McMurray	$2,218	$2,195
Other investment properties	$1,067	$1,050
Properties sold *	n/a	$3,100
Impaired Property **	n/a	$2,303
Total	$1,709	$1,767

* The operating results of properties sold are analysed separately as the properties do not contribute to net operating income, subsequent to the closing date of sale. During 2012, the operating results for "Properties sold" pertain solely to Siena Apartments.

** As a result of a fire at the property, Parsons Landing has been segregated from operating properties and analysed separately under the caption "Impaired Property".

3. Income and Cash Flow

	Year Ended December 31		
	2012	2011	Increase (Decrease)
Net operating income			
Fort McMurray properties	$ 14,196,751	$ 12,946,676	$ 1,250,075
Other investment properties	7,433,023	7,883,809	(450,786)
Sub-total	21,629,774	20,830,485	799,289
Properties sold	699,411	2,455,450	(1,756,039)
Impaired Property	100,044	2,443,456	(2,343,412)
Total net operating income	22,429,229	25,729,391	(3,300,162)
Interest income	969,607	328,145	641,462
Forgiveness of debt	859,561	-	859,561
Interest expense	(33,261,469)	(33,162,993)	(98,476)
Trust expense	(2,323,979)	(2,611,313)	287,334
Income recovery on Parsons Landing	3,278,987	-	3,278,987
Insurance proceeds	925,355	-	925,355
Loss before the following	(7,122,709)	(9,716,770)	2,594,061
Profit on sale of investment properties	915,531	487,095	428,436
Fair value gains	10,308,723	11,612,337	(1,303,614)
Fair value adjustment of Parsons Landing	(3,500,000)	-	(3,500,000)
Income (loss) before taxes and discontinued operations	601,545	2,382,662	(1,781,117)
Current income tax expense	49,763	-	49,763
Deferred income tax expense	-	91,922	(91,922)
Income (loss) before discontinued operations	551,782	2,290,740	(1,738,958)
Income from discontinued operations	19,546,526	2,744,491	16,802,035
Income (loss) and comprehensive income (loss)	$ 20,098,308	$ 5,035,231	$ 15,063,077

	Year Ended December 31		
	2012	2011	Increase (Decrease)
Cash provided by (used in) operating activities	$ (4,538,612)	$ (1,566,188)	$ (2,972,424)

A summary of the key financial performance indicators of LREIT is provided in the "Financial Summary" section of the MD&A which precedes this "Executive Summary".

After excluding profit on property sales, fair value gains, fair value adjustment of Parsons Landing, discontinued operations and income taxes, the loss for 2012 decreased by $2.6 Million compared to 2011. The decrease in the loss is mainly due to income related to insurance proceeds of $0.9 Million, forgiveness of debt of $0.9 Million, a $0.6 Million increase in interest income.

The decrease in the combined total of net operating income and the income recovery on Parsons Landing is comprised of the income recovery on Parsons Landing of $3.3 Million, and a decrease in net operating income of $3.3 Million. The decrease in net operating income mainly reflects a decrease in net operating income at Parsons Landing (due to the fire) and Siena Apartments (due to the sale of the property), partially offset by an increase in the net operating income from the Fort McMurray property portfolio.

The forgiveness of debt occurred in conjunction with the refinancing of one of the mortgage loans. The insurance proceeds are in regard to the insurance claim for furniture and equipment of Parsons Landing.

An analysis of the increase in interest expense is provided below.

4. Fair Value Gains

In accordance with the IFRS accounting policies which were adopted by LREIT, the carrying value of investment properties is adjusted to reflect changes in fair value. During 2012, the fair value of investment properties increased by $10.3 Million

The increase in fair value is supported by appraisals for 14 properties that were obtained in 2012 and for 6 properties in 2011 with an aggregate fair value of $420.5 Million.

The increase in fair value is a non-cash component of income and does not affect the operating cash flow of the Trust.

5. Divestiture Program

	Properties Sold				
	2009	2010	2011	2012	Total
Number of properties sold	13	5	-	3	21
Number of condominium units sold	-	-	4	9	13
Gross proceeds	$ 90,392,000	$ 40,835,000	$ 1,927,100	$102,896,400	$ 236,050,500
Net proceeds at closing	$ 29,631,650	$ 17,563,501	$ 52,120	$ 21,927,121	$ 69,174,392
Vendor take-back financing received	6,300,000	3,790,650	-	-	10,090,650
Total proceeds	$ 35,931,650	$ 21,354,151	$ 52,120	$ 21,927,121	$ 79,265,042

LREIT is pursuing the sale of the seniors' housing complexes and/or other properties. During 2012, LREIT sold one investment property (Siena Apartments) and two seniors' housing complexes (the Clarington Seniors' Residence and Riverside Terrace) under its divestiture program. In October 2011, LREIT also commenced a condominium sales program at Lakewood Townhomes. As of December 31, 2012, 13 condominium units have been sold, including 9 units which were sold during 2012.

Profit on Sale of Investment Properties / Seniors' Housing Complexes

The profit on sale of investment properties / seniors' housing complexes represents the extent to which the net proceeds from the sale of the property exceeds the carrying value of the property as determined at the end of the preceding quarter. Investment properties are carried at fair market value. Seniors' housing complexes are carried at cost less accumulated amortization.

During 2012, the sale of the Siena Apartments resulted in a profit on sale of $0.3 Million and the sale of 9 condominium units resulted in a profit on sale of $0.6 Million. During 2011, the sale of the four condominium units resulted in a profit on sale of $0.5 Million.

During 2012, the sale of the two seniors' housing complexes resulted in a profit on sale of $15.0 Million.

6. Interest Expense - Investment Properties

	Year Ended December 31		
	2012	2011	Increase (Decrease)
Interest expense	$ 33,261,469	$ 33,162,993	$ 98,476

Key Variables

	December 31 2012	2011
Weighted average interest rate of total mortgage loan debt		
Investment properties	7.3 %	6.9 %
Seniors' housing complexes	5.0 %	7.3 %
Combined operations	7.2 %	6.9 %

Key Events Affecting Interest Expense

Total interest expense for the investment properties increased by $0.1 Million or 0.3% during 2012 compared to 2011. The increase is due to a $2.8 Million increase in interest expense related to mortgage loan prepayment charges, largely offset by a $1.8 Million decrease in interest expense related to the accretion of the debt component of debentures and a $1.0 Million decrease in "mortgage loan interest", including swap mortgage loans.

7. Discontinued Operations

During 2012, income from discontinued operations increased by $16.8 Million. The increase in income mainly reflects a combined profit on the sale of the Clarington Seniors' Residence and Riverside Terrace of $15.0 Million and a $3.5 Million increase in income tax recoveries, partially offset by an $0.9 Million decrease in net operating income and an $0.8 Million increase in interest expense.

The decrease in operating income is due to the sale of the Clarington Seniors' Residence in May 2012. As the sale of Riverside Terrace occurred in December 2012, operating income was not significantly affected by the sale. The increase in interest expense mainly reflects a $1.3 Million prepayment charge for the repayment of the Riverside Terrace first mortgage loan in the second quarter of 2012, partially offset by a $0.7 Million decrease in mortgage loan interest. The decrease in mortgage loan interest is mainly due to the elimination of the mortgage loan debt for the Clarington Seniors' Residence on the sale of the property in May 2012 and the retirement of the mortgage loan debt for Riverside Terrace in June 2012.

8. Financing

Mortgage Refinancing

During 2012, the mortgage loan debt of LREIT for both continuing and discontinued operations, and including swap mortgage loans, decreased by $76.5 Million, comprised of the following:

- regular payments of principal of $8.5 Million;
- the discharge of $65.1 Million of mortgage loan debt, including one swap mortgage loan, on the sale of three properties and nine condominium units. For analytical purposes, the debt discharged includes $27.9 Million of mortgage loan debt which was discharged on Riverside Terrace in June 2012 upon the receipt of $31.5 Million of additional financing, as the $31.5 Million of additional financing was subsequently discharged on the sale of Riverside Terrace in December 2012;
- a net decrease in mortgage loan debt of $4.5 Million resulting from the refinancing of the mortgage loans for the Lakewood Apartments, the downtown Fort McMurray properties and Colony Square. The net decrease represents the gross mortgage proceeds of $62 Million less mortgage loans discharged of $66.5 Million and reflects mortgage loan forgiveness of $0.9 Million;
- blanket mortgage loan financing of $12 Million;
- the prepayment or reduction of other mortgage loans and swap mortgage loans by $9.7 Million; and
- a reduction in the fair value component of swap mortgages of $1.8 Million.

Debt Maturities

With the exception of three mortgage loans in breach of debt service coverage requirements, all of the mortgage loans, for both investment properties and discontinued operations, which matured as of December 31, 2012 have been renewed or refinanced.

Debt Covenants

Three matured loans and one swap mortgage loan which are in breach of debt service coverage requirements have a total principal balance of $97.3 Million as of December 31, 2012 and are secured by five investment properties in Fort McMurray. The loans are repayable on demand. A forbearance extension to March 31, 2013, has been received for the three mortgage loans. These loans are expected to be refinanced in 2013. The covenant breach for the swap mortgage loan is expected to be eliminated through modified loan terms.

Debentures

As of December 31, 2012, the total face value of the Series G debentures is $24.96 Million. The debentures mature on February 28, 2015. The terms of the debentures also provide for the net proceeds from property sales to be applied against the principal amount of the debentures after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing to 2668921 Manitoba Ltd. under the revolving loan commitment.

Revolving Loan with 2668921 Manitoba Ltd.

LREIT utilizes a revolving loan commitment from 2668921 Manitoba Ltd.

During 2012, the interest rate on the loan has ranged from 9.75% to 12%. The maximum loan balance has ranged from $10 Million to $15 Million. The loan was renewed effective January 1, 2013 with a term expiring June 30, 2013, and a maximum amount of $12 Million.

During 2012, the total interest expense associated with the revolving loan commitment was $1.0 Million, compared to $1.2 Million during 2011.

As of the date of this report, the amount available under the revolving loan commitment was $4.7 Million.

9. Parsons Landing

In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. In June 2012, an agreement was reached with the builder under which the builder agreed to reconstruct the property and attend to the recovery of the insurance claims for property damage and revenue losses. The cost of reconstruction is expected to be fully covered under the insurance policy.

In June 2012, the purchase agreement was also amended to provide for an extension of the closing date to the date which is 90 days following the receipt of the occupancy permit for the last residential units to be reconstructed. In addition, under the terms of the amended agreement, insurance proceeds for revenue losses shall be for the benefit of the Trust.

As of December 31, 2012, the balance owing in regard to the acquisition of Parsons Landing, excluding accrued interest, is $45.72 Million.

Pending the reconstruction of Parsons Landing, the revenue of the property consists of accrued revenue in regard to the recovery of insurance proceeds for revenue losses. In accordance with IFRS, the insurance recoveries are recorded as a separate line item, titled, "Income recovery on Parsons Landing" and are not included in the calculation of net operating income. As a result there is not any revenue or operating income disclosed for the "Impaired Property" segment in 2012, aside from amounts which are attributable to the period before the fire occurred on February 5, 2012.

Income of LREIT for 2012 reflects the following in regard to Parsons Landing:

- A fair value adjustment (expense) of $3.5 Million reflecting the net reduction in value of the property as a result of the fire and the increase in fair value during reconstruction.
- An income recovery of $3.3 Million, for the period subsequent to the fire.
- Net operating income of $0.1 Million, for the period prior to the fire.
- Insurance proceeds of $0.9 Million.

10. Liquidity

	December 31 2012	December 31 2011
Unrestricted cash	$ 1,254,278	$ 1,170,619
Restricted cash	$ 7,801,248	$ 15,246,600
Working capital deficit	$ 4,462,801	$ 13,510,274

Key Events affecting liquidity

- During 2012, the net cash outflow from operating activities, regular repayments of principal on long-term debt and capital expenditures was $16.1 Million.
- Additional mortgage loan financing: After accounting for blanket mortgage loan financing ($12 Million) funds released from escrow ($6.9 Million); the net decrease in debt on refinancing the mortgage loans for Lakewood Apartments, the downtown Fort McMurray properties and Colony Square ($4.5 Million); and the prepayment of other mortgage and swap mortgage loans ($9.7 Million), the net proceeds of mortgage loan financing was $4.7 Million.
- Net proceeds from property sales: During 2012, LREIT sold one investment property, two seniors' housing complexes and nine condominium units resulting in net proceeds of $21.9 Million.
- Revolving loan: During 2012, net repayments of the revolving loan amounted to $7.0 Million, resulting in a loan balance of $5.0 Million as of December 31, 2012.
- Transaction costs: During 2012, expenditures on transaction costs associated with mortgage loan financing, amounted to $3.3 Million including $0.4 Million fees associated with mortgage loans with covenant breaches.

10. Liquidity (continued)

Liquidity summary

During 2012, the net proceeds from property sales and additional mortgage loan financing represented the main source of financing of LREIT, supplemented by periodic advances on the revolving loan. Interest-free advances from Shelter Canadian served as an interim source of funds in the first and third quarter of 2012 prior to the completion of the additional mortgage loan financing. In the first quarter of 2012, service fees and revolving loan interest were also partially deferred. The working capital deficiency of LREIT decreased from a balance of $13.5 Million as of December 31, 2011, to a balance of $4.5 Million as of December 31, 2012.

11. Risks and Uncertainties

The key risks and uncertainties affecting the current operations of LREIT include the following:

- as of the date of this report, the breach of covenants which remain on three mortgage loans and one swap mortgage loan encompasses $97.3 Million of mortgage loan debt;
- the working capital deficiency of the Trust;
- the concentration of properties in Fort McMurray and the resulting exposure to the Canadian oil sands industry;
- the impact of the timing of the increase in rental rates and the improvement in occupancy levels in Fort McMurray on the ability of the Trust to renew mortgage loan financing;
- ability of the Trust to complete additional property sales;
- ability of the Trust to complete additional renewal and/or upward refinancing; and
- reliance on Shelter Canadian and its parent 2668921 Manitoba Ltd. for interim funding.

As a result of the improvement in the occupancy level of the Fort McMurray portfolio, the extension of the Series G debentures in December 2011; the renewal or refinancing of mortgage loans and ongoing discussions with lenders for mortgages which have matured to the date of this report; and three property sales in 2012, management believes that LREIT has the financial capacity to continue operations for the next twelve months.

The financial capacity of LREIT to continue operations is dependent on stabilized cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio, the completion of property sales and/or upward refinancing, the continued ability of the Trust to repay, renew or refinance debt at maturity, renewal of the revolving loan commitment from 2668921 Manitoba Ltd., and the continued availability of interim funding from Shelter Canadian. In the event that the net proceeds from property sales are less than anticipated, or in the absence of additional upward refinancing and/or continued interim funding from Shelter Canadian and its parent company 2668921 Manitoba Ltd., prior to completion of additional property sales, LREIT may not have the ability to fund all of its debt obligations.

A more detailed description of key risks is provided in the "Risks and Uncertainties" section of this report and certain additional risks are described in the Annual Information Form.

CONTINUING OPERATIONS AND LIQUIDITY

The Financial Statements have been prepared using the going concern assumption.

The "going concern" basis of accounting is appropriate due to management's expectation of maintaining adequate liquidity, renewing maturing mortgage debt, meeting all mortgage principal and interest payment obligations, obtaining modified loan terms from lenders, the continued financial support of Shelter Canadian and its parent company 2668921 Manitoba Ltd., completing upward financing and reducing high interest debt and generating additional capital through the completion of property divestitures.

The main variables affecting the liquidity of LREIT for 2013 are as follows:

Funding Requirements

Working Capital Deficiency

As at December 31, 2012, LREIT has a working capital deficiency of approximately $4.5 Million, representing a decrease of approximately $9.0 Million, compared to the working capital deficiency as of December 31, 2011. The working capital deficiency consists primarily of the amount drawn on the revolving loan commitment from 2668921 Manitoba Ltd. of $5.0 Million, accounts payable and other liabilities of approximately $3.3 Million, less unrestricted cash of approximately $1.3 Million, rent and other receivables of approximately $1.3 Million and deposits, prepaids and other current assets of approximately $1.4 Million. The working capital calculation excludes the amount payable on Parsons Landing.

The decrease in the working capital deficiency from December 31, 2011 is mainly due to a decrease in the amount drawn on the revolving loan commitment from 2668921 Manitoba Ltd., the repayment of advances from Shelter Canadian in February 2012, and the payment of accounts payable.

Operating Activities

LREIT completed 2012 with a cash outflow from operating activities of approximately $4.5 Million, including working capital adjustments and approximately $2.1 Million, excluding working capital adjustments. The cash outflow from operating activities, excluding working capital adjustments, decreased by approximately $0.5 Million during 2012, compared to 2011.

The main components of cash flow from operating activities are net operating income on a cash basis, the income recovery on Parsons Landing, interest paid and working capital adjustments, from both investment properties and discontinued operations. The Fort McMurray property portfolio is the main contributor to net operating income. Interest paid includes interest payments for mortgage loan debt, including the revolving loan from 2668921 Manitoba Ltd., mortgage bonds and debentures.

In general terms and excluding working capital adjustments, LREIT is expected to achieve an improvement in its operating cash flow position during 2013, mainly due to a reduction in interest payments as a result of the refinancing of mortgage loan debt at lower interest rates.

Ongoing Funding Commitments

The ongoing funding commitments of LREIT include regular payments of debt, transaction costs for debt financing, capital improvements and the cash outflow from operating activities. After accounting for these outflows, LREIT completed 2012 with a cash shortfall of $19.3 Million, compared to a shortfall of $17.6 Million during 2011. Although the extent of the shortfall is expected to be lower in 2013, LREIT will continue to require other sources of cash to meet its ongoing funding commitments.

Series G Debentures

The 9.5% Series G debentures provide for the net proceeds from property sales to be applied to prepay the principal amount of the debentures after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing to 2668921 Manitoba Ltd. under the revolving loan commitment. The face value of the debentures is $24,961,000 as of December 31, 2012. The extent of debenture repayments, if any, is dependent on the extent of property sales, the amount of mortgage indebtedness related to the property sold and the balance of the revolving loan from 2668921 Manitoba Ltd.

Monthly Payments for Parsons Landing

As previously reported, a fire occurred at Parsons Landing in February 2012 which substantially destroyed one entire wing of the property and resulted in wide spread damage to the other two wings. During the period of reconstruction, the $300,000 monthly interest to the builder is expected to be funded from insurance proceeds. During 2012, the income recovery related to the insurance proceeds amounted to $3.3 Million, compared to a total interest payment of $3.3 Million for the period from February 2012 to December 2012.

A more detailed description of the status of the Parsons Landing property is presented in the "Parsons Landing" section of the MD&A.

Sources of Capital

Upward Refinancing of Mortgage Loans

Excluding regular payments of principal and mortgage loan debt discharged on the sale of properties, LREIT obtained additional mortgage loan financing in the net amount of approximately $1.4 Million in 2012. The additional financing was comprised of a new blanket mortgage loan ($12 Million), upward financing of Riverside Terrace ($3.6 Million), net of the prepayment of other mortgage and swap mortgage loans ($9.7 Million) and debt on refinancing the mortgage loans for Lakewood Apartments, the downtown Fort McMurray properties and Colony Square ($4.5 Million).

As a result of the above refinancing of Lakewood Apartments, the downtown Fort McMurray properties and Colony Square, $6.9 Million of funds were released from escrow.

LREIT expects to generate additional capital from the upward refinancing of mortgage loan debt in 2013. The opportunity to complete upward refinancings is limited, given the extent to which the existing property portfolio is leveraged, the mortgage loans with covenant breaches and the maximum 75% mortgage loan debt to appraised value restriction pursuant to the terms of the Declaration of Trust.

Property Sales

The sale of properties under the divestiture sale program of LREIT represents a primary source of capital. Although the timing and completion of property sales is subject to uncertainty the current expectations of management is that LREIT will complete the sale of the two remaining seniors' housing complexes in 2013. The condominium sales program for the Lakewood Townhomes is expected to be substantially completed in 2015.

There is no assurance that LREIT will sell properties proposed for sale on favourable terms or at all.

Revolving Loan Commitment

The Trust utilizes a revolving loan commitment from 2668921 Manitoba Ltd. (the parent company of Shelter Canadian). Effective January 1, 2013, the revolving loan commitment was renewed for a six month term to June 30, 2013 at an interest rate of 12% with a maximum balance of $12 Million. The amount available under the revolving loan commitment was $6.98 Million as of December 31, 2012 and $4.7 Million as of the date of this report.

Although additional draws on the revolving loan may be required in 2013, the general expectation of management is that there will be a net reduction in the balance of the revolving loan during 2013.

Credit Support From Shelter Canadian

Shelter Canadian has provided LREIT with interim funding on a periodic basis, pending the receipt of funds from financing activities. The interim funding has been provided in the form of interest-free advances and deferred service fees. As of December 31, 2011, interim funding consisted of interest-free advances of $1,183,000 and deferred service fees of $425,833. During the first quarter of 2012, all of the interim funding was fully repaid.

On July 31, 2012, an interest-free advance of $10.2 Million was received from Shelter Canadian which partially funded the repayment of a $22.3 Million first mortgage loan. The advance was repaid on August 2, 2012 from the proceeds of a new first mortgage financing of $20.4 Million.

Mortgage Loans Receivable

As of December 31, 2012, LREIT has mortgage loans receivable of $11.9 Million, comprised of four loans, including the $3.2 Million and $7.9 Million of vendor take-back mortgages associated with the sale of Riverside Terrace and the Clarington Seniors' Residence, respectively.

Subsequent to December 31, 2012, the $3.2 Million vendor take-back mortgage associated with the sale of Riverside Terrace was paid in full.

Other Factors

Other factors which could impact the liquidity of LREIT or affect property operations are:

*Mortgage Loans in Breach of Covenant Requirement*s

As of December 31, 2012, there are three mortgage loans and one swap mortgage loan with a total principal balance of $97.3 Million which are in breach of debt service coverage requirements. One of the loans is encumbered against the Lakewood Townhomes and three loans are encumbered against four other properties in Fort McMurray.

A forbearance extension to March 31, 2013 has been received for the three mortgage loans. Management believes that the covenant breaches will be satisfactorily resolved through extension of the forbearance agreements, debt repayment, modified loan terms and/or refinancing and in the case of Lakewood Townhomes, the completion of the condominium sales program.

Maturing Debt

With the exception of three mortgage loans which are in breach of debt service coverage requirements and are repayable on demand, all of the LREIT mortgage loans which have matured to date have been renewed or refinanced.

Summary

Management expects that the proceeds from upward refinancings, supplemented by draws on the revolving loan commitment and periodic credit support from Shelter Canadian, as required, will be sufficient to fund the projected funding commitments of LREIT for 2013. As of the date of this report, the amount available under the revolving loan is $4.7 Million.

In summary, management believes that the going concern assumption is appropriate and that LREIT will have sufficient liquidity to address its operating and debt obligations.

OVERVIEW OF OPERATIONS AND INVESTMENT STRATEGY

General

LREIT is an unincorporated closed-end real estate trust which was established on April 23, 2002, under the laws of the Province of Manitoba. LREIT became a publicly traded entity on August 30, 2002. The trust units of LREIT are listed on the Toronto Stock Exchange under the symbol "LRT.UN" and the Series G debentures are listed on the Toronto Stock Exchange under the symbol "LRT.DB.G". The second mortgage bonds and two series of warrants are listed on the Toronto Stock Exchange under the symbols "LRT.NT.A", "LRT.WT" and "LRT.WT.A", respectively.

The stated investment objectives of LREIT are to maximize unit values and provide stable cash distributions to the Unitholders by creating a large diversified portfolio of quality real estate investments through the ongoing acquisition and development of multi-unit residential properties.

The investment policies and operations of LREIT are subject to the overall control and direction of the Trustees, pursuant to the terms of the Declaration of Trust. Shelter Canadian provides asset management services to LREIT, pursuant to the terms of a Services Agreement. Shelter Canadian is also responsible for the property management function for the investment properties of LREIT, pursuant to the terms of a Property Management Agreement.

The core business activities of LREIT include acquisition, development, financing, management and divestiture activities pertaining to real estate properties in Canada. As of December 31, 2012, the real estate portfolio of LREIT consists of 19 multi-family residential properties, two commercial properties and one mixed residential/commercial property (the "investment properties"), as well as two seniors' housing complexes (the "discontinued operations") under "assets held for sale". Rental revenue from the leasing of the real estate properties is the primary source of revenue for LREIT.

Investment in Properties

Prior to 2009, the primary investment strategy of LREIT was to expand its income base through the acquisition of additional properties. In 2006 and 2007, LREIT focused its investment activities on the acquisition and development of new residential rental properties in Fort McMurray, Alberta due to the high level of economic growth and the favourable rate of return which was being generated by real estate investments in Fort McMurray prior to the economic downturn which began in 2008.

The investment properties which were acquired or developed by LREIT in Fort McMurray during 2007 and 2008 were primarily responsible for the significant growth in operating income and operating cash flow that was achieved by LREIT in 2008. In 2009 and 2010, the decline in economic conditions in Fort McMurray resulted in a reduction in the profitability of the Fort McMurray property portfolio and a decrease in the operating income of LREIT. As a result of an increase in activity in the oil sands industry, the occupancy levels and operating income from the Fort McMurray property portfolio have improved relative to previous years. During 2012 the average occupancy level for the Fort McMurray property portfolio was 90%, compared to 82% in 2011 and 68% in 2010. The improvement in the occupancy level in 2012 was affected by a decrease in occupancy at the downtown Fort McMurray properties (a major renovation project was in process, requiring that units be unoccupied) and at Lakewood Townhomes (a condominium sales program is underway, requiring that several units be unoccupied). Occupancy and rental revenue (excluding Lakewood Townhomes) are expected to increase as the demand for rental housing continues to grow.

The Financial Statements of LREIT provide segmented results for investment properties, with "Fort McMurray", "Other Investment Properties", "Properties Sold" and "Impaired Property" representing the segments. Operating results pertaining to general trust operations are disclosed separately in the segmented financial information.

Operations

LREIT seeks to maximize the operating income of its property portfolio through the implementation of financial management practices, operating procedures, responsive management services and proactive leasing strategies. LREIT also completes capital improvements and upgrades to its properties on an ongoing basis and undertakes major renovation programs or expansion projects at selected properties, as deemed appropriate.

An in-suite upgrade program for the six properties which are located in the downtown area of Fort McMurray was substantially completed in the third quarter of 2012. The total cost of the two year program was approximately $2.6 Million. Additional upgrades are planned for 2013.

Financing

The purchase price of new property acquisitions is typically funded from the proceeds of mortgage loans with the remaining balance funded from other investment capital. The investment capital of LREIT has been primarily raised through the completion of trust unit or convertible debenture offerings as well as public offerings of investment units, comprised of second mortgage bonds and trust unit purchase warrants. LREIT also utilizes the upward refinancing of mortgage loan debt, second mortgage loans and bridge financing as sources of investment capital. LREIT also utilizes a revolving loan commitment from 2668921 Manitoba Ltd. as an interim source of funds. Interest-free advances from Shelter Canadian have also periodically served as an interim funding source.

Pursuant to the terms of the Declaration of Trust, the total mortgage loan indebtedness of LREIT shall not exceed 75% of the appraised value of LREIT's total property portfolio. As of December 31, 2012, the total mortgage loan indebtedness of LREIT was less than 75% of the appraised value of LREIT's total property portfolio.

The ratio of net operating income to mortgage loan debt service costs is one of the measures utilized to assess the overall financial position of the Trust. During 2012, the mortgage loan debt service coverage ratio was 0.95, compared to 0.97 in 2011. The mortgage loan debt service coverage ratio excludes net operating income and debt service costs for Parsons Landing.

Divestiture Program

General

LREIT initiated a divestiture program in 2009 targeting the sale of assets, with estimated gross proceeds in excess of $250 Million. The objective of the divestiture program is to fund operating losses in Fort McMurray, to reduce total debt, including debenture debt and higher cost mortgage loan financing, and to enable LREIT to improve its working capital position. The sale of properties under the divestiture program is also required in order for LREIT to generate sufficient cash inflows to meet its ongoing funding obligations and restore working capital.

During 2009 and 2010, LREIT sold 18 properties at a combined gross selling price of $131.2 Million. The total net proceeds from sale were approximately $57.3 Million, after accounting for expenses, the repayment or assumption of debt and the subsequent receipt of take-back financing provided to purchasers. The 2010 Annual Report provides a report on the disbursement of divestiture program proceeds. LREIT did not complete any property sales under its divestiture program during 2011, aside from the sale of four condominium units at Lakewood Townhomes at a combined gross selling price of $1.9 Million.

During 2012, LREIT sold one investment property (Siena Apartments) and two seniors' housing complexes for total net proceeds of approximately $22.4 Million after repayment of mortgage loan debt, the assumption of vendor take-back mortgages in the amount of $10.7 Million and sales expenses. During 2012, 9 condominium units were also sold at Lakewood Townhomes at a combined gross selling price of $4.4 Million.

In 2013, LREIT is pursuing the sale of the two remaining seniors' housing complexes and/or other properties and continuing with the condominium sales program at Lakewood Townhomes.

Lakewood Townhomes Condominium Sales

The Lakewood complex is comprised of 64 townhomes and a 111 suite apartment building. In October, 2011, LREIT commenced a condominium sales program for the Lakewood Townhomes. After funding sale renovation costs, a contribution to the reserve fund of the condominium corporation and closing costs, net sales proceeds will be applied to reduce the first mortgage loan until such time that the first mortgage loan is repaid in full. The condominium sales program is expected to be substantially completed in 2015. The condominium sales program encompasses services and renovations fees payable to Shelter Canadian. See "Related Party Transactions".

As of December 31, 2012, 13 condominium units have been sold at a combined gross selling price of $6.3 Million.

Distributions

Due to the downturn in rental market conditions in Fort McMurray in 2008, LREIT suspended cash distributions in March 2009.

TAX CHANGES

LREIT qualifies as a closed-end mutual fund trust for income tax purposes. Prior to the enactment of legislation relating to the federal income taxation of publicly listed or traded trusts, LREIT was not subject to taxation on its income for a year to the extent that such income was distributed to the unitholders of LREIT, and those unitholders were, and would have been, subject to taxation as appropriate on such distributed income.

New legislation relating to the federal income taxation of specified investment flow-through trusts and partnerships (each a "SIFT") was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2012, are referred to as the "SIFT Rules". LREIT became a SIFT and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, certain distributions of income from a SIFT are no longer deductible in computing a SIFT's taxable income, and a SIFT is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception"). The REIT Exception contains a number of technical tests related to the property and revenue of a trust which must be monitored on an ongoing basis.

LREIT did not qualify for the REIT Exception, and therefore was subject to the SIFT Rules, in 2011 and 2012. The REIT Exception is applied on an annual basis and accordingly LREIT may be able to qualify for the REIT Exception in 2013 and subsequent years. Prior to the end of 2012, LREIT disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of the non-qualifying properties and other transactions, LREIT intends to qualify for the REIT Exception in 2013 and subsequent years. If LREIT qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to LREIT during that year, and LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, LREIT intends to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of LREIT. The determination as to whether LREIT qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that LREIT will qualify for the REIT Exception in 2013 and subsequent years. There can be no assurance that LREIT will qualify for the REIT Exception and that LREIT will not be subject to income taxes imposed by the SIFT Rules in 2013 or any subsequent year.

PARSONS LANDING

Possession of Property and Closing/Financing Agreement

On September 1, 2008, the Trust acquired possession of Parsons Landing for a total cost of $63,200,000. The permanent mortgage financing for the purchase of Parsons Landing is uncompleted and, as a result, the builder agreed to several extensions of the closing date under the purchase agreement, with a requirement for LREIT to make additional payments on the balance owing of $500,000 on May 12, 2009, $2 Million on February 17, 2012 and $3 Million, at closing. The builder also agreed to accept interest of $300,000 per month to the closing date and to forgive interest in excess of $300,000 per month, for the period from January 1, 2010 to the closing date, provided the acquisition is completed on the closing date, as extended. As of December 31, 2012, interest in excess of $300,000 per month amounted to $20,478,331.

On closing, the builder has agreed to provide a second mortgage, to a maximum amount of $12,000,000, for a 3 year term with interest at 8% for the first 30 months, 12% for the next 4 months and 24% thereafter. On closing, the builder has also agreed to provide a credit of $1,440,000 for furniture purchased by the Trust. The Trust may also elect, at any time, to surrender possession of Parsons Landing, along with the furniture, to the builder for the amount of $1. In addition, 2668921 Manitoba Ltd. agreed to maintain the revolving loan commitment with the Trust, in the amount of $8,800,000, until closing.

Destruction of Property by Fire

In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. In June 2012, an agreement was reached with the builder under which the builder agreed to reconstruct the property and attend to the recovery of the insurance claims for property damage and revenue losses. The cost of reconstruction is expected to be fully covered under the insurance policy. All damaged materials have been removed from the property and reconstruction work has commenced.

In June 2012, the purchase agreement was also amended to provide for an extension of the closing date to the date which is 90 days following the date on which an occupancy permit is received for the last residential units to be reconstructed. In addition, under the terms of the amended agreement, insurance proceeds for revenue losses shall be for the benefit of the Trust. During the period of reconstruction, the $300,000 monthly interest payment is expected to be funded from the insurance proceeds. In the event that insurance proceeds for revenue losses are less than the monthly interest payment, the shortfall shall be forgiven.

Impact on Financial Statements

The circumstances at Parsons Landing have impacted the Financial Statements of LREIT, as follows:

Payable on acquisition of Parsons Landing

As of December 31, 2012, the balance owing in regard to the acquisition of Parsons Landing, excluding accrued interest, is $45,720,000.

Fair value adjustment of Parsons Landing

Parsons Landing is classified as an investment property and is carried at fair value. The carrying value of the property at December 31, 2011 was $47,800,000.

During the first quarter of 2012 and in the absence of an agreement with the builder to reconstruct the property in a coordinated manner with the insurer, the investment property was written down from the carrying value of $47.8 Million at December 31, 2011 to $20.0 Million at March 31, 2012, which represented the fair value of the investment property after accounting for the loss in value resulting from the fire. The write-down of $27.8 Million was reflected as a loss in the first quarter financial statements under the line title, "Impairment of investment property".

Following the commitment by the builder to reconstruct the property and pursue recovery of all construction costs from the insurer, the estimated fair value of the property has been adjusted on a quarterly basis, as necessary, to reflect the estimated fair value at the date of completion of reconstruction, discounted for the estimated time period to closing. As of December 31, 2012, the estimated fair value was $44.3 Million representing an increase of $24.3 Million compared to the estimated fair value at March 31, 2012. The financial statements for 2012 reflect an impairment loss of $3.5 Million, representing the first quarter write down of $27.8 Million, net of the subsequent increases in fair value of $24.3 Million.

Insurance proceeds

An insurance policy for the furniture and equipment of the property was arranged by the Trust. As of December 31, 2012, the insurer has agreed to process a cash settlement of $925,355 in respect of the loss. Insurance proceeds of $925,355 are reflected in the financial statements of the Trust as income under the line title "Insurance proceeds".

Net operating income and interest expense

The Financial Statements reflect operating revenues and expenses of Parsons Landing from January 1, 2012 to the date of the fire on February 5, 2012, as well as the $300,000 monthly interest payment for January 2012.

Subsequent to February 5, 2012, the Financial Statements reflect accrued revenue in regard to the recovery of insurance proceeds for revenue losses and the monthly interest in the amount of $300,000. The accrued revenue in regard to insurance recoveries is recorded as a separate line item, "Income recovery on Parsons Landing" in the Statement of Comprehensive Income.

During 2012, the income recovery on Parsons Landing amounted to $3,278,987 compared to total monthly interest payments of $3.3 Million for the eleven month period from February 2012 to December 2012.

REAL ESTATE PORTFOLIO

Portfolio Summary - December 31, 2012

As of December 31, 2012, the property portfolio of LREIT consists of 24 rental properties, 22 of which are classified as "Investment properties" on the Statement of Financial Position of the Trust, including all of the unsold condominium units at Lakewood Townhomes. The remaining two properties consist of two seniors' housing complexes which are accounted for as "property and equipment" under "discontinued operations" and classified under "Assets classified as held for sale" on the Statement of Financial Position of the Trust. The entire portfolio of 24 properties has a total purchase price of approximately $413.9 Million and encompasses 2,244 suites and 139,243 square feet of leasable commercial area.

There were not any changes to the number of properties in the property portfolio between January 1, 2011 and March 31, 2012. During the second quarter of 2012, LREIT sold one of the investment properties (Siena Apartments) and one of the seniors' housing complexes (Clarington Seniors' Residence). In the fourth quarter, a second seniors' housing complex (Riverside Terrace) was also sold. In addition, 13 condominium units have been sold at the Lakewood Townhomes, comprised of the sale of four condominium units in the fourth quarter of 2011, and nine condominium units throughout 2012. The fire at Parsons Landing also resulted in the temporary removal of 160 suites from rental operations at the beginning of February 2012.

After accounting for the three property sales, the condominium sales program at Lakewood Townhomes and the fire at Parsons Landing, the number of "revenue generating" suites in the investment property portfolio (including all of the unsold condominium units at Lakewood Townhomes) decreased by 235 suites or 11.2% as of December 31, 2012, compared to December 31, 2011, while the number of "revenue generating" suites in discontinued operations decreased by 293 suites or 57.5%

A list of all of the properties in the LREIT investment portfolio is provided in Schedule I of this report.

Composition of Property Portfolio of Investment Properties

The 22 properties which are classified as investment properties consist of two commercial properties located in Burlington, Ontario and Airdrie, Alberta; one mixed-use residential and commercial property located in Winnipeg, Manitoba (Colony Square); 13 multi-family residential properties, including Parsons Landing, in Fort McMurray, Alberta; two multi-family properties in Yellowknife, Northwest Territories; and four multi-family properties located in Thompson, Manitoba, Brandon, Manitoba, Edson, Alberta and Peace River, Alberta.

As noted above, the properties in "discontinued operations" consist of the two seniors' housing complexes.

Properties Held for Sale/Discontinued Operations

Discontinued operations is a segment or distinct line of business which is being disposed of by the Trust under a coordinated plan, or a subsidiary which was acquired for resale purposes. As LREIT is actively pursuing the disposition of all of its seniors' housing complexes, the two seniors' housing complexes of LREIT are categorized as "discontinued operations". All of the assets and liabilities of properties in discontinued operations are reflected on the Statement of Financial Position as "Assets or liabilities classified as held for sale.

Income from properties in discontinued operations is disclosed separately on the Statement of Comprehensive Income of LREIT.

The cash inflows and outflows from properties in discontinued operations are included with the cash inflows and outflows from investment properties in the Statement of Cash Flows. The increase or decrease in cash held in discontinued operations is separately deducted or added to the Statement of Cash Flows.

In regard to the condominium sales program at Lakewood Townhomes, the rental revenues, operating costs and interest expense which are attributable to units sold, as well as the profit on sale of condominium units, are included with investment properties. The carrying value of investment properties are reduced on a proportional basis as units are sold and the net proceeds of sale are applied to reduce the first mortgage loan.

Analysis of Operating Results

In this report, the analysis of operating results excludes the operating results from discontinued operations, except where noted.

During 2012, the operating results for investment properties included the operating results for 23 investment properties for the period from January 1, 2012 to the sale date of the Siena Apartments on May 1, 2012. For the period from May 1, 2012 to December 31, 2012 the operating results for investment properties include the operating results for 22 investment properties. The sale of 13 condominium units at Lakewood Townhomes and the fire at Parsons Landing also affected the comparability of results for 2012 and 2011.

During 2011, the operating results for investment properties included the operating results for 23 investment properties. There were no investment properties classified as "held-for-sale" at the end of any of the quarterly reporting periods in 2011 or 2012.

Loans and Receivables

As of December 31, 2012, "Loans and receivables" consisted of a 12.5% second mortgage loan of $7.9 Million and an interest free mortgage loan of $275,000, due May 8, 2014 both of which pertain to the sale of Clarington Seniors' Residence on May 9, 2012, a 5.0% second mortgage loan of $3.2 Million which pertains to the sale of Riverside Terrace due December 6,2017, a 5% second mortgage loan of $500,000 arising from the sale of a property, due October 1, 2014 and a 12% $250,000 secured note receivable from a previous tenant which is due on demand.

Subsequent to December 31, 2012, the loan receivable of $3.2 Million pertaining to the sale of Riverside Terrace was paid in full.

CAPITAL STRUCTURE

Capital Structure - December 31, 2012

	December 31, 2012		December 31, 2011	
	Amount	%	Amount	%
Long-term debt	$ 88,235,737	21.7 %	$ 130,476,452	31.1 %
Current portion of long-term debt	217,988,812	53.5 %	208,484,873	49.7 %
Equity	100,829,954	24.8 %	80,510,813	19.2 %
Total capitalization	$ 407,054,503	100.0 %	$ 419,472,138	100.0 %

Long-term Debt

The long-term debt of LREIT includes mortgage loans, a swap mortgage loan, mortgage bonds, debenture debt, a defeased liability, mortgage guarantee fees payable and accrued interest payable, less unamortized transaction costs. On the Statement of Financial Position, the long-term debt of investment properties is separated into a current and non-current portion, while the long-term debt for the two seniors' housing complexes in discontinued operations is classified under "Liabilities classified as held for sale". The long-term debt for the seniors' housing complexes consists solely of mortgage loan debt, less unamortized transaction costs. The amount payable in regard to the acquisition of the Parsons Landing is included in trade and other payables.

Change in Total Long-term Debt

As disclosed in the following chart, the total long-term debt of LREIT as of December 31, 2012 decreased by $77,002,083 or 19.3% compared to the total long-term debt as of December 31, 2011. The decrease is mainly comprised of a $44,265,307 decrease in the mortgage loan debt of discontinued operations and a $25,053,520 decrease in the swap mortgage loan debt of investment properties.

	December 31 2012	December 31 2011	Increase (Decrease)
Long-term debt - Investment properties			
Secured long-term debt			
Mortgages loans	$ 247,654,245	$ 254,863,171	$ (7,208,926)
Swap mortgage loans	17,888,836	42,942,356	(25,053,520)
Mortgage bonds	14,458,831	14,058,307	400,524
Debentures	24,961,000	25,312,000	(351,000)
Defeased liability	2,701,511	2,755,325	(53,814)
Total secured long-term debt	307,664,423	339,931,159	(32,266,736)
Mortgage guarantee fees	133,864	-	133,864
Accrued interest payable	1,746,367	2,019,182	(272,815)
Unamortized transaction costs	(3,320,105)	(2,989,016)	(331,089)
Total long-term debt - Investment properties	306,224,549	338,961,325	(32,736,776)
Total long-term debt - Properties held for sale	15,278,462	59,543,769	(44,265,307)
Total long-term debt	$ 321,503,011	$ 398,505,094	$ (77,002,083)

Swap Mortgage Loans

The swap mortgage loan debt of LREIT decreased by $25,053,520 during 2012. As disclosed in the following chart, the decrease was mainly due to the discharge of one of the swap mortgage loans on the sale of the Siena Apartments and the partial repayment of the remaining loan.

	Year Ended December 31, 2012
Prepayment of swap mortgage loan on Millennium Village in Q3 (1)	$ (4,287,000)
Regular repayment of principal on swap mortgage loans	(798,226)
Decrease in the fair value of interest rate swaps	(1,027,801)
Discharge of swap mortgage loans on sale of Siena Apartments in Q2	(18,593,723)
Reduction of fair value of interest rate swaps on sale of property	(346,770)
Decrease in swap mortgage loans	(25,053,520)
Swap mortgage loans - December 31, 2011	42,942,356
Swap mortgage loan - December 31, 2012	$ 17,888,836

(1) The pay down of the swap mortgage loan for Millennium Village was funded by the upward refinancing of the six apartment properties in downtown Fort McMurray, the application of collateral deposits of $1.7 Million and working capital.

Prepayment of swap mortgage loan excludes the mortgage prepayment charge in the amount of $713,000 which was required in order to repay a lump-sum amount of $4,287,000.

Interest on the swap mortgage loans, as well as the change in the fair value of the interest rate swaps, are included in interest expense.

Mortgage Loans Payable

Change in Total Mortgage Loan Debt

As of December 31, 2012, the mortgage loan debt of LREIT decreased by $52,066,094 compared to the amount payable as of December 31, 2011. As disclosed in the following chart, the decrease is comprised of a decrease in the mortgage loan debt of $7,208,926 of investment properties and a decrease of $44,857,168 in the mortgage loan debt of the seniors' housing complexes in discontinued operations.

	Year Ended December 31, 2012		
	Total	Investment Properties	Seniors' Housing Complexes
Proceeds of mortgage loan financing	$ 105,475,000	$ 105,475,000	$ -
Repayment of mortgage loans on refinancing *	(93,476,681)	(65,569,644)	(27,907,037)
Forgiveness of debt	(859,561)	(859,561)	-
Net proceeds (repayment)	11,138,758	39,045,795	(27,907,037)
Regular repayment of principal on mortgage loans	(7,681,749)	(6,481,618)	(1,200,131)
Prepayment of mortgage loans	(5,435,000)	(4,435,000)	(1,000,000)
Reduction of mortgage loans on sale of properties	(50,088,103)	(35,338,103)	(14,750,000)
Decrease in mortgage loans	(52,066,094)	(7,208,926)	(44,857,168)
Total mortgage loans - December 31, 2011	315,015,968	254,863,171	60,152,797
Total mortgage loans - December 31, 2012	$ 262,949,874	$ 247,654,245	$ 15,295,629

* Repayment of mortgage loans on refinancing excludes the mortgage prepayment charges in the aggregate amount of $3,327,634 which were required in order to upward refinance the first mortgage loans of Riverside Terrace and Colony Square.

Investment Properties

Proceeds of Mortgage Loan Financing

Proceeds of mortgage loan financing of $105,475,000, as disclosed in the preceding chart, are comprised of additional mortgage loan financing of $12.0 Million obtained in February 2012, additional mortgage financing of $31.5 Million obtained in June 2012 and new mortgage loan financing in the total amount of $62.0 Million, comprised of new mortgage loan financing for Lakewood Apartments ($18.9 Million in Q2), Colony Square ($22.7 Million in Q3) and the six apartment properties in downtown Fort McMurray ($20.4 Million in Q3).

The proceeds of the $12.0 Million additional mortgage loan financing obtained in February 2012 were used to repay $1.5 Million of mortgage loan debt and for general working capital purposes. The proceeds of the $31.5 Million first mortgage loan were used to repay $27.9 Million of mortgage loan debt of Riverside Terrace and for general working capital purposes.

Repayment of Mortgage Loans on Refinancing

The repayment of mortgage loans on refinancing of $65,569,644 is comprised of the repayment of the previous mortgage loan for Lakewood Apartments, the downtown Fort McMurray properties and Colony Square. The repayment of the previous first mortgage loans for Colony Square encompassed prepayment charges of $2,038,548.

The repayment of the previous mortgage loan for Lakewood Apartments encompassed interest-free advances from Shelter Canadian in the amount of $2.4 Million, the application of restricted cash deposits of $2.2 Million and the forgiveness of debt in the amount of $0.9 Million. The repayment of the previous first mortgage loan for the downtown Fort McMurray properties was initially funded by the application of collateral deposits of $1.9 Million, a $10.1 Million advance under the revolving loan commitment from 2668921 Manitoba Ltd. and an interest-free advance from Shelter Canadian of $10.2 Million.

Reduction of Mortgage Loans on Sale of Properties

The reduction of mortgage loans on sale of properties is comprised of the discharge of the additional mortgage loan financing obtained in June 2012 of $31.2 Million and $4.1 Million of first mortgage loan debt discharged on condominium sales at Lakewood Townhomes. As previously disclosed, LREIT also discharged $18.6 Million of swap mortgage loan debt in the second quarter of 2012 on the sale of the Siena Apartments.

Discontinued Operations (Seniors' Housing Complexes)

The decrease in the mortgage loan debt for discontinued operations of approximately $44.9 Million, as disclosed in the preceding chart, consists of $27.91 Million of first and second mortgage loan debt which was discharged on Riverside Terrace in the second quarter of 2012 from $31.5 Million of new mortgage loan financing of investment properties; $14.75 Million of first mortgage loan debt which was discharged on the sale of the Clarington Seniors' Residence in the second quarter of 2012; a $1 Million one-time lump-sum prepayment of principal on the mortgage of Elgin Lodge; and regular repayments of principal of $1,200,131. The repayment of the mortgage debt for Riverside Terrace encompassed a prepayment charge of $1,289,083.

As of December 31, 2012, the total long-term debt in discontinued operations of $15,295,629 is comprised of first mortgage loans in respect of Chateau St. Michael's and Elgin Lodge.

Regular Repayments of Principal

During 2012, the cash outflow for regular repayments of mortgage loan principal for both investment properties and discontinued operations amounted to $7,681,749, compared to $7,825,763 for 2011.

Change in Debt, Excluding Properties Sold

Excluding debt transactions related to properties sold, the total long-term debt of LREIT decreased by $11.9 Million during 2012. Debt transactions related to properties sold includes the debt discharged on Clarington Seniors' Residence, Siena Apartments and Lakewood Townhomes and the debt transactions related to Riverside Terrace resulting in a further reduction of mortgage debt of $65.1 Million.

Composition of Mortgage Loan Debt - December 31, 2012

Summary of Mortgage Loans Payable

Year of Maturity (Note 1)	Weighted Average Interest Rate	Amount December 31, 2012	Percentage of Total
Investment Properties			
Fixed rate			
2013	4.4 %	$ 50,823,637	19.3 %
2014	5.0 %	9,012,773	3.4 %
2015	4.8 %	6,387,510	2.4 %
2016	5.0 %	11,553,909	4.4 %
2017	5.7 %	20,114,109	7.6 %
	4.8 %	97,891,938	37.1 %
Demand/variable rate	9.0 %	149,762,307	57.0 %
Principal amount		247,654,245	94.1 %
Discontinued Operations			
Demand/variable rate	5.0 %	15,295,629	5.9 %
Total		$ 262,949,874	100.0 %

(1) The year of maturity for the above noted schedule reflects the contractual obligation and does not reflect the requirement under IFRS to disclose loans with covenant breaches as payable on demand.

Mortgage Loan Debt Summary *

	2012 Q 4	2012 Q 3	2012 Q 2	2012 Q 1
Weighted average interest rate - Investment properties				
Fixed rate mortgage loans	4.8%	4.9%	5.0%	5.5%
Variable rate mortgage loans	9.0%	9.0%	8.9%	8.9%
Ratio of mortgage loans and swap mortgage loans, compared to carrying value of income-producing properties and discontinued operations *	68%	72%	73%	74%
Ratio of mortgage loans, swap mortgage loans, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	78%	81%	83%	82%

	2011 Q 4	2011 Q 3	2011 Q 2	2011 Q 1
Weighted average interest rate - Investment properties				
Fixed rate mortgage loans	5.7%	5.7%	6.0%	6.3%
Variable rate mortgage loans	8.5%	8.5%	8.6%	8.6%
Ratio of mortgage loans and swap mortgage loans, compared to carrying value of income-producing properties and discontinued operations *	74%	74%	73%	73%
Ratio of mortgage loans, swap mortgage loans, debentures (at face value) and mortgage bonds (at face value) compared to carrying value of income-producing properties and discontinued operations *	82%	83%	81%	82%

* Excludes amount payable on the acquisition of Parsons Landing and property value for Parsons Landing.

Weighted Average Interest Rates

Total

As of December 31, 2012, the weighted average interest rate of the mortgage loan debt for investment properties, discontinued operations and total mortgage loan debt is 7.3%, 5.0% and 7.2%, respectively, compared to 6.9%, 7.3% and 6.9% at December 31, 2011.

The weighted average interest rate for mortgage loan debt excludes the interest on acquisition payable on Parsons Landing. The interest payments on the acquisition payable represent an effective interest rate of 8%.

Discontinued Operations

The mortgage loan debt in discontinued operations has a weighted average interest rate of 5.0% as of December 31, 2012, compared to 7.3% as of December 31, 2011.

Investment Properties

The weighted average interest rates for investment properties are disclosed in the chart above.

Long-term Debt Maturities

With the exception of three mortgage loans which are in breach of debt service coverage requirements, all of the mortgage loans which matured as of December 31, 2012, for both investment properties and discontinued operations, have been renewed or refinanced.

A summary of the mortgage loan debt which matures during 2013 is provided in the "Capital Resources and Liquidity" section of this report.

Debt Covenant Breaches

As noted in the following chart, the three mortgage loans and one swap mortgage loan in breach of debt service coverage requirements have a total principal balance of $97,251,339 as of December 31, 2012 and are secured by five investment properties in Fort McMurray. The three mortgage loans have matured and are repayable on demand. A forbearance extension to March 31, 2013, has been received for the three matured mortgage loans.

Property	Covenant Requirement	Type of Mortgage	Mortgage Balance December 31, 2012	Maturity Date	
Mortgage Loans					
Fort McMurray					
Lakewood Townhomes	1.1	First	$ 11,430,588	July 18, 2010	(1)
Laird's Landing	1.2	First	52,770,092	October 1, 2011	(1)
Woodland Park, Nelson Ridge Estates	1.2	Second	16,636,627	October 31, 2010	(1)
Sub-total			80,837,307		
Swap mortgage loan					
Fort McMurray					
Millennium Village	(2)	First	16,414,032	May 1, 2018	
			$ 97,251,339		

(1) The loans are repayable on demand. A forbearance to March 31, 2013 has been provided by the lender.
(2) The covenant requirement is a 1.15 debt service coverage for all Trust operations.

During 2012, LREIT eliminated debt covenant breaches for three mortgage loans with a total principal balance of approximately $67.2 Million secured against eight properties. The debt covenant breaches were eliminated as a result of refinancing of the mortgage loans.

Management believes that the remaining covenant breaches will be satisfactorily resolved through extensions of the forbearance agreements, debt repayment, modified loan terms and/or refinancing.

The covenant breaches have not resulted in an acceleration of the repayment of the mortgage loans. Management does not anticipate that the lenders of the three mortgage loans and swap mortgage loan with covenant breaches will demand repayment of the mortgage loans, provided that scheduled monthly payments of principal and interest continue to be made. There can be no assurance, however, that the lenders will not accelerate payment of the mortgage loans. There are no cross-default covenants with respect to the other mortgage loans of the Trust other than mortgage loans on investment properties which secure the mortgage bonds.

As of December 31, 2012, the cash deposits on mortgage loans with covenant breaches amounted to $4,419,637.

Notwithstanding the fact that the Fort McMurray property portfolio achieved improved occupancy and operating income levels, the properties are not expected to reach income levels in 2013 which satisfy the existing covenant requirements. The first mortgage loan for the Lakewood Townhomes will be repaid from net proceeds of the condominium sales program.

During 2012, the total fees related to covenant breaches and forbearance agreements amounted to $356,716. The fees are initially recorded as transaction costs and amortized over the term of the applicable mortgage. During 2012, interest expense included amortization charges related to fees on covenant breaches and forbearance agreements of $385,642, compared to $977,210 during 2011.

Mortgage Bonds

The debt of LREIT includes mortgage bonds with a face value of $16,000,000. The mortgage bonds mature on December 23, 2015. Interest is payable semi-annually on May 31 and November 30 in each year, as well as on the maturity date. The bonds are secured by second mortgages registered against five investment properties. The mortgage bonds were issued pursuant to a public offering which had a final closing date of January 28, 2011. The first interest payment occurred on May 31, 2011.

In accordance with IFRS, the initial book value of the mortgage bonds was determined to be $13,699,574 based on the valuation methodology as established under IFRS. The carrying value of the mortgage bonds, as of December 31, 2012, of $13,425,127 is based on the initial book value plus accretion from the date of issue, net of unamortized transaction costs.

Warrants

The $16 Million mortgage bond offering included the issuance of 16,000,000 warrants. Each warrant entitles the holder to purchase one unit of LREIT at a price of $0.75 per unit at any time for a period of five years expiring December 23, 2015. During 2012, 175,000 units were issued on the exercise of warrants. As a result, 15,825,000 warrants remain outstanding.

LREIT also issued 6,780,000 warrants on March 9, 2010. The March 2010 warrants entitle the holder to purchase one unit of LREIT at a price of $1.00 per unit at any time for a period of five years expiring March 9, 2015. The 6,780,000 warrants have not been exercised and remain outstanding.

Debentures

The Declaration of Trust for LREIT does not impose any limitations on the amount of debenture debt which may be issued by the Trust.

Between August 2002 and December 2006, LREIT issued $69,543,000 of debentures in seven separate debenture offerings. With the exception of the Series G debentures, all of the debenture debt was repaid or converted to trust units.

The Series G convertible debentures were issued in December 2006 with a maturity date of December 31, 2011. In October 2011, the debenture holders approved an extension of the maturity date to February 28, 2015, with an increase in the interest rate to 9.5%. The restructured debentures are not convertible and interest or principal may not be paid through the issuance of trust units. The net proceeds from property sales after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing from time to time to 2668921 Manitoba Ltd. under the revolving loan commitment are to be used to redeem the Series G debentures on a pro rata basis.

The following is a summary of the Series G debenture debt.

Summary of Debenture Offering

Issue Date/Maturity Date	Series	Interest Rate	Amount Issued	Purchased and Cancelled Year Ended December 31 2012	Purchased and Cancelled As of December 31 2011	Net Amount Outstanding December 31 2012
Debentures						
Jan. 1/12/Feb. 28/15	G	9.5 %	$ 25,312,000	$ (351,000)	$ -	$ 24,961,000
Unamortized transaction costs						(613,105)
Book value, December 31, 2012						$ 24,347,895
Allocation of book value						
Debt component						$ 24,961,000
Unamortized transaction costs						(613,105)
December 31, 2012						$ 24,347,895

The carrying value of debentures is included in "Long-Term Debt" in the Statement of Financial Position of LREIT.

Trust Units

Units Outstanding

Authorized	unlimited
Issued as of,	
- December 31, 2011	17,988,339
- December 31, 2012	18,084,011
- March 13, 2013	18,091,011

As of December 31, 2012, LREIT had 18,084,011 units outstanding, representing an increase of 95,672 units or 0.5%, compared to the number of units outstanding as of December 31, 2011. The increase is comprised of 175,000 units which were issued on the exercise of warrants net of 79,328 units which were purchased and cancelled under the normal course issuer bid during the first quarter of 2012.

A summary of the Distribution Reinvestment Plan (DRIP), the Normal Course Issuer Bid (NCIB), Unit Option Plan and the Deferred Unit Plan are provided in the Annual Information Form (AIF). The AIF is available on the SEDAR website at www.sedar.com.

OTHER LIABILITIES

Acquisition Payable

The amount payable on the acquisition of Parsons Landing is included in "Trade and other payables" on the Statement of Financial Position of LREIT. Interest on "acquisition payable" is included in interest expense.

As of December 31, 2012, the amount payable in regard to the acquisition of Parsons Landing, excluding accrued interest, is $45,720,000.

During the period from March 1, 2009 to December 31, 2009, interest charges in excess of $300,000 per month totaling $5,841,638 were forgiven by the vendor in regard to the amount payable.

Interest charges for the period from January 1, 2010 to December 31, 2012, amounted to $31,278,331 of which $21,020,640 pertains to 2010 and 2011 and $10,257,691 pertains to 2012. Based on the actual events which have occurred since the initial payment deadline date, management expects that the entire amount of the "excess interest" which has accrued since January 1, 2010 will be forgiven and, as such, the financial statements for 2012 reflect the forgiveness of interest in the amount of $6,657,691. The recognition of the forgiveness of interest has resulted in the reduction of accrued interest payable by $20,478,331 for the 36 month period ended December 31, 2012. "Excess interest" represents the interest charges in excess of the $300,000 monthly interest payments which are required by the vendor. The interest of $300,000 per month represents an effective interest rate of 8%.

Revolving Loan Commitment

The liabilities of LREIT include a revolving loan commitment from 2668921 Manitoba Ltd., the parent company of Shelter Canadian. The revolving loan is included in "Trade and other payables" on the Statement of Financial Position of LREIT. Interest on the revolving loan is included in interest expense and categorized under "mortgage loan interest". Renewal and extension fees are included in transaction costs.

The amount and interest rate on the revolving loan is subject to periodic change at the end of each loan term. During 2012, the amount withdrawn on the revolving loan fluctuated from a high of $15 Million to a low of $3 Million. As of December 31, 2012, the amount withdrawn on the revolving loan was $5,025,000.

During 2012, the total interest expense associated with the revolving loan commitment was $963,422, compared to $1,230,505 during 2011. Renewal and extension fees were $225,000 in 2012, compared to $50,000 in 2011.

Effective January 1, 2013, the loan was renewed for a term expiring June 30, 2013, with a maximum loan amount of $12 Million at an interest rate of 12%, subject to a maximum interest and fee payment of $404,916 for the period from January 1 to June 30, 2013. The renewal encompassed a fee of $25,000.

Additional information regarding the revolving loan commitment is provided in the section of this report titled "Related Party Transactions".

ANALYSIS OF INCOME (LOSS)

Overall Results

Analysis of Income (Loss)

	Year Ended December 31		Increase (Decrease)	
	2012	2011	Amount	%
Rentals from investment properties	$ 38,410,992	$ 41,852,726	$ (3,441,734)	(8.2)%
Property operating costs	15,981,763	16,123,335	141,572	0.9 %
Net operating income	22,429,229	25,729,391	(3,300,162)	(12.8)%
Interest income	969,607	328,145	641,462	195.5 %
Forgiveness of debt	859,561	-	859,561	- %
Interest expense	(33,261,469)	(33,162,993)	(98,476)	0.3 %
Trust expense	(2,323,979)	(2,611,313)	287,334	(11.0)%
Income recovery on Parsons Landing	3,278,987	-	3,278,987	- %
Insurance proceeds	925,355	-	925,355	- %
Loss before the following	(7,122,709)	(9,716,770)	2,594,061	26.7 %
Profit on sale of investment properties	915,531	487,095	428,436	88.0 %
Fair value gains	10,308,723	11,612,337	(1,303,614)	11.2 %
Fair value adjustment of Parsons Landing	(3,500,000)	-	(3,500,000)	- %
Income (loss) before taxes and discontinued operations	601,545	2,382,662	(1,781,117)	74.8 %
Current income tax expense	49,763	-	(49,763)	- %
Deferred income tax expense	-	91,922	91,922	(100.0)%
Income (loss) before discontinued operations	551,782	2,290,740	(1,738,958)	75.9 %
Income from discontinued operations	19,546,526	2,744,491	16,802,035	612.2 %
Income and comprehensive income	$ 20,098,308	$ 5,035,231	$ 15,063,077	(299.2)%

During 2012, the loss of LREIT, before profit on property sales, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations decreased by $2,594,061 compared to 2011. The decrease in the loss is mainly due to income related to insurance proceeds of $925,355, forgiveness of debt of $859,561 and a $641,462 increase in interest income.

After accounting for fair value gains, profit on property sales, fair value adjustment of Parsons Landing, income taxes and discontinued operations, LREIT completed 2012 with comprehensive income of $20,098,308 compared to $5,035,231 during 2011.

Investment Properties

The investment properties of LREIT are separated in four categories, as noted below.

Fort McMurray (Twelve properties)

Accounting for approximately 46% of the residential suites in the portfolio of investment properties, the twelve multi-residential buildings in the Fort McMurray property portfolio, excluding Parsons Landing, represent the most significant revenue component in LREIT's overall operations.

Other Investment Properties (Nine Properties)

The nine other investment properties consist of one mixed use residential/commercial property, two commercial properties, and six multi-family residential rental properties in locations throughout Western Canada.

Impaired Property (One Property)

Pending reconstruction of Parsons Landing, the revenue generating capacity of the property is impaired. As a result, and in accordance with IFRS, Parsons Landing has been segregated from operating properties and analysed separately under the caption "Impaired Property". Parsons Landing will continue to be classified as an Impaired Property for segmented reporting purposes until the completion of reconstruction and re-leasing of the building.

Pending the reconstruction of the property, the income of the property consists of accrued revenue in regard to the recovery of insurance proceeds for revenue losses.

In accordance with IFRS, the insurance recoveries are recorded as a separate line item, titled, "Income recovery on Parsons Landing" and are not included in the calculation of net operating income. As a result there is not any revenue or operating income disclosed for the "Impaired Property" segment in 2012, aside from amounts which are attributable to the period before the fire occurred on February 5, 2012.

In several instances throughout this report, the income recovery on Parsons Landing is combined with net operating income in order to derive an income amount for comparative purposes which includes all the income associated with Parsons Landing.

Properties Sold (One Property)

The operating results of properties sold are analysed separately as the properties do not contribute to the net operating income of the Trust, subsequent to the closing date of sale. The operating results for properties sold for the year ended December 31, 2012 pertain solely to the Siena Apartments.

An analysis of the average monthly rents and occupancy level for the investment properties is provided in the following sections of this report.

Discontinued Operations

At December 31, 2012, the property portfolio includes two seniors' housing complexes which are classified under discontinued operations (During 2012, two seniors' housing complexes were sold - Riverside Terrace on December 6, 2012 and the Clarington Seniors' Residence on May 9, 2012). The following analyses exclude the revenue and operating costs of the seniors' housing complexes.

Net Operating Income

Net operating income consists of rental revenue less property operating costs.

Rental Revenue

All of the rental revenue of LREIT is derived from the leasing of residential units or commercial space. Rental revenue includes revenue from all investment properties, including a portion of the rental revenue which is attributable to any investment properties which are sold during the year, including condominium units at Lakewood Townhomes.

Rental Revenue Results

Analysis of Total Rental Revenue

	Year Ended December 31					
			Increase (Decrease)		% of Total	
	2012	2011	Amount	%	2012	2011
Fort McMurray	$ 22,965,656	$ 21,068,980	$ 1,896,676	9 %	60 %	50 %
Other investment properties	14,254,048	14,084,247	169,801	1 %	37 %	34 %
Sub-total	37,219,704	35,153,227	2,066,477	6 %	97 %	84 %
Properties sold	796,861	2,672,453	(1,875,592)	(70)%	2 %	6 %
Impaired property	394,427	4,027,046	(3,632,619)	(90)%	1 %	10 %
Total	$ 38,410,992	$ 41,852,726	$ (3,441,734)	(8)%	100 %	100 %

As disclosed in the chart above, the total revenue from the investment properties of LREIT, excluding properties sold and the impaired property, increased by $2,066,477 during 2012, compared to 2011. The increase is comprised of an increase in revenue from investment properties in Fort McMurray of $1,896,676 and an increase in revenue from the other investment properties of $169,801.

The increase in revenue from the Fort McMurray property portfolio reflects an increase in the average occupancy level, as well as an increase in the average rental rate. As disclosed in the charts below, the average occupancy level for the Fort McMurray portfolio increased from 82% during 2011, to 90% in 2012, while the average monthly rental rate increased by $23 or 1.1%.

During 2012, revenue for "properties sold" decreased by $1,875,592 due to the sale of Siena Apartments effective May 1, 2012. Revenue from the "Impaired property" decreased by $3,632,619 as the property is under reconstruction following the fire in February 2012. As previously noted, the recovery of insurance proceeds for revenue losses is recorded as a separate income category after the calculation of net operating income.

Occupancy Level, by Quarter

	2012				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	92 %	90 %	87 %	88 %	90 %
Other investment properties	98 %	97 %	97 %	98 %	97 %
Properties sold	100 %	n/a	n/a	n/a	n/a
Impaired property	n/a	n/a	n/a	n/a	n/a
Total	95 %	92 %	91 %	92 %	92 %

	2011				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	64 %	79 %	94 %	93 %	82 %
Other investment properties	98 %	98 %	98 %	99 %	98 %
Properties sold	100 %	100 %	100 %	100 %	100 %
Impaired property	63 %	91 %	94 %	97 %	86 %
Total	75 %	87 %	95 %	95 %	88 %

The occupancy level represents the portion of potential revenue that was achieved.

Average Monthly Rents, by Quarter

	2012				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	$2,124	$2,191	$2,251	$2,293	$2,218
Other investment properties	$1,075	$1,069	$1,048	$1,076	$1,067
Properties sold	$3,100	n/a	n/a	n/a	n/a
Impaired property	n/a	n/a	n/a	n/a	n/a
Total	$1,704	$1,684	$1,704	$1,739	$1,709

	2011				
	Q1	Q2	Q3	Q4	12 Month Average
Fort McMurray	$2,260	$2,211	$2,180	$2,129	$2,195
Other investment properties	$1,034	$1,065	$1,050	$1,064	$1,050
Properties sold	$3,100	$3,100	$3,100	$3,100	$3,100
Impaired property	$2,370	$2,319	$2,282	$2,241	$2,303
Total	$1,790	$1,784	$1,759	$1,743	$1,767

Property Operating Costs

Analysis of Property Operating Costs

	Year Ended December 31		Increase (Decrease)	
	2012	2011	Amount	%
Fort McMurray	$ 8,768,905	$ 8,122,304	$ 646,601	8 %
Other investment properties	6,821,025	6,200,438	620,587	10 %
Sub-total	15,589,930	14,322,742	1,267,188	9 %
Properties sold	97,450	217,003	(119,553)	(55)%
Impaired property	294,383	1,583,590	(1,289,207)	(81)%
Total	$ 15,981,763	$16,123,335	$ (141,572)	(1)%

During 2012, property operating costs for the portfolio of investment properties, excluding properties sold and the impaired property, increased by $1,267,188 or 9%, compared to 2011. The increase is comprised of a $646,601 increase in the Fort McMurray portfolio and an increase of $620,587 in the operating costs of the other investment properties portfolio.

The increase in operating costs for the Fort McMurray portfolio mainly reflects an increase in maintenance costs associated with ongoing renovations. The increase in operating costs for the Other investment property portfolio reflects an increase in maintenance expense mostly associated with repairs to building exterior.

Summary of Net Operating Income and Operating Margin

Analysis of Net Operating Income

	Net Operating Income							
	Year Ended December 31		Increase (Decrease)		Percent of Total		Operating Margin	
	2012	2011	Amount	%	2012	2011	2012	2011
Fort McMurray	$ 14,196,751	$ 12,946,676	$ 1,250,075	10 %	63 %	50 %	62 %	61 %
Other investment properties	7,433,023	7,883,809	(450,786)	(6)%	33 %	31 %	52 %	56 %
Sub-total	21,629,774	20,830,485	799,289	4 %	96 %	81 %	58 %	59 %
Properties sold	699,411	2,455,450	(1,756,039)	(72)%	3 %	10 %	n/a	n/a
Impaired property	100,044	2,443,456	(2,343,412)	(96)%	- %	9 %	n/a	n/a
Total	$ 22,429,229	$ 25,729,391	$ (3,300,162)	(13)%	100 %	100 %	58 %	61 %

After considering the increase in rental revenue and the increase in property operating costs, as analysed in the preceding sections of this report, the net operating income for the portfolio of investment properties, excluding properties sold and the impaired property, increased by $799,289 or 4% during 2012, compared to 2011.

The increase in net operating income is comprised of an increase in net operating income from the Fort McMurray properties, partially offset by a decrease in net operating income from the Other investment properties. As disclosed in the chart above, the net operating income of the Fort McMurray portfolio increased by $1,250,075 during 2012, compared to 2011, while the net operating income of the Other investment properties portfolio decreased by $450,786.

Overall, the operating margin for the property portfolio, excluding properties sold and the impaired property, decreased from 59% during 2011, to 58% during 2012. The decrease in the overall operating margin reflects a decrease in the operating margin for the Other investment properties portfolio, partially offset by an increase in the operating margin for the Fort McMurray property portfolio.

The operating margin is a measurement of the relative profitability of the investment properties and represents the amount of rental income which is derived from rental revenues, on a percentage basis. The operating margin is calculated by dividing net operating income by rental revenue.

After accounting for the decrease in net operating income related to properties sold and the impaired property (Parsons Landing), net operating income decreased by $3,300,162 during 2012, compared to 2011. The decrease in net operating income was almost entirely offset by the income recovery for Parsons Landing. Specifically, after accounting for the income recovery on Parsons Landing of $3,278,987, the combined total of net operating income and income recovery on Parsons Landing decreased by $21,175 during 2012, compared to 2011.

The income recovery on Parsons Landing of $3,278,987 exceeded the decrease in net operating income of Parsons Landing by $935,575. The income recovery consists of the amount recovered under the insurance policy for revenue losses, less certain continuing operating costs such as property taxes and insurance which are deducted from the gross insurance recovery through an "occupancy fee". In comparison, net operating income consists of total actual revenues less total actual operating costs.

Interest Income

Interest income is comprised almost exclusively of interest income on mortgage loans receivable, defeasance assets and cash.

During 2012 interest income amounted to $969,607 compared to $328,145 during 2011. The increase in interest income mainly reflects an increase in interest income related to mortgage loans receivable.

Forgiveness of Debt

The refinancing of the first mortgage loan for the Lakewood Apartments in January 2012 encompassed the forgiveness of debt in the amount of $859,561. In accordance with IFRS, the entire amount of the debt forgiveness is recognized as income in 2012.

Interest Expense

Interest expense includes interest expense for investment properties and discontinued operations. On the Statement of Comprehensive Income, interest expense for investment properties is disclosed as a separate line item, while interest expense for discontinued operations is included in the line item "Income from discontinued operations". On the Consolidated Statement of Cash Flows, "interest expense" and "interest paid" includes the total amount of interest for both investment properties and discontinued operations.

As disclosed in the following chart, total interest expense amounted to $37,786,525 during 2012, of which $33,261,469 pertains to investment properties and $4,525,056 pertains to discontinued operations.

Total interest expense for investment properties increased by $98,476 or 0.3% during 2012, compared to 2011. The increase is due to a $2,751,548 increase in interest expense related to mortgage loan prepayment charges, largely offset by a $1,772,441 decrease in interest expense related to the accretion of the debt component of debentures and a $969,966 decrease in "mortgage loan interest", including swap mortgage loans.

Total interest expense for discontinued operations increased by $800,331 or 21% during 2012, compared to 2011. The increase is due to a $1,289,083 increase in interest expense related to mortgage loan prepayment charges and an increase of amortization of transaction costs of $192,928, largely offset by a $681,680 decrease in "mortgage loan interest".

Interest expense encompasses a number of "non-cash" expenses, including amortization charges for transaction costs, accretion and the change in fair value of interest rate swaps. The $898,807 increase in interest expense during 2012, compared to 2011, is comprised of a $2,600,514 increase in the cash component of interest expense, partially offset by a $1,701,707 decrease in the "non-cash" component of interest expense.

Interest expense on the revolving loan from 2668921 Manitoba Ltd. is included in mortgage loan interest.

Analysis of Interest Expense

	Year Ended December 31		Increase (Decrease)	
	2012	2011	Amount	%
Investment Properties				
Mortgage Loans				
Mortgage loan interest	$ 19,386,689	$ 19,468,784	$ (82,095)	- %
Swap mortgage loan interest	1,465,708	2,353,579	(887,871)	(38)%
Mortgage prepayment charges	2,751,548	-	2,751,548	- %
Amortization of transaction costs	2,412,014	2,169,067	242,947	11 %
Change in value of interest rate swaps	(1,027,800)	(745,198)	(282,602)	(38)%
Total - mortgage loans	24,988,159	23,246,232	1,741,927	7 %
Mortgage Bonds				
Mortgage bond interest	1,440,000	1,440,000	-	- %
Accretion of debt component	400,524	324,448	76,076	23 %
Amortization of transaction costs	235,975	179,247	56,728	32 %
Total - mortgage bonds	2,076,499	1,943,695	132,804	7 %
Debentures				
Interest on debentures	2,371,295	2,159,766	211,529	10 %
Accretion of debt component	-	1,772,441	(1,772,441)	(100)%
Amortization of transaction costs	225,516	440,859	(215,343)	(49)%
Total - debentures	2,596,811	4,373,066	(1,776,255)	(41)%
Acquisition Payable				
Interest on acquisition payable	3,600,000	3,600,000	-	- %
Total - acquisition payable	3,600,000	3,600,000	-	- %
Total interest expense - investment properties	33,261,469	33,162,993	98,476	- %
Discontinued Operations				
Mortgage Loans				
Mortgage loan interest	2,658,578	3,340,258	(681,680)	(20)%
Mortgage prepayment charge	1,289,083	-	1,289,083	- %
Amortization of transaction costs	577,395	384,467	192,928	(50)%
Total interest expense - discontinued operations	4,525,056	3,724,725	800,331	21 %
Total - interest expense	$ 37,786,525	$ 36,887,718	$ 898,807	2 %

Cash and Non-cash Component				
Non-cash component				
Accretion	$ 400,524	$ 2,096,889	$ (1,696,365)	(81)%
Amortization of transaction costs	3,450,900	3,173,640	277,260	9 %
Change in value of interest rate swaps	(1,027,800)	(745,198)	(282,602)	(38)%
Total non-cash component	2,823,624	4,525,331	(1,701,707)	(38)%
Cash component				
Interest	30,922,270	32,362,387	(1,440,117)	(4)%
Mortgage prepayment charges	4,040,631	-	4,040,631	- %
Total cash component	34,962,901	32,362,387	2,600,514	8 %
Total - interest expense	$ 37,786,525	$ 36,887,718	$ 898,807	2 %

Cash Component of Interest Expense

The cash component of interest expense consists of mortgage loan interest, including mortgage loan interest in discontinued operations, swap mortgage loan interest, mortgage prepayment charges, debenture interest, mortgage bond interest, and interest on the revolving loan.

During 2012, the total cash component of interest expense increased by $2,600,514 or 8%, compared to 2011. The increase reflects $4,040,631 of mortgage loan prepayment charges, partially offset by a decrease of $758,437 and $681,680 in the cash component of interest expense for investment properties and discontinued operations, respectively.

As a percentage of net operating income for both investment properties and discontinued operations and after including the income recovery on Parsons Landing, the cash component of interest on mortgage loans, swap mortgage loans and acquisition payable, increased from 89% during 2011 to 99% during 2012. The increase in the ratio is due to the mortgage prepayment charges which were incurred during 2012, partially offset by an increase in the combined total of net operating income and the income recovery on Parsons Landing.

If mortgage prepayment charges were removed from the cash component of interest expense, the interest-to-net-operating-income ratio would be 87% during 2012.

After including the cash component of interest on mortgage bonds and debentures, the interest-to-income ratio is 112% for 2012, compared to 100% for 2011. If mortgage prepayment charges were removed from the cash component of interest expense, the interest-to-income ratio would be 99% during 2012.

Mortgage Loan Interest

Investment Properties

Mortgage loan interest for investment properties decreased by $82,095 or 0.4% during 2012, compared to 2011, comprised of a decrease in interest expense on the revolving loan from 2668921 Manitoba Ltd. of $267,084 and a decrease in interest on bank line of credit of $221,482, partially offset by an increase in interest on mortgage loan debt of $406,471.

Discontinued Operations

Mortgage loan interest for discontinued operations decreased by $681,680 or 20% during 2012, compared to 2011. The decrease is mainly due to the elimination of the mortgage loan debt for the Clarington Seniors' Residence on the sale of the property in May 2012 and the retirement of the mortgage loan debt for Riverside Terrace in June 2012.

Swap Mortgage Loan Interest

Swap mortgage loan interest decreased by $887,871 during 2012, compared to 2011 as a result of the sale of Siena Apartments in May 2012 and a lump sum prepayment of $4,287,000 on the Millennium Village swap mortgage loan.

Mortgage Bond Interest

Interest on the mortgage bonds was equal to $1,440,000 in 2012 and in 2011.

Debenture Interest

During 2012, interest on debentures increased by $211,529, compared to 2011, due to the increase in the interest rate for the Series G debentures from 7.5% to 9.5%, effective January 1, 2012.

Interest on Acquisition Payable

Interest expense associated with the balance owing on Parsons Landing is reflected in "interest on acquisition payable". Interest on acquisition payable was equal to $3,600,000 for both 2012 and 2011 and reflects the assumption that interest in excess of this amount will be forgiven at closing.

Non-cash Component of Interest Expense

Summary

As indicated in the preceding chart, the non-cash component of interest expense decreased $1,701,707 during 2012, compared to 2011. The decrease is comprised of a decrease in accretion of $1,696,365 and a decrease in expense of $282,602 in regard to the change in fair value of interest rate swaps, partially offset by an increase in amortization of transaction costs of $277,260.

Accretion

For 2012, accretion only encompasses accretion on mortgage bonds of $400,524, where as in 2011, accretion encompasses accretion on mortgage bonds of $324,448 and accretion on the Series G debentures of $1,772,441.

Amortization of Transaction Costs

Transaction costs related to mortgage loans, mortgage bonds and debentures are capitalized and expensed through amortization charges. During 2012, amortization of transaction costs increased by $277,260, compared to 2011.

The increase in amortization of transaction costs is mainly attributable to the fact that amortization of transaction cost expense was comparatively high during 2012 due to fees associated with the refinancing of mortgage loan debt which was in breach of debt service covenants.

Amortization charges represent a "non-cash" expense and are excluded from the determination of cash flow from operating activities. The actual cash outlay in regard to transaction costs is included in the determination of cash flow from financing activities.

Change in Value of Interest Rate Swaps

As disclosed in the preceding chart, the variance between the change in value of interest rate swaps in 2012, compared to 2011, served to decrease interest expense by $282,602 during 2012.

During 2008, LREIT entered into interest rate swap arrangements whereby the interest rate on two floating rate mortgages were fixed for the five and ten year terms of the mortgages. The main purpose of the interest rate swap arrangement is to reduce the risk associated with floating interest rates. In accordance with IFRS, the swap mortgage loans are recorded at "fair value" on the Statement of Financial Position of the Trust. Changes in fair value are recorded to interest expense. Increases in the fair value of the interest rate swaps serve to increase interest expense, while decreases in fair value serve to decrease interest expense.

In very general terms, the fair value of the interest rate swaps is based on the difference between the net present value of projected payments under the fixed rate mortgages, compared to the net present value of projected payments under the floating rate mortgages. During 2012, the fair value of the interest rate swaps decreased by $1,374,571. The decrease reflects the sale of Siena Apartments and the assumption of the swap mortgage loan by the purchaser and the $4,287,000 lump sum prepayment on the Millennium Village swap mortgage loan in August 2012. During 2011, the fair value of the interest rate swaps decreased by $745,198.

As the decrease in value in 2012 was greater than the decrease in value in 2011, the change in value of the interest rate swaps resulted in a decrease in interest expense in 2012 of $282,602, compared to 2011.

Although the change in the fair value of the interest rate swaps has served to decrease interest expense during 2012, the change in value is a non-cash transaction which is excluded from the determination of cash flow from operating activities of the Trust. As a result of fluctuations in market interest rates, the fair value of the interest rate swaps may change significantly in the future, however, the change in value has no impact on cash outflows throughout the entire term of the swap agreements. The change in value provides an indication of the relative benefit of a fixed rate mortgage, compared to a variable rate mortgage, during a specified period of time.

Trust Expense

During 2012, trust expense decreased by $287,334, compared to 2011. The decrease is mainly due to a decrease in service fees, a decrease in professional fees and final closing costs for properties sold in 2010 that were included in the trust expense of the first quarter of 2011.

Profit on Sale of Investment Properties

The profit on sale of investment properties represents the extent to which the net proceeds from the sale of an investment property exceeds the carrying value of the property as determined at the end of the preceding year.

During 2012, LREIT sold one investment property which resulted in a profit on sale of $346,770. Nine units were also sold under the condominium sales program at the Lakewood Townhomes, resulting in a profit on sale of $568,761. During 2011, LREIT did not complete any property sales, aside from the sale of four condominium units at Lakewood Townhomes resulting in a profit on sale of $487,095.

Fair Value Gains

In 2012, the carrying value of investment properties increased by $13,215,617, comprised of a valuation gain of $10,308,723 and capital expenditures of $2,906,894.

The fair value of investment properties is based on a comprehensive valuation process.

Fair Value Adjustment of Parsons Landing

The fair value adjustment of Parsons Landing of $3.5 Million consists of the initial write-down of the carrying value of the property of $47.8 Million, net of subsequent increase in the carrying value of the property to $44.3 Million as of December 31, 2012.

Discontinued Operations

Income from discontinued operations includes the net operating income, interest expense and income tax for the seniors' housing complexes, as well as gains resulting from the sale of Clarington Seniors' Residence and Riverside Terrace. The sale of Clarington Seniors' Residence on May 9, 2012 resulted in a gain on sale of $1,904,697 and the sale of Riverside Terrace on December 6, 2012 resulted in a gain on sale of $13,129,614.

During 2012, LREIT generated income from discontinued operations of $19,546,526 compared to $2,744,491 during 2011, representing an increase of $16,802,035.

Analysis of Income from Discontinued Operations

	Year Ended December 31 2012	Year Ended December 31 2011	Increase (Decrease)
Rental income	$ 12,948,869	$ 15,371,667	$ (2,422,798)
Property operating costs	7,319,163	8,849,075	1,529,912
Net operating income	5,629,706	6,522,592	(892,886)
Interest expense	4,525,056	3,724,725	(800,331)
Profit on sale	15,034,311	-	(15,034,311)
Tax expense (recovery)			
Current	1,960,834	81,078	(1,879,756)
Deferred	(5,368,399)	(27,702)	5,340,697
Tax expense (recovery)	(3,407,565)	53,376	3,460,941
Income from discontinued operations	$ 19,546,526	$ 2,744,491	$ 16,802,035

The increase in income from discontinued operations during 2012 reflects a combined profit on the sale of Clarington Seniors' Residence and Riverside Terrace of $15,034,311, partially offset by an $892,886 decrease in net operating income and an $800,331 increase in interest expense. The decrease in operating income is mainly due to the sale of the Clarington Seniors' Residence in May 2012. As the sale of Riverside Terrace occurred in December 2012, operating income was not significantly affected by the sale. The increase in interest expense mainly reflects a $1,289,083 prepayment charge for the repayment of the Riverside Terrace first mortgage loan in the second quarter of 2012, partially offset by a decrease in mortgage loan interest. The decrease in mortgage loan interest is mainly due to the elimination of the mortgage loan debt for the Clarington Seniors' Residence on the sale of the property in May 2012 and the retirement of the mortgage loan debt for Riverside Terrace in June 2012.

Deferred Taxes

As previously stated, management believes that LREIT will qualify for the REIT excemption in 2013 and that LREIT will not record taxable income in 2013 and future years, as a result of the payment of distributions to Unitholders. As a result, deferred tax assets and liabilities relating to investment properites will not be recognized in future years.

The estimate of the deferred tax assets and liabilities is subject to periodic change. To the extent that the net deferred income tax position increases or decreases, there is a corresponding increase or decrease in the deferred tax expense or recovery of the Trust, with the increase or decrease having a direct impact on bottom-line results.

In determining a deferred tax asset, the Trust considers the likelihood of realizing the deferred tax asset and if the likelihood that a tax asset will not be realized is high, the deferred tax asset is not recorded.

At December 31, 2012, temporary differences between the carrying values and tax values of investment properties and mortgage bonds has created deferred tax liabilities of $1,306,711 and $504,840, respectively. The deferred tax liabilities are completely offset by deferred tax assets created by temporary differences between tax values and carrying values of transaction costs, interest rate swaps, and unused tax losses available for carry forward.

Comparison to Preceding Quarter

Analysis of Income (Loss)

	2012			2011	
	Q4	Q3	Increase (Decrease)	Q4	Increase (Decrease)
Rentals from investment properties	9,432,387	9,206,783	225,604	11,196,590	(1,764,203)
Property operating costs	4,137,920	3,851,511	286,409	4,013,791	(124,129)
Net operating income	5,294,467	5,355,272	(60,805)	7,182,799	(1,888,332)
Interest income	354,645	281,209	73,436	162,836	191,809
Interest expense	(8,532,653)	(10,196,949)	1,664,296	(7,709,989)	(822,664)
Trust expense	(751,957)	(407,263)	(344,694)	(560,688)	(191,269)
Income recovery on Parsons Landing	885,329	869,547	15,782	-	885,329
Insurance proceeds	525,355	400,000	125,355	-	525,355
Loss before the following	(2,224,814)	(3,698,184)	1,473,370	(925,042)	(1,299,772)
Profit (loss) on sale of investment properties	16,967	-	16,967	487,095	(470,128)
Fair value gains	1,329,884	38,614	1,291,270	1,709,960	(380,076)
Fair value adjustment of Parsons Landing	500,000	500,000	-	-	500,000
Income (loss) for the period before taxes and discontinued operations	(377,963)	(3,159,570)	2,781,607	1,272,013	(1,649,976)
Current income tax expense	49,763	-	49,763	-	49,763
Deferred income tax expense (recovery)	-	(181,339)	181,339	-	-
Income (loss) for the period before discontinued operations	(427,726)	(2,978,231)	2,550,505	1,272,013	(1,699,739)
Income from discontinued operations	17,014,084	598,502	16,415,582	333,267	16,680,817
Comprehensive income (loss)	$ 16,586,358	$ (2,379,729)	$ 18,966,087	$ 1,605,280	$ 14,981,078

Comparison to Preceding Quarter

During the fourth quarter of 2012, the loss of LREIT, before profit on sale of investment properties, fair value gains, fair value adjustment of Parsons Landing, income taxes and discontinued operations, decreased by $1,473,370 compared to the third quarter of 2012. The decrease in the loss mainly reflects a decrease in interest expense of $1,664,296, partially offset by an increase in Trust expense. The decrease in interest expense mainly reflects the fact that interest expense was comparatively high in the third quarter of 2012 due to the inclusion of $2.75 Million in mortgage prepayment charges, partially offset by a $233,604 increase in mortgage loan interest.

During the fourth quarter of 2012, fair value gains in regard to the carrying value of investment properties amounted to $1,329,884, compared to $38,614 during the third quarter of 2012, representing an increase of $1,291,270. During the fourth quarter of 2012, the profit on sale of investment properties of $16,967 represents the profit from the sale of one condominium unit at Lakewood Townhomes. During the third quarter of 2012, LREIT did not complete any property sales.

Income from discontinued operations increased by $16,415,582 during the fourth quarter of 2012, compared to the third quarter of 2012. The increase in income mainly reflects the $13.0 Million profit on the sale and $3.6 Million in net income tax recoveries relating to Riverside Terrace.

After accounting for the variance in fair value gains/adjustments, profit on sale, income from discontinued operations and income tax expense, LREIT completed the fourth quarter of 2012 with comprehensive income of $16,586,358, compared to a comprehensive loss of $2,379,729 during the third quarter of 2012.

Comparison to Fourth Quarter of 2011

During the fourth quarter of 2012, the loss of LREIT, before profit on sale of investment property, fair value gains, income taxes and discontinued operations, increased by $1,299,772 compared to the fourth quarter of 2011. The increase in the loss mainly reflects a decrease in net operating income of $1,888,332, an increase in interest expense of $822,664, partially offset by an increase in insurance proceeds of $525,355, and an increase in the income recovery on Parsons Landing of $885,329. During the fourth quarter of 2012, the combined total of net operating income and the income recovery on Parsons Landing decreased by $1,003,003, compared to the fourth quarter of 2011.

The increase in interest expense is mainly due to an increase in mortgage loan interest, including swap mortgage loan interest and an increase in amortization of transaction costs.

The insurance proceeds are in regard to the insurance claim for furniture and equipment of Parsons Landing.

The decrease in the combined total of net operating income and the income recovery on Parsons Landing is comprised of a decrease in net operating income of $1,888,332, partially offset by the income recovery on Parsons Landing of $885,329. The decrease in net operating income mainly reflects a decrease in net operating income at Parsons Landing (due to the fire), Siena Apartments (due to the sale of the property) and for the Fort McMurray property portfolio due to an increase in operating costs.

After accounting for the variance in fair value gains/adjustments, profit on sale, income from discontinued operations and income tax expense, LREIT completed the fourth quarter of 2012 with comprehensive income of $16,586,358, compared to $1,605,280 during the fourth quarter of 2011.

Revenue and Net Operating Income Analysis

The following analysis provides comparative results for the fourth quarter of 2012, compared to the third quarter of 2012 and the fourth quarter of 2011 for the investment properties of LREIT, as well as the seniors' housing complexes in discontinued operations.

	2012			2011	
	Q4	Q3	Increase (Decrease)	Q4	Increase (Decrease)
Revenue					
Fort McMurray	$ 5,871,662	$ 5,686,706	$ 184,956	$ 5,965,024	$ (93,362)
Other investment properties	3,560,725	3,520,077	40,648	3,585,293	(24,568)
Sub-total	9,432,387	9,206,783	225,604	9,550,317	(117,930)
Properties sold	-	-	-	535,813	(535,813)
Impaired property	-	-	-	1,110,460	(1,110,460)
Total revenue - investment properties	9,432,387	9,206,783	225,604	11,196,590	(1,764,203)
Total revenue - discontinued operations	2,515,686	2,881,136	(365,450)	3,994,295	(1,478,609)
Total revenue	$ 11,948,073	$ 12,087,919	$ (139,846)	$ 15,190,885	$ (3,242,812)
Net operating income					
Fort McMurray	$ 3,461,265	$ 3,564,420	$ (103,155)	$ 3,853,742	$ (392,477)
Other investment properties	1,831,143	1,790,852	40,291	1,990,637	(159,494)
Sub-total	5,292,408	5,355,272	(62,864)	5,844,379	(551,971)
Properties sold	2,059	-	2,059	609,518	(607,459)
Impaired property	-	-	-	728,902	(728,902)
Total net operating income - investment properties	5,294,467	5,355,272	(60,805)	7,182,799	(1,888,332)
Total net operating income - discontinued operations	865,162	1,180,213	(315,051)	1,617,080	(751,918)
Total net operating income	$ 6,159,629	$ 6,535,485	$ (375,856)	$ 8,799,879	$ (2,640,250)

The decrease in net operating income for discontinued operations in the fourth quarter of 2012, compared to the third quarter of 2012, mainly reflects the sale of Riverside Terrace in December 2012.

The decrease in net operating income for discontinued operations in the fourth quarter of 2012, compared to the fourth quarter of 2011, reflects the sale of Riverside Terrace in December 2012 and Clarington Seniors' Complex in May 2012.

Summary of Quarterly Results

Quarterly Analysis

	2012 Q4	2012 Q3	2012 Q2	2012 Q1
Rentals from investment properties	$ 9,432,387	$ 9,206,783	$ 9,387,902	$ 10,383,920
Net operating income	$ 5,294,467	$ 5,355,272	$ 5,820,776	$ 5,958,714
Income (loss) for the period before taxes and discontinued operations	$ (377,963)	$ (3,159,570)	$ 30,700,786	$ (26,561,708)
Income (loss) and comprehensive income (loss)	$ 16,586,358	$ (2,379,729)	$ 32,121,151	$ (26,229,472)
PER UNIT				
Net operating income				
- basic	$ 0.282	$ 0.287	$ 0.314	$ 0.321
- diluted	$ 0.280	$ 0.285	$ 0.312	$ 0.320
Income (loss) for the period before taxes and discontinued operations				
- basic	$ (0.020)	$ (0.169)	$ 1.654	$ (1.433)
- diluted	$ (0.020)	$ (0.169)	$ 1.646	$ (1.433)
Income (loss) and comprehensive income (loss)				
- basic	$ 0.884	$ (0.128)	$ 1.731	$ (1.415)
- diluted	$ 0.878	$ (0.128)	$ 1.722	$ (1.415)

Quarterly Analysis

	2011 Q4	2011 Q3	2011 Q2	2011 Q1
Rentals from investment properties	$ 11,196,590	$ 11,142,567	$ 10,363,052	$ 9,150,517
Net operating income	$ 7,182,799	$ 7,103,623	$ 6,319,962	$ 5,123,007
Income (loss) for the period before taxes and discontinued operations	$ 1,272,013	$ 1,594,954	$ 4,103,543	$ (4,587,848)
Income (loss) and comprehensive income (loss)	$ 1,605,280	$ 2,275,638	$ 4,900,921	$ (3,746,608)
PER UNIT				
Net operating income				
- basic	$ 0.388	$ 0.384	$ 0.343	$ 0.279
- diluted	$ 0.387	$ 0.384	$ 0.343	$ 0.279
Income (loss) for the period before taxes and discontinued operations				
- basic	$ 0.069	$ 0.086	$ 0.223	$ (0.250)
- diluted	$ 0.069	$ 0.086	$ 0.223	$ (0.250)
Income (loss) and comprehensive income (loss)				
- basic	$ 0.087	$ 0.123	$ 0.266	$ (0.204)
- diluted	$ 0.087	$ 0.123	$ 0.266	$ (0.204)

Income (Loss) Per Unit

Analysis of Income (Loss) per Unit

	Year Ended December 31 2012	Year Ended December 31 2011	Change	
Income and comprehensive income				
- basic	$ 1.079	$ 0.273	$ 0.806	295 %
- diluted	$ 1.073	$ 0.272	$ 0.801	294 %
Income (loss) for the year before taxes and discontinued operations				
- basic	$ 0.032	$ 0.129	$ (0.097)	(75)%
- diluted	$ 0.032	$ 0.129	$ (0.097)	(75)%

Excluding income taxes and discontinued operations, LREIT generated income of $601,545 ($0.032 per unit) during 2012, compared to income of $2,382,662 ($0.129 per unit) during 2011, representing an decrease in income of $1,781,117 ($0.097 per unit).

As the weighted average number of units has not changed significantly, increasing by only 1% since December 31, 2011, the decrease in income per unit mainly reflects the decrease in the overall income of the Trust before income tax expense and discontinued operations.

ANALYSIS OF CASH FLOWS

Operating Activities

Calculation of Cash Flow from Operating Activities

The net cash flow from operating activities is equal to the cash component of net operating income less net interest paid, the cash component of trust expense and the net increase or decrease in other working capital items (disclosed as "working capital adjustments") for both investment properties and the seniors' housing complexes classified as discontinued operations. The calculation of the cash component of net operating income excludes "accrued rent receivable", while the calculation of the cash component of trust expense excludes "unit based compensation". Net interest paid consists of interest paid, net of interest received.

"Interest paid" on the Consolidated Statements of Cash Flows of $31,195,083 includes the cash component of interest expense of $34,962,901 for both investment properties and discontinued operations, less the cash component of interest expense pertaining to mortgage prepayment charges of $4,040,631, plus the increase in accrued interest between December 31, 2011 and December 31, 2012 of $272,813. Mortgage prepayment charges are included in Financing Activities on the Consolidated Statements of Cash Flows under the line titles "repayment of mortgage loans on refinancing" and "prepayment of mortgage loans".

Due to the exclusion of prepayment charges in the calculation of cash flow from operations and to a lesser extent, the exclusion of non-cash items such as amortization of transaction costs, accretion of mortgage bonds and change in fair value of interest rate swaps, there is a substantial difference between interest expense on the Statement of Comprehensive Income and interest paid on the Consolidated Statements of Cash Flows.

2012 vs 2011 Comparatives

Cash from Operating Activities

	Year Ended December 31			
	2012			2011
	Investment Properties	Seniors' Housing Complexes	Total	Total
Net operating income	$ 22,429,229	$ 5,629,706	$ 28,058,935	$ 32,274,111
Accrued rent receivable	371,443	-	371,443	(553,953)
Net operating income - cash basis	22,800,672	5,629,706	28,430,378	31,720,158
Income recovery on Parsons Landing	3,278,987	-	3,278,987	-
Insurance proceeds	925,355	-	925,355	-
Trust expense	(2,323,979)	-	(2,323,979)	(2,611,313)
Non-cash component of trust expense	131,318	-	131,318	87,921
Trust expense - cash basis	(2,192,661)	-	(2,192,661)	(2,523,392)
Interest paid	(28,363,853)	(2,831,230)	(31,195,083)	(32,007,967)
Interest received	617,668	-	617,668	280,422
Interest expense - cash basis	(27,746,185)	(2,831,230)	(30,577,415)	(31,727,545)
Income tax recovery (expense) - current	(49,763)	(1,960,834)	(2,010,597)	(96,731)
Cash from operating activities, before working capital adjustments	(2,983,595)	837,642	(2,145,953)	(2,627,510)
Working capital adjustments, net	(3,785,126)	1,392,467	(2,392,659)	1,061,322
Cash provided by (used in) operating activities	$ (6,768,721)	$ 2,230,109	$ (4,538,612)	$ (1,566,188)

During 2012, the net cash deficiency from operating activities, excluding working capital adjustments, decreased by $481,557 compared to 2011. The decrease in the cash deficiency from operating activities, excluding working capital adjustments, reflects a decrease in interest paid of $0.8 Million; the receipt of insurance proceeds of $0.9 Million, a decrease in interest "paid" of $0.8 Million, a decrease in the cash component of trust expense $0.3 Million, an increase in interest received of $0.3 Million, largely offset by an increase in current income tax expense of $1.9 Million.

The decrease in interest paid is mainly due to the discharge of mortgage loan debt on the sale of properties.

The increase in current income tax expense reflects the tax incurred on the sale of Riverside Terrace.

Comparison to Third Quarter of 2012

Cash from Operating Activities

	Three Months Ended			
	December 31, 2012			September 30, 2012
	Investment Properties	Seniors' Housing Complexes	Total	Total
Net operating income	$ 5,294,467	$ 865,162	$ 6,159,629	$ 6,535,485
Accrued rent receivable	(83,787)	-	(83,787)	96,672
Net operating income - cash basis	5,210,680	865,162	6,075,842	6,632,157
Income recovery on Parsons Landing	885,329	-	885,329	869,547
Insurance proceeds	525,355	-	525,355	400,000
Trust expense	(751,957)	-	(751,957)	(407,263)
Non-cash component of trust expense	75,068	-	75,068	18,750
Trust expense - cash basis	(676,889)	-	(676,889)	(388,513)
Interest paid	(8,379,185)	(179,406)	(8,558,591)	(6,338,277)
Interest received	249,120	-	249,120	123,823
Net interest - cash basis	(8,130,065)	(179,406)	(8,309,471)	(6,214,454)
Income tax recovery (expense) - current	(49,763)	(2,044,312)	(2,094,075)	(274,737)
Cash from operating activities, before working capital adjustments	(2,235,353)	(1,358,556)	(3,593,909)	1,024,000
Working capital adjustments, net	1,779,778	2,240,465	4,020,243	(535,917)
Cash provided by (used in) operating activities	$ (455,575)	$ 881,909	$ 426,334	$ 488,083

During the fourth quarter of 2012, LREIT experienced a cash outflow from operating activities, excluding working capital adjustments of $3,593,909, representing a decrease in cash flow of $4.6 Million, compared to the third quarter of 2012. The increase in the cash outflow from operating activities, excluding working capital adjustments, is mainly due to a $2.2 Million increase in interest paid and a $1.8 Million increase in current income tax expense.

The increase in interest paid is attributable to the timing of interest payments on the Series G debentures and mortgage bonds. Interest payments on the Series G debentures and mortgage bonds are approximately $2.1 Million higher in the second and fourth quarters of the year, compared to the first and third quarters of the year.

The decrease in the cash component of the combined total of net operating income and the income recovery on Parsons Landing is comprised of a $556,315 decrease in net operating income, partialy offset by a $15,782 increase in the income recovery.

Fourth Quarter Comparatives

Cash from Operating Activities

	Three Months Ended December 31			
	2012			2011
	Investment Properties	Seniors' Housing Complexes	Total	Total
Net operating income	$ 5,294,467	$ 865,162	$ 6,159,629	$ 8,822,493
Accrued rent receivable	(83,787)	-	(83,787)	(76,774)
Net operating income - cash basis	5,210,680	865,162	6,075,842	8,745,719
Income recovery on Parsons Landing	885,329	-	885,329	-
Insurance proceeds	525,355	-	525,355	-
Trust expense	(751,957)	-	(751,957)	(560,688)
Non-cash component of trust expense	75,068	-	75,068	27,376
Trust expense - cash basis	(676,889)	-	(676,889)	(533,312)
Interest paid	(8,379,185)	(179,406)	(8,558,591)	(8,564,985)
Interest received	249,120	-	249,120	115,113
Interest expense - cash basis	(8,130,065)	(179,406)	(8,309,471)	(8,449,872)
Income tax recovery (expense) - current	(49,763)	(2,044,312)	(2,094,075)	111,958
Cash from operating activities, before working capital adjustments	(2,235,353)	(1,358,556)	(3,593,909)	(125,507)
Working capital adjustments, net	1,779,778	2,240,465	4,020,243	1,660,955
Cash provided by (used in) operating activities	$ (455,575)	$ 881,909	$ 426,334	$ 1,535,448

The net cash outflow excluding working capital adjustments, increased by $3,468,402 during the fourth quarter of 2012, compared to the fourth quarter of 2011. The increase in operating cash outflow, before working capital adjustments, is mainly due to an increase in income tax expense of $2.2 Million and a decrease in the combined total of net operating income (on a cash basis) and the income recovery on Parsons Landing of $1.8 Million, partially offset by an increase in insurance proceeds of $0.5 Million.

The decrease in the combined total of net operating income (on a cash basis) and the income recovery on Parsons Landing is comprised of a $2.7 Million decrease in net operating income and a $0.9 Million increase in the income recovery.

The decrease in net operating income is mainly due to the sale of properties and the fire at Parsons Landing. In the fourth quarter of 2011, Parsons Landing was in full operations and income recoveries did not commence until after the fire occurred in February 2012.

Although the total debt of LREIT was lower in the fourth quarter of 2012, interest paid for the fourth quarter of 2012 was comparable to interest paid for the fourth quarter of 2011 due to an increase in the weighted average interest rate on variable rate mortgage loans.

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

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

During 2012, the FFO deficiency decreased by $66,123, compared to 2011, while the AFFO deficiency increased by $1,514,108. On a basic per unit basis, the FFO deficiency decreased by $0.007 per unit, while the AFFO deficiency increased by $0.077 per unit.

The cash increase or decrease from discontinued operations is included in the calculation of FFO and AFFO.

Funds from Operations/Adjusted Funds from Operations *

	Year Ended December 31	
	2012	2011
Comprehensive income	$ 20,098,308	$ 5,035,231
Add (deduct):		
Deferred taxes	(5,368,399)	70,695
Profit on sale of investment properties	(915,531)	(487,095)
Profit on sale of discontinued operations	(15,034,311)	-
Taxes on sale of discontinued operations	1,960,834	-
Fair value gains	(10,308,723)	(11,612,337)
Fair value adjustment of Parsons Landing	3,500,000	-
Forgiveness of debt	(859,561)	-
Funds from operations (FFO) *	(6,927,383)	(6,993,506)
Add (deduct):		
Straight-line rent adjustment	371,443	(553,953)
Accretion of debt component of debentures and mortgage bonds	400,524	2,096,889
Unit-based compensation	131,318	87,921
Change in fair value of interest rate swaps	(1,027,800)	(745,198)
Capital expenditures on investment properties	(2,906,894)	(2,288,861)
Capital expenditures on property and equipment	(38,368)	(86,344)
Adjusted funds from operations (AFFO) *	$ (9,997,160)	$ (8,483,052)
FFO per unit *		
- basic and diluted	$ (0.372)	$ (0.379)
AFFO per unit *		
- basic and diluted	$ (0.537)	$ (0.460)

* FFO and AFFO are non-IFRS financial measures of operating performance widely used by the real estate industry. Accordingly, FFO and AFFO should not be construed as an alternative to net income or cash flow from operating activities determined in accordance with IFRS.

FFO has been calculated in accordance with the recommendations of RealPac. The method that is used by LREIT for calculating FFO and AFFO may differ from other issuers' methods and accordingly, may not be comparable with measures used by other issuers. The FFO and AFFO per unit amounts have been calculated on a basis consistent with that prescribed by IFRS for calculating earnings per unit.

AFFO is determined by taking the amounts reported as FFO and deducting what is commonly referred to as capital expenditures. Capital expenditures are referred to as expenditures that by standard accounting definitions are accounted for as capital in that the expenditure itself has a useful life in excess of the current financial year and also adds or maintains the value of the related asset.

Distributable Income

Distributable income is a financial measurement which is commonly used to assess the cash distribution capabilities and cash flows of investment trusts and, as such, management believes that the disclosure of distributable income provides useful information to investors. Distributable income does not have any standardized meaning prescribed by IFRS and, therefore, the method that is used by LREIT for calculating distributable income may not be comparable to similar measures presented by other issuers. The most directly comparable IFRS measurement of the cash flows of LREIT is the "net cash flow from operating activities", as disclosed in the Consolidated Statement of Cash Flows in the Financial Statements. Accordingly, a reconciliation between the net cash flow from operating activities and distributable income is provided in the chart below.

Reconciliation Between Cash from Operating Activities and Distributable Loss

	Year Ended December 31	
	2012	2011
Cash provided by (used in) operating activities	$ (4,538,612)	$ (1,566,188)
Changes in non-cash operating items	2,392,659	(1,061,322)
	(2,145,953)	(2,627,510)
Add (deduct):		
Capital expenditures on investment properties	(2,906,894)	(2,288,861)
Capital expenditures on property and equipment	(38,368)	(86,344)
Distributable loss	$ (5,091,215)	$ (5,002,715)
Per unit		
- basic and diluted	$ (0.273)	$ (0.271)

Distributable income (loss) is comprised of cash from operating activities, excluding working capital adjustments, less capital expenditures. Cash from operating activities and capital expenditures includes components from both investment properties and discontinued operations.

Working capital adjustments are excluded from LREIT's calculation of distributable loss as working capital adjustments are subject to significant temporary fluctuations which are typically reversed over time, mainly due to timing differences in accounts receivable and accounts payable.

During 2012, the distributable loss of LREIT was $5,091,215, representing an increase in the distributable loss of $88,500 compared to 2011.

Distributions

In March 2009, LREIT suspended cash distributions due to the decline in rental market conditions in Fort McMurray and the impact on operating cash flow. Cash distributions will continue to be suspended for the foreseeable future, given the other funding priorities of LREIT.

CAPITAL RESOURCES AND LIQUIDITY

Source and Use of Funds - General

LREIT requires ongoing sources of cash to fund the cash outflow from operating activities, as well as regular mortgage loan principal payments, transaction costs for debt financing and capital expenditures. In addition, LREIT requires additional capital on a periodic basis to fund lump-sum debenture and mortgage bond repayments. Additional capital is also periodically required to fund the repayment of mortgage loans on refinancing to the extent that there is a variance between the repayment amount and the amount of new mortgage loan proceeds. As cash distributions on units were suspended in March 2009, the current funding requirements of LREIT do not encompass the funding of cash distributions.

After accounting for regular payments of debt, transaction costs for debt financing, capital improvements and the cash outflow from operating activities, LREIT completed 2012 with a cash shortfall of $19.3 Million, compared to a shortfall of $17.6 Million during 2011. Although the extent of the shortfall is expected to be lower in 2013, LREIT will continue to require other sources of cash to meet its ongoing funding commitments.

The net cash inflow from the upward refinancing of properties and the revolving loan facility from 2668921 Manitoba Ltd., represent the primary funding sources for the cash outflow from operating activities, regular mortgage loan principal payments, transaction costs and capital expenditures. The net proceeds from property sales will be used to repay advances from 2668921 Manitoba Ltd. with any remaining proceeds to be applied to the redemption of the Series G debentures.

Financing Activities

As disclosed in the Consolidated Statements of Cash Flows, the financing activities of LREIT resulted in a cash outflow of $21,842,413 during 2012. Financing activities consist primarily of cash inflows and outflows related to the repayment and refinancing of mortgage loan debt, including transaction costs, as well as cash inflows and outflows related to the revolving loan commitment and the receipt and repayment of advances from Shelter Canadian.

Details regarding transactions related to mortgage loan financing activities, the revolving loan and the advances from Shelter Canadian are provided in other sections of this report.

Investing Activities

Capital Improvements

As disclosed in the Consolidated Statements of Cash Flows, the investing activities of LREIT resulted in a net cash inflow of $26,861,055 during 2012. Investing activities include net proceeds from property sales of $21,927,121, a cash inflow of $7,736,373 in regard to a change in restricted cash, cash outflows of $2,906,894 and $38,368 in regard to capital expenditures on investment properties and discontinued operations, respectively, and cash inflows of $142,823 in regard to a decrease in defeasance assets.

LREIT has a continuous capital improvement program with respect to its investment properties. The program is designed to extend the useful life of the properties, improve the quality of tenants' physical surroundings.

LREIT capitalizes all expenditures related to the improvement of its properties if the expenditures are incurred with the objective of enhancing net operating income in the future.

Net Proceeds from Property Sales

The net proceeds from property sales are net of selling expenses and any mortgage loan debt which was discharged on sale or assumed by or provided to the Purchaser.

Restricted Cash

The cash inflow in regard to restricted cash is mainly comprised of the application of $2,525,045 of reserves to the Lakewood Apartments mortgage loan balance at refinancing, the repayment of Parsons Landing security deposits of $387,250, the application of $890,858 of reserves to Colony Square mortgage loan balance at refinancing, and the application of $3,661,034 of collateral deposits to a mortgage against six apartment properties in downtown Fort McMurray.

Cash Flow Summary

During 2012, the net cash inflow from operating, financing and investing activities was $83,659. After providing for the opening cash balance of $1,170,619, LREIT completed 2012 with a cash balance of $1,254,278.

Sources and Use of Funds - 2013

Sources

Working Capital/Existing Cash

As of December 31, 2012, the unrestricted cash balance of LREIT was $1,254,278 and the working capital deficit was $4,462,801. The working capital deficit consists of current assets less current liabilities, excluding the amount payable on acquisition of Parsons Landing, the current portion of long-term debt, and assets and liabilities of a long-term nature which are included in current assets or liabilities under the "held for sale" classification. Working capital also includes the tenant security deposit liability net of the security deposit balance in restricted cash. The amount due on the revolving loan from 2668921 Manitoba Ltd. in the amount of $5,025,000 is included in the calculation of the working capital deficit.

Working capital is a commonly used financial measurement of an entity's liquidity and is generally derived by deducting current assets from current liabilities. Working capital is a non-IFRS measurement and the method which is used by LREIT for calculating the working capital deficit may differ from the method which is used by other issuers. Accordingly, the working capital deficit as calculated by LREIT may not be comparable to the working capital measurements which are provided by other issuers.

Revolving Loan Commitment from 2668921 Manitoba Ltd.

LREIT utilizes a revolving loan commitment from 2668921 Manitoba Ltd. (the parent company of Shelter Canadian). The revolving loan commitment currently provides for a maximum loan amount of $12 Million at an interest rate of 12% with a maturity date of June 30, 2013. As of the date of this report, $4.7 Million is available under the revolving loan commitment.

Additional information regarding the financing arrangements with 2668921 Manitoba Ltd. are provided in the section of this report titled "Related Party Transactions".

Cash Outflow from Operating Activities

The main components of cash flow from operating activities are net operating income on a cash basis, the income recovery on Parsons Landing, interest paid and working capital adjustments, from both investment properties and discontinued operations. Income tax expense may also have a significant impact on cash flow from operating activities. The Fort McMurray property portfolio is the main contributor to net operating income. Interest paid includes interest payments for mortgage loan debt, including the revolving loan from 2668921 Manitoba Ltd., mortgage bonds and debentures and the amount payable on acquisition of Parsons Landing.

In general terms and excluding working capital adjustments, LREIT is expected to achieve an improvement in its operating cash flow position during 2013, mainly due to a reduction in interest payments as a result of the refinancing of mortgage loan debt at lower interest rates.

Sale Proceeds

LREIT is pursuing property sales under its divestiture program. The current expectations of management are that the two remaining seniors' housing complexes and/or other properties will be sold by December 31, 2013. The timing and extent of projected property sales cannot be reasonably predicted. The condominium sales program at the Lakewood Townhomes is expected to be substantially completed in 2015.

Mortgage Loans Receivable

As of December 31, 2012, LREIT has mortgage loans receivable of $11.9 Million, of which approximately $8.7 Million or 73% is due in 2014 and $3.2 Million or 27% is due in 2017.

Subsequent to December 31, 2012, the $3.2 Million loan receivable was paid in full.

Upward Refinancing of Mortgage Loans

LREIT expects to generate additional capital from the upward refinancing of mortgage loan debt in 2013. The opportunity to complete upward refinancings is limited, given the extent to which the existing property portfolio is leveraged, the mortgage loans with covenant breaches and the maximum 75% mortgage loan debt to appraised value restriction pursuant to the terms of the Declaration of Trust.

Debt and/or Equity Offerings

LREIT may pursue additional offerings of debt and/or equity in the future as a source of investment capital. LREIT may also issue trust units to vendors as consideration for real property acquisitions.

Uses

Parsons Landing

The funding commitments under the purchase agreement for Parsons Landing are comprised of a $3,000,000 payment on closing as a final reduction of the amount payable and payments of $300,000 per month as interest on the amount payable.

The payment of $3,000,000 at closing would reduce the amount payable on closing to $42,720,000.

The $300,000 monthly interest charge is being funded from insurance proceeds until the completion of reconstruction of the building.

Long-term Debt Principal Payments

A summary of the debt obligations of LREIT for 2013 and for the next five years, is provided in the following chart:

Summary of Contractual Obligations - Long-term Debt

Payments Due by Period	Total	2013	2014/2015	2016/2017	2018 and beyond
Regular mortgage loans	$ 166,816,938	$ 120,888,291	$ 16,394,689	$ 29,533,958	$ -
Variable rate demand loans	80,837,307	80,837,307	-	-	-
Sub-total - Investment properties	247,654,245	201,725,598	16,394,689	29,533,958	-
Loans on properties held for sale	15,295,629	15,295,629	-	-	-
Total mortgage loan debt	262,949,874	217,021,227	16,394,689	29,533,958	-
Swap mortgage loan *	16,414,032	494,615	1,175,033	1,319,713	13,424,671
Debentures and mortgage bonds *	40,961,000	-	40,961,000	-	-
Total	$ 320,324,906	$ 217,515,842	$ 58,530,722	$ 30,853,671	$ 13,424,671

* Swap mortgage loan, debentures and mortgage bonds are reflected at face value.

The above chart reflects mortgage payments in accordance with the payment terms specified by the applicable mortgage loan.

Under IFRS, mortgages in breach of debt covenants are required to be reflected as currently due. If the above chart was adjusted to reflect mortgages in breach of debt covenants as current, the swap mortgage loan would be fully repayable in 2013 and the total mortgage due in 2013 would increase to $233,435,259.

Summary of Mortgage Loan Debt "Due in 2013"

The amount of long-term debt which is considered to be "current", in accordance with IFRS, includes any mortgage which is in default of a debt covenant.

An analysis of the mortgage loan debt which is considered due in 2013 in the amount of $217,021,227 is provided on the following chart.

	Investment Properties		Properties Held for Sale		Total
Mortgages					
Demand loans with covenant breaches	$ 80,837,307	(1)	$ -		$ 80,837,307
Fixed term mortgages due in 2013	118,917,653	(2)	-		118,917,653
	199,754,960		-		199,754,960
Loans on assets held for sale	-		15,295,629	(3)	15,295,629
	199,754,960		15,295,629		215,050,589
Principal repayments	1,970,638		-		1,970,638
	$ 201,725,598		$ 15,295,629		$ 217,021,227

(1) Consists of three mortgage loans which matured in 2010 or 2011 and are in breach of debt service coverage requirements. An analysis of the mortgage loans is provided in the "Mortgage Loans Payable" section of the MD&A.

(2) Consists of 10 mortgage loans, one of which in the aggregate principal balance of $6,329,378 was refinanced; one of which in the aggregate principal balance of $20.4 Million was refinanced by a $21 Million mortgage loan; two of which in the aggregate principal balance of $39,025,000 are expected to be repaid from a new $42 Million first mortgage loan by March 31, 2013; three of which in the aggregate principal balance of $15,624,894 are expected to be refinanced on similar terms; two of which in the aggregate principal balance of $28,038,381 are expected to be refinanced by two new mortgage loans with an aggregate principal balance of $30.9 Million; and one of which in the aggregate principal balance of $9.5 Million was reduced by a $2.0 Million prepayment in January 2013 and is expected to be repaid from proceeds of upward refinancing in March 2013 and April 2013.

(3) Consists of a prime plus 2% first mortgage loan of $10,604,208 and a prime plus 2% first mortgage loan of $4,691,421 which mature on August 31, 2013 and June 30, 2013, respectively. The first mortgage loans are expected to be renewed under similar terms and conditions. In accordance with IFRS, mortgages of discontinued operations are held as current.

Principal Payments - Debentures and Mortgage Bonds

As of December 31, 2012, the total face value of the restructured Series G debentures is $24,961,000. The debentures mature on February 28, 2015. The terms of the debentures also provide for the net proceeds from property sales to be applied to prepay the principal amount of the debentures after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing to 2668921 Manitoba Ltd. from time to time under the revolving loan commitment.

The 9% second mortgage bonds of LREIT mature on December 23, 2015. As of December 31, 2012, the total face value of the mortgage bonds is $16,000,000.

Reserves Required by Mortgage Loan Agreements

In accordance with mortgage loan agreements, cash deposits are provided to certain lenders to fund future capital repairs and/or as additional security relating to breaches of debt service coverage requirements. As of December 31, 2012, cash deposits in regard to mortgage loans amount to $5,407,263, of which $4,419,637 pertains to mortgage loans which are in breach of debt service coverage requirements.

It is anticipated that there will not be any additional cash deposits required for existing loans which are in breach of debt service coverage requirements in 2013.

Capital Expenditures

Capital expenditures for investment properties and the seniors' housing complexes are expected to be approximately $3.6 Million for 2013.

Summary

Management expects that the proceeds from upward refinancings, supplemented by draws on the revolving loan commitment and periodic credit support from Shelter Canadian, as required, will be sufficient to fund the projected funding commitments of LREIT for 2013. As of the date of this report, the amount available under the revolving loan is $4.7 Million.

The net proceeds from property sales will be used to repay advances from 2668921 Manitoba Ltd. with any remaining proceeds to be applied to the redemption of the Series G debentures.

RELATED PARTY TRANSACTIONS

Shelter Canadian

Asset and Property Management

Shelter Canadian provides administrative and asset management services to LREIT, pursuant to the terms of a Services Agreement. The Services Agreement provides for the remuneration of Shelter Canadian to be established at a level which is commensurate with customary comparable market asset management fees, subject to the discretion of the Governance, Compensation and Nominating Committee of the Board of Trustees.

Shelter Canadian currently receives a service fee equal to 0.3% of the gross book value of the total assets of the Trust. The gross book value of the total assets of the Trust is defined as the total assets, as disclosed on the most recently issued Financial Statements, excluding cash, valuation adjustments and defeasance assets. The Services Agreement provides for payment of the fee to occur on a monthly basis, on the last day of each month. The Services Agreement expires December 31, 2019.

Shelter Canadian is also the Property Manager for LREIT, pursuant to the Property Management Agreement. Shelter Canadian has a direct involvement in the management of all of the investment properties in the portfolio of LREIT and acts as the Property Manager for all of the properties, except for the seniors' housing complexes, where LREIT has retained third party managers to provide on site management services due to the nature of the operations. In accordance with the terms of the Property Management Agreement, Shelter Canadian receives a property management fee equal to 4% of gross receipts from the investment properties where it acts as Property Manager. In regard to commercial properties, Shelter Canadian is also entitled to leasing commissions on new leases of 3% to 5% of base rental payments and leasing commissions on renewal of 1 1/2% to 2 1/2% of base rental payments. Shelter Canadian is also entitled to tenant improvement and renovation fees equal to 5% of the total cost of such work. In August 2011, the term of the Property Management Agreement was extended from December 31, 2015 to December 31, 2019.

Property management fees are included in property operating costs. Leasing commissions and tenant improvement and renovation fees are capitalized to investment properties. During the period of major in-suite renovations or development operating costs are capitalized to the cost of buildings and properties under development.

During 2012, the fees payable to Shelter Canadian for investment properties included service fees of $1,598,895 and property management fees of $1,547,632.

Services fee and renovation fee for Lakewood Townhomes condominium sales program

The Trust has entered into an agreement with Shelter Canadian, in regard to the condominium sales program at Lakewood Townhomes. Under the agreement, Shelter Canadian will administer the sales program and completion of the in-suite renovations. The Trust pays a service fee equal to 5% of the gross sales proceeds. Shelter Canadian is responsible for the payment of a fixed fee to an external real estate broker for providing brokerage services. If it is necessary to increase the fixed fee due to market conditions, the fee payable to Shelter Canadian increases by the amount of the increase in the fixed rate. The Trust also pays a renovation fee equal to 5% of the cost of the in-suite upgrade costs for the condominium sales program.

The Trust incurred service fees of $306,395 for 2012 (2011 - $25,589) and renovation fees of $3,534 for 2012 (2011 - nil).

The terms of the condominium sales program, including the service fee and renovation fee, were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the service fee and renovation fee.

Loans

LREIT utilizes a revolving "operating" loan commitment from 2668921 Manitoba Ltd., the parent company of Shelter Canadian. The revolving loan commitment is secured by mortgage charges against the title to six investment properties, one seniors' housing complex and the assignment of a mortgage loan in the amount of $7,888,320.

A summary of the terms for the revolving loan commitment are provided in the following chart.

Revolving Loan Term From	To	Renewal Fees	Interest Rate	Maximum Interest Charge	Maximum Loan Commitment
December 1, 2010	June 30, 2011	$ 50,000	14.00%	$ n/a	$ 10,000,000
June 30, 2011	December 31, 2011	-	11.00%	n/a	12,000,000
January 1, 2012	March 31, 2012	-	9.75%	162,594	12,000,000
April 1, 2012	August 31, 2012	75,000	10.00%	n/a	15,000,000
September 1, 2012	December 31, 2012	150,000	12.00%	500,870	15,000,000
January 1, 2013	June 30, 2013	25,000	12.00%	379,916	12,000,000

2668921 Manitoba Ltd. has agreed to maintain the revolving loan commitment with the Trust, in the amount of $8,800,000, until the closing date of the Parsons Landing acquisition.

During 2012, interest on the loan commitment amounted to $963,422, compared to $1,230,505 in 2011.

Interest on the revolving loan is included in interest expense. Renewal and extension fees are included in transaction costs.

During 2011, the Trust obtained interest-free advances from Shelter Canadian. Included in trade and other payables at December 31, 2011 is a balance of $1,183,000 payable to Shelter Canadian in regard to interest-free advances. The interest-free advances payable, as at December 31, 2011, as well as $5,594,000 of additional interest-free advances obtained in January and February 2012, were repaid in full in February 2012.

During the third quarter of 2012, an interest-free advance of $10.6 Million was received from Shelter Canadian which partially funded the repayment of a $22.3 Million first mortgage loan. The advance was subsequently repaid from the proceeds of new first mortgage financing of $20.4 Million.

The terms of the revolving loan and interest-free advances and the granting of security were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the loans. All necessary regulatory approvals were obtained for the revolving loan and all renewals.

Key Management Compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of LREIT, directly or indirectly. LREIT does not pay any compensation directly to its key management personnel, other than securities based compensation under its unit option plan. The services are provided to LREIT by Shelter Canadian pursuant to the Services Agreement. The estimated aggregate compensation for those services under the agreement for the year ended December 31, 2012 was $564,000 (2011 - $554,000). In addition, the Trust granted unit options to its key management personnel with a fair value of $48,076 (2011 - $1,500).

OPERATING RISKS AND UNCERTAINTIES

An investment in units of LREIT encompasses the risks which are inherent in the ownership and operation of a portfolio of residential and commercial properties, as well as the normal risks which are associated with an investment in a real estate investment trust. For a summary of certain additional key risks relating to LREIT, see the Annual Information Form, which is available at www.sedar.com.

The key risks include the following:

Continuing Operations

As previously disclosed in this report, there are a number of variables and risk factors which are considered in assessing whether LREIT has the ability to continue to operate, including: (i) the cash deficiency from operations sustained by LREIT during 2012 and prior years, (ii) the breach of debt covenant requirements which, as of the date of this report, remain on three mortgage loans and one swap mortgage loan, encompassing $97.3 Million of mortgage debt, (iii) the impact of the timing of increased rental rates and the improvement in occupancy levels in Fort McMurray and the ability of the Trust to continue to secure financing on the Fort McMurray properties, (iv) the working capital deficit of the Trust, as of December 31, 2012 in the amount of $4,462,801, (v) the reliance on Shelter Canadian and its parent company 2668921 Manitoba Ltd. for interim funding, (vi) the significant concentration of properties in Fort McMurray, (vii) the successful completion of additional property sales under the divestiture program, and (viii) the ability to complete upward refinancings to generate additional funds.

The financial capacity of LREIT to continue operations is dependent on improving cash flows from operations and, in particular, the operating cash flow from the Fort McMurray portfolio, the completion of property sales and/or upward refinancings, the continued ability of the Trust to repay, renew or refinance debt at maturity, the renewal of the revolving loan commitment from 2668921 Manitoba Ltd., and the continued availability of interim funding from Shelter Canadian. In the event that the net proceeds from property sales are less than anticipated, or in the absence of additional upward refinancing and/or continued interim funding from Shelter Canadian and its parent company 2668921 Manitoba Ltd., prior to completion of additional property sales, LREIT may not have the ability to fund all of its debt obligations.

Management believes that the going concern assumption is appropriate for the Financial Statements as the increasing economic activity in Fort McMurray has resulted in improved occupancy levels, and as the Trust has successfully sold 21 properties, including three properties during 2012; the Trust has successfully renewed mortgage loans at maturity and/or obtained forbearance arrangements. The Trust extended extended the maturity date for the Series G debentures and successfully eliminated covenant breaches on three mortgage loans in investment properties and one mortgage loan in discontinued operations through refinancing and/or improved operations.

Real Property Ownership

The properties of LREIT are subject to the normal risks common to real property ownership and operation, including the risk of a reduced demand due to changes in general economic conditions, local real estate markets, competition from other available premises and various other factors.

The properties of LREIT generate income through rent payments made by the tenants of the properties. Upon the expiry of any lease, there can be no assurance that the lease will be renewed or the tenant replaced. The terms of any subsequent lease may be less favourable than the existing lease. Leasing results are affected by a number of factors, including location of the property and, in particular, the level of supply and demand in the local rental market.

Credit Support from Shelter Canadian

Shelter Canadian has provided LREIT with interim funding on a periodic basis, pending the receipt of funds from financing activities. The interim funding has been provided in the form of interest-free advances and deferred service fees. As of December 31, 2011, interim funding consisted of interest-free advances of $1,183,000 and deferred service fees of $425,833. During the first quarter of 2012, $5,594,000 of additional interest-free advances obtained in January and February 2012, as well as all of the interim funding was fully repaid.

During the third quarter of 2012, an interest-free advance of $10.6 Million was received from Shelter Canadian which partially funded the repayment of a $22.3 Million first mortgage loan. The advance was subsequently repaid from the proceeds of new first mortgage financing of $20.4 Million.

The continuation of interim funding from Shelter Canadian may be necessary to ensure the ongoing operations of LREIT pending the generation of cash inflows from upward refinancings or property sales to the extent required to restore working capital.

Revolving Loan Commitment From 2668921 Manitoba Ltd.

The financial capacity of LREIT to continue operations is partially dependent on the ongoing renewal of the revolving loan commitment from 2668921 Manitoba Ltd. which is subject to ongoing regulatory approval. The periodic deferral of interest payments on the revolving loan may be necessary in 2013 depending on the timing of upward refinancings or property sales.

2668921 Manitoba Ltd. (the parent company of Shelter Canadian) has periodically deferred interest payments on the revolving loan. As of December 31, 2011, deferred interest on the revolving loan amounted to $294,000. The deferred interest was fully repaid during the first quarter of 2012.

Public Market Risk

It is not possible to predict the price at which units will trade in the future and there can be no assurance that an active trading market for the units will be sustained. The units will not necessarily trade at values determined solely by reference to the value of the properties of LREIT. Accordingly, the units may trade at a premium or a discount to the value implied by the value of the properties of LREIT. The market price for the units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of LREIT.

Completion of Divestiture Program

In 2009, LREIT initiated a divestiture program targeting the sale of assets, with a value in excess of $250 Million. The objective of the divestiture program is to reduce total debt, including debenture debt, and in particular higher cost interim mortgage loan financing. The sale of properties under the divestiture program is also required in order for LREIT to generate sufficient cash inflows to meet its ongoing funding obligations and restore working capital.

During 2009, LREIT sold 13 properties under the divestiture program at a combined gross selling price of $90.4 Million. During 2010, LREIT sold five additional properties at a combined gross selling price of $40.8 Million. During 2011, LREIT did not complete any property sales. During 2011, LREIT sold four condominium units at Lakewood Townhomes at a gross selling price of $1.9 Million.

During 2012, LREIT sold one investment property and two seniors' housing complexes at a combined gross selling price of $98.5 Million, as well as nine condominium units at Lakewood Townhomes at a gross selling price of $4.4 Million.

The current expectations of management are that the two remaining seniors' housing complexes and/or other properties will be sold by December 31, 2013. In addition, the condominium sale program for the Lakewood Townhomes is expected to be substantially completed in 2015.

There can be no assurance that LREIT will complete the divestiture program under the time frame or to the extent which is contemplated by management.

Completion of Parsons Landing Acquisition

In June 2012, agreements were finalized under which the builder has agreed to complete the reconstruction of the Parsons Landing and attend to the recovery of the insurance claim for property in a manner which is expected to result in the cost of reconstruction being fully funded from insurance proceeds. The builder has also agreed to extend the closing date of the acquisition to a date which is 90 days after the final occupancy permit is obtained.

The builder has also agreed to accept interest payments of $300,000 per month in regard to the amount payable on closing. During the period of reconstruction, the monthly interest payment is expected to be fully funded from insurance proceeds for revenue losses.

There is a risk that financing arrangements for Parsons Landing will not be completed by the extended closing date and the property may be listed for sale. In the event of sale, LREIT could incur a full or partial loss of the cumulative payments made to the vendor. Interest charges in the amount of $20,478,331 as at December 31, 2012 which have been recorded as forgiven, may also become payable. See "Parsons Landing".

Concentration of LREIT's Portfolio in One Market

The property portfolio of LREIT has significant exposure to the Fort McMurray, Alberta market. The sale of properties which are located outside of Fort McMurray will also serve to increase the exposure of LREIT's portfolio to the Fort McMurray market.

At December 31, 2012, there were 24 properties in the real estate portfolio of LREIT comprised of 22 properties in the investment property portfolio and 2 seniors' housing complexes which are reflected in discontinued operations. The investment property portfolio consists of two commercial properties, 19 residential properties and one mixed residential/commercial property, comprising a total of 2,027 rental units. The residential property portfolio includes 13 properties that are located in Fort McMurray, one of which is an impaired property (Parsons Landing). The remaining 11 properties comprise a total of 928 suites, or 46% of the total residential suites in the investment property portfolio. The 12 properties have an aggregate carrying value of $260.2 Million, which represents approximately 61% of the total aggregate carrying value of the investment property portfolio.

The 12 properties in Fort McMurray accounted for 60% of the total revenue of LREIT during 2012 and 63% of the net operating income.

During 2012, the income recovery on Parsons Landing, combined with the net operating income for Parsons Landing for the 36 day period prior to the fire, amounted to $3,379,031. In 2011, the net operating income for Parsons Landing was $2,443,456. Pending the reconstruction of Parsons Landing, the income contribution of Parsons Landing is subject to the uncertainty surrounding a number of variables, including the amount of the income recovery for revenue losses and the completion date for reconstruction.

Oil Sands Industry

As disclosed above, LREIT has a high concentration of properties in the Fort McMurray, Alberta market and employees from the oil sands industry represent the primary tenant base of the Fort McMurray portfolio.

Based on the recent growth in the level of construction activity in the oil sands industry and the resulting substantial increase in occupancy levels of the Fort McMurray properties, the residential property market in Fort McMurray has improved; however, there can be no assurance as to the extent of the improvement and there is the possibility that market conditions may decline. LREIT financial results for future periods are subject to numerous uncertainties arising from a marked slowdown in the oil sands industry and a weak general economy.

Certain significant expenditures, including property taxes, utility payments, maintenance costs, mortgage payments, insurance costs and related charges must be made throughout the period of ownership of real property regardless of whether the property is producing any income. If LREIT were unable to meet mortgage payments on any property, losses could be sustained as a result of the mortgage's exercise of its rights of foreclosure or sale.

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relation to demand or the perceived desirability of such investments. Such illiquidity may tend to limit LREIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If LREIT were to be required to liquidate its real property investments, the proceeds to LREIT might be significantly less than the aggregate carrying value of its properties.

Financing

General

The ability of LREIT to raise additional capital for operating or investing activities is subject to uncertainty. Factors which could impair the ability of LREIT to raise additional capital include a downturn in general economic conditions, a more restrictive capital market, a change in legislation and numerous other factors beyond the control of LREIT.

The adoption of more restrictive and conservative lending policies by mortgage lenders following the economic downturn in October 2008, combined with the decline in operating income of the Fort McMurray property portfolio, increased the level of risk for LREIT in regard to debt financing. As a result of an improvement in market conditions the level of risk has declined.

In the event that LREIT is unable to renew its mortgage loan debt at maturity, or obtain replacement financing, LREIT would not be in a position to repay the debt and would be in default of its debt obligations. In such event, the lenders could potentially take action against LREIT and the indebted properties. As disclosed in the following sections of this report, LREIT is in breach of mortgage loan covenants on three mortgage loans which have matured and, in the absence of renewal agreements or replacement financing, are considered to be repayable on demand.

Mortgage Maturities

With the exception of the first mortgage loan of $11,430,588 for the Lakewood Townhomes which matured on July 18, 2010, the second mortgage loan of $16,636,627 for Woodland Park and Nelson Ridge Estates which matured on October 31, 2010 and the $52,770,092 first mortgage loan for Laird's Landing, which matured October 1, 2011, all of which are in breach of the debt service coverage requirements, all of the mortgage loans for investment properties which matured to the date of this report were renewed, or refinanced. The three loans are repayable on demand. A forbearance extension has been received from the lender in regard to the covenant breaches for the three loans to March 31, 2013. The first mortgage loan for the Lakewood Townhomes will be repaid from the net proceeds of the condominium sales program.

All mortgage loans for discontinued operations which have matured to the date of this report have been renewed or refinanced.

Covenant Breaches

As previously disclosed, as of the date of this report, LREIT is in breach in regard to debt service coverage requirements for three mortgage loans and one swap mortgage loan related to five properties with a total balance of $97.3 Million. Forbearance extensions to March 31, 2013 have been received for the three mortgage loans.

There is a risk that the lenders of the mortgage loans which are in breach of covenant requirements could demand early repayment of the loans. Management does not anticipate that the lenders will demand early repayment, provided that LREIT continues to be current with its scheduled payments and interest. Management expects LREIT to remain current with its scheduled payments of principal and interest.

The expectation is that the covenant breaches will continue to be addressed through extensions of the forbearance agreements, debt repayment, modified loan terms and/or refinancing.

At December 31, 2012, $4,419,637 is on deposit with a mortgage lender in order to provide cash reserves for three of the mortgage loans which were in breach of debt service coverage requirements. During 2012, 2011 and 2010, fees of $356,716, $625,245 and $1.2 Million, respectively, were incurred in regard to mortgage loans in breach of debt covenant requirements. There is a risk that significant additional cash reserve deposits may be required and/or that significant additional fees may be incurred.

During 2012, LREIT was not required to remit any additional deposits in regard to the mortgage loans with covenant breaches.

Payment of Cash Distributions

A return on an investment in units is not comparable to the return on an investment in a fixed-income security. The recovery of the initial investment in units is at risk and the return on an investment in units is based on many performance assumptions. The ability of LREIT to pay distributions is dependent upon a number of factors, including the level of operating cash flows, the amount of cash reserves, the debt covenants and obligations of the Trust, the working capital requirements of the Trust and the future capital requirements of the Trust. The Trust does not currently pay cash distributions. To the extent that it does make cash distributions in the future, such cash distributions may be reduced or suspended at any time. In addition, the market value of the units may decline if LREIT is unable to provide a satisfactory return to Unitholders.

LREIT currently qualifies as a mutual fund trust for income tax purposes. In accordance with the terms of the Declaration of Trust, the distributions of LREIT are established at the discretion of the Trustees. If circumstances permit and subject to the application of the SIFT Rules discussed below, it is the intent of the Trust to distribute an amount which is not less than all of its taxable income to its Unitholders. The Declaration of Trust provides that if the Trustees determine that available cash is not sufficient to satisfy payment of distributions, the Trustees may declare that the distribution be satisfied through the issuance of additional units, followed by an immediate consolidation of units such that, subject to the Declaration of Trust, unitholders own the same number of units on a post-consolidation basis.

Due to the decline in operating cash flow since 2009, LREIT suspended cash distributions.

Changes to Tax Treatment of Trusts

LREIT qualifies as a closed-end mutual fund trust for income tax purposes. Prior to the enactment of legislation relating to the federal income taxation of publicly listed or traded trusts, LREIT was not subject to taxation on its income for a year to the extent that such income was distributed to the unitholders of LREIT, and those unitholders were, and would have been, subject to taxation as appropriate on such distributed income.

New legislation relating to the federal income taxation of specified investment flow-through trusts and partnerships (each a "SIFT") was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2012, are referred to as the "SIFT Rules". LREIT became a SIFT and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, certain distributions of income from a SIFT are no longer deductible in computing a SIFT's taxable income, and a SIFT is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception"). The REIT Exception contains a number of technical tests related to the property and revenue of a trust which must be monitored on an ongoing basis.

LREIT did not qualify for the REIT Exception, and therefore was subject to the SIFT Rules, in 2011 and 2012. The REIT Exception is applied on an annual basis and accordingly LREIT may be able to qualify for the REIT Exception in 2013 and subsequent years. Prior to the end of 2012, LREIT disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of the non-qualifying properties and other transactions, LREIT intends to qualify for the REIT Exception in 2013 and subsequent years. If LREIT qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to LREIT during that year, and LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, LREIT intends to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of LREIT. The determination as to whether LREIT qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that LREIT will qualify for the REIT Exception in 2013 and subsequent years. There can be no assurance that LREIT will qualify for the REIT Exception and that LREIT will not be subject to income taxes imposed by the SIFT Rules in 2013 or any subsequent year.

Please refer to the Annual Information Form for a more detailed discussion of the SIFT Rules.

Legal Claims

In the normal course of operations, the Trust will become subject to a variety of legal and other claims. Management and legal counsel evaluate all claims on their apparent merits, and accrue management's best estimate of the estimated costs to satisfy such claims. Although the outcome of legal and other claims are not reasonably determinable, management believes that any such outcome will not be material.

Relationship with Shelter Canadian

The financial performance of LREIT will depend in part on the performance of Shelter Canadian in providing administrative and asset management services to the Trust, pursuant to the Services Agreement.

Reliance on Key Personnel

The success of LREIT is highly dependent on the services of certain management personnel, including Arni Thorsteinson. The loss of the services of such personnel could have an adverse effect on LREIT.

Other

Other risks and uncertainties are more fully explained in the other regulatory filings of LREIT, including the Annual Information Form.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Financial Statements of LREIT, in accordance with IFRS, requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. The estimates are based on historical experience and on other assumptions that are believed to be reasonable under the circumstances. Under different assumptions or conditions, the actual results may differ, potentially materially, from the estimated amounts. Many of the conditions impacting the assumptions and estimates are beyond the control of management. The estimates and assumptions are evaluated on a periodic basis.

Financial Statement items which encompass estimates include the following:

- determination of "fair value" of investment property: the determination of the fair value of investment properties requires the use of estimates on future cash flows from assets (considering the implication of lease terms, tenant profiles, capital expenditures anticipated within the year, property conditions and similar variables) and discount rates applicable to those assets. These estimates are based on local market conditions existing at the Statement of Financial Position date;

- determination of "fair value" of swap mortgage loans: the fair value of interest rate swap arrangements is based on the difference between the market rental rates for a fixed term mortgage loan with same maturity and the variable interest rate payable under the mortgage;

- the determination of the fair value of the mortgage bond; at inception, the fair value of the mortgage bond was based on market interest rates with the residual value used to value the trust unit purchase warrants;

- determination of recoverable amount for rent and other receivables: rent and other receivables are recognized at the lower of the original invoiced value or recoverable amount. An allowance for uncollectible receivables is recorded when there is objective evidence that the Trust will not be able to recover the amount in full;

- interest expense on the acquisition payable: interest expense on the acquisition payable reflects the estimate that excess interest will be forgiven. Excess interest for 2012 is $6,657,691. Cumulative excess interest from January 1, 2010 to December 31, 2012 is $20,478,331;

- unit-based compensation expense: unit-based compensation expense is based on the estimated fair value of the applicable options using the Black-Scholes option pricing method; and

- the determination of the amount of temporary differences, the timing of reversal and the tax rate to be used in calculating deferred income tax assets and liabilities are based on estimates.

TAXATION

Taxation of LREIT

LREIT qualifies as a closed-end mutual fund trust for income tax purposes. Prior to the enactment of legislation relating to the federal income taxation of publicly listed or traded trusts, LREIT was not subject to taxation on its income for a year to the extent that such income was distributed to the unitholders of LREIT, and those unitholders were, and would have been, subject to taxation as appropriate on such distributed income.

New legislation relating to the federal income taxation of specified investment flow-through trusts and partnerships (each a "SIFT") was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2012, are referred to as the "SIFT Rules". LREIT became a SIFT and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, certain distributions of income from a SIFT are no longer deductible in computing a SIFT's taxable income, and a SIFT is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception"). The REIT Exception contains a number of technical tests related to the property and revenue of a trust which must be monitored on an ongoing basis.

LREIT did not qualify for the REIT Exception, and therefore was subject to the SIFT Rules, in 2011 and 2012. The REIT Exception is applied on an annual basis and accordingly LREIT may be able to qualify for the REIT Exception in 2013 and subsequent years. Prior to the end of 2012, LREIT disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of the non-qualifying properties and other transactions, LREIT intends to qualify for the REIT Exception in 2013 and subsequent years. If LREIT qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to LREIT during that year, and LREIT shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of LREIT. Under such circumstances, LREIT intends to make sufficient distributions to its unitholders so that LREIT will not be subject to taxation.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of LREIT. The determination as to whether LREIT qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that LREIT will qualify for the REIT Exception in 2013 and subsequent years. There can be no assurance that LREIT will qualify for the REIT Exception and that LREIT will not be subject to income taxes imposed by the SIFT Rules in 2013 or any subsequent year.

Taxation of Unitholders

The Declaration of Trust generally requires LREIT to claim the maximum amount of capital cost allowance for purposes of computing its income for tax purposes. If LREIT qualifies for the REIT Exception, a Unitholder is required to include, in computing income for tax purposes each year, the portion of the amount of net income and net taxable capital gains of LREIT paid or payable to the Unitholder in the year. Distributions in excess of the taxable income of LREIT for the year which are allocated to a Unitholder are not included in computing the taxable income of the Unitholder. However, the adjusted cost base of the units which are held by a Unitholder will generally be reduced by the amount of distributions not included in income.

The cash distributions which have been paid to the Unitholders since the inception of LREIT as a real estate investment trust in September 2002, have exceeded the income of LREIT, as calculated for income tax purposes. All of the distributions, which have been paid by LREIT from September 2002 to December 31, 2012, have represented a reduction in adjusted cost base of the units, with the exception of the special distributions paid by LREIT in December 2009 and December 2010.

If LREIT does not qualify for the REIT Exception, certain distributions from LREIT which would otherwise have been ordinary income will be characterized as dividends in addition to being subject to tax in LREIT at rates similar to the combined federal and provincial corporate tax rates. Distributions to Canadian resident individuals will be deemed to be "eligible dividends", qualifying for the enhanced dividend tax credit.

Upon the disposition or deemed disposition by a Unitholder of a unit, a capital gain (or a capital loss) will generally be realized to the extent that the net proceeds of disposition of the unit exceed (or are exceeded by) the adjusted cost base of the unit. Currently, only 50% of a capital gain ("taxable capital gain") must be included in computing a Unitholders' income and 50% of a capital loss (an "allowable capital loss") may be deducted against taxable capital gains.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

No changes were made to the design of the internal controls over financial reporting during 2012 that have materially affected, or are reasonable likely to materially affect, the effectiveness of the internal control system.

Readers are cautioned, however, that a control system can only provide reasonable, not absolute, assurance that the objectives of the control system are achieved. Due to the inherent limitations in all control systems, an evaluation of controls cannot provide absolute assurance that all control issues, including instances of fraud, if any, have been detected. Inherent limitations include the possibility that the assumptions and judgments of management could ultimately prove to be incorrect under varying conditions and circumstances; or that isolated errors could prove to have a significant impact on the reliability of information.

Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and it is not possible to provide complete assurance that a control system will succeed in achieving its stated goals under all potential future conditions.

ADDITIONAL INFORMATION

Additional information relating to LREIT, including the Annual Information Form, is available on the SEDAR website at www.sedar.com. SEDAR acts as a facilitator for the electronic filing of securities information, as required by the securities regulatory agencies in Canada.

APPROVAL BY TRUSTEES

The content of the 2012 Annual Report of Lanesborough Real Estate Investment Trust, including Schedule I, and the delivery of the report to the Unitholders has been approved by the Trustees.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
March 13, 2013

LANESBOROUGH REAL ESTATE INVESTMENT TRUST
MANAGEMENT'S DISCUSSION AND ANALYSIS
2012 ANNUAL REPORT

SCHEDULE I

Real Estate Portfolio as of December 31, 2012

Property Portfolio

Property	Location	Purchase Price	Acquisition Date	Suites/ Leasable Area - Sq. Ft.	Occupancy December 31 2012
INVESTMENT PROPERTIES					
RESIDENTIAL					
Manitoba					
Highland Tower (1)	Thompson	$ 5,700,000	January 2005	77	94 %
Colony Square (2)	Winnipeg	29,907,700	October 2008	428	99 %
Willowdale Gardens	Brandon	4,326,000	January 2006	88	100 %
Alberta					
Norglen Terrace	Peace River	2,500,000	October 2004	72	96 %
Nelson Ridge Estates	Fort McMurray	40,575,000	April 2005	225	88 %
Gannet Place	Fort McMurray	6,873,700	June 2006	37	92 %
Lunar Apartments	Fort McMurray	4,457,100	June 2006	24	92 %
Parkland Apartments (3)	Fort McMurray	2,230,200	June 2006	12	67 %
Skyview Apartments	Fort McMurray	5,385,800	June 2006	29	86 %
Snowbird Manor	Fort McMurray	6,314,500	June 2006	34	91 %
Whimbrel Terrace	Fort McMurray	6,873,700	June 2006	37	95 %
Laird's Landing	Fort McMurray	51,350,000	August 2006	189	95 %
Woodland Park	Fort McMurray	37,865,000	March 2007	107	99 %
Lakewood Apartments (4)	Fort McMurray	34,527,719	July 2007	111	82 %
Lakewood Townhomes (4) (5)	Fort McMurray	20,218,536	July 2007	51	39 %
Millennium Village	Fort McMurray	24,220,000	November 2007	72	92 %
Parsons Landing (6)	Fort McMurray	60,733,000	September 2008	160	n/a
Westhaven Manor	Edson	4,050,000	May 2007	48	88 %
Northwest Territories					
Beck Court	Yellowknife	14,300,000	April 2004	120	93 %
Nova Court (7)	Yellowknife	15,000,000	March 2007	106	100 %
Total - Residential		**$ 377,407,955**	Total suites	**2,027**	
COMMERCIAL					
Retail and Office					
Colony Square (2)	Winnipeg, MB	$ 7,931,600	October 2008	83,190	96 %
Light Industrial					
156 / 204 East Lake Blvd.	Airdrie, AB	1,600,000	June 2003	39,936	100 %
Purolator	Burlington	1,200,000	September 2003	16,117	100 %
		2,800,000		56,053	
Total - Commercial		**10,731,600**	Total leasable area	**139,243**	
Total investment properties		**$ 388,139,555**			

Property Portfolio

Property	Location	Purchase Price	Acquisition Date	Suites/ Leasable Area - Sq. Ft.	Occupancy December 31 2012
SENIORS' HOUSING COMPLEXES					
Saskatchewan					
Chateau St. Michael's	Moose Jaw	$ 7,600,000	June 2006	93	96 %
Ontario					
Elgin Lodge	Port Elgin	18,122,000	June 2006	124	69 %
Total seniors' housing complexes		**$ 25,722,000**	Total suites	**217**	
Total real estate portfolio		**$ 413,861,555**			

Notes to the Property Portfolio:

(1) Includes the cost of major renovations and asset additions.

(2) Colony Square is comprised of one mixed residential/commercial property.

(3) Parkland Apartments has undergone extensive renovations requiring that the suites be unoccupied. The renovations were completed in the third quarter of 2012.

(4) Effective September 30, 2011, Lakewood Apartments and Lakewood Townhomes are reflected as two separate properties. Prior to this date, the analysis reflected one property of 175 units.

(5) Lakewood Townhomes is comprised of 64 condominium units. The number of suites as of December 31, 2012 reflects the sale of four condominium units in 2011 and nine condominium units in 2012. Thirteen units are unoccupied and held as available for sale.

(6) LREIT obtained possession of Parsons Landing on September 1, 2008. In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. The closing date for Parsons Landing is expected to occur 90 days following the receipt of the final occupancy permit for the reconstructed property.

(7) Property includes 8,400 square feet of commercial space.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The consolidated financial statements and management's discussion and analysis contained in the annual report are the responsibility of the management of Lanesborough Real Estate Investment Trust. To fulfil this responsibility, management maintains systems of internal control which are designed to give reasonable assurance that transactions are authorized and properly recorded, assets are safeguarded and financial records are properly maintained to provide reliable financial information for the preparation of the consolidated financial statements and other financial information. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards and, where appropriate, reflect estimates based on management's best judgment in the circumstances.

The consolidated financial statements have been reviewed and approved by the Board of Trustees and by the Audit Committee, which is comprised of independent Trustees. The Audit Committee meets regularly with management and the auditors. The auditors have full and free access to the Audit Committee.

MNP LLP, the independent auditors, appointed by the Unitholders, have examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the consolidated financial statements.

"Arni C. Thorsteinson"

Arni C. Thorsteinson
Chief Executive Officer

"Kenneth J. Dando"

Kenneth J. Dando
Chief Financial Officer

March 13, 2013

To the Unitholders of Lanesborough Real Estate Investment Trust:

We have audited the consolidated financial statements of Lanesborough Real Estate Investment Trust and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011 and the consolidated statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and 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 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 audit. We conducted our audit 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 the auditors' judgment, 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, the auditor considers internal controls 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 controls. 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 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 financial position of Lanesborough Real Estate Investment Trust and its subsidiaries as at December 31, 2012 and 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates that Lanesborough Real Estate Investment Trust as at December 31, 2012 has a working capital deficit of $4,462,801 and is in breach of certain debt covenants. These conditions, along with other matters as set forth in Note 2, indicate the existence of a material uncertainty that may cast significant doubt about the Trust's ability to continue as a going concern.

Winnipeg, Manitoba
March 13, 2013

MNP LLP
Chartered Accountants

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31 2012	December 31 2011
ASSETS		
Non-current assets		
Investment properties (Note 5)	**$427,967,800**	$451,857,370
Loans and receivables (Note 6)	**11,863,320**	500,000
Defeasance assets (Note 7)	**3,025,370**	3,168,193
Restricted cash (Note 8)	**7,801,248**	15,246,600
Total non-current assets	**450,657,738**	470,772,163
Current assets		
Cash	**1,254,278**	1,170,619
Rent and other receivables (Note 9)	**1,274,277**	2,328,256
Deposits and prepaids (Note 10)	**1,363,730**	1,209,170
	3,892,285	4,708,045
Assets classified as held for sale (Note 11)	**27,002,555**	79,739,862
Total current assets	**30,894,840**	84,447,907
TOTAL ASSETS	**$481,552,578**	$555,220,070
LIABILITIES AND EQUITY		
Liabilities		
Non-current liabilities		
Long-term debt (Note 12)	**$ 88,235,737**	$130,476,452
Total non-current liabilities	**88,235,737**	130,476,452
Current liabilities		
Trade and other payables (Note 13)	**54,040,678**	65,901,274
Current portion of long-term debt (Note 12)	**217,988,812**	208,484,873
Deposits from tenants	**2,428,393**	2,829,861
	274,457,883	277,216,008
Liabilities classified as held for sale (Note 11)	**18,029,004**	67,016,797
Total current liabilities	**292,486,887**	344,232,805
Total liabilities	**380,722,624**	474,709,257
Total equity	**100,829,954**	80,510,813
TOTAL LIABILITIES AND EQUITY	**$481,552,578**	$555,220,070

Approved by the Board of Trustees

"Charles Loewen" *"Cheryl Barker"*

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31	
	2012	**2011**
Rentals from investment properties	**$ 38,410,992**	$ 41,852,726
Property operating costs	**15,981,763**	16,123,335
Net operating income	**22,429,229**	25,729,391
Interest income	**969,607**	328,145
Forgiveness of debt (Note 12)	**859,561**	-
Interest expense (Note 14)	**(33,261,469)**	(33,162,993)
Trust expense	**(2,323,979)**	(2,611,313)
Profit on sale of investment properties	**915,531**	487,095
Fair value gains (Note 5)	**10,308,723**	11,612,337
Fair value adjustment of Parsons Landing (Note 5)	**(3,500,000)**	-
Income recovery on Parsons Landing (Note 5)	**3,278,987**	-
Insurance proceeds (Note 5)	**925,355**	-
Income before taxes and discontinued operations	**601,545**	2,382,662
Current income tax expense (Note 15)	**49,763**	-
Deferred income tax expense (Note 15)	**-**	91,922
Income before discontinued operations	**551,782**	2,290,740
Income from discontinued operations (Note 11)	**19,546,526**	2,744,491
Income and comprehensive income	**$ 20,098,308**	$ 5,035,231
Income per unit before discontinued operations:		
Basic	**$ 0.030**	$ 0.124
Diluted	**$ 0.029**	$ 0.124
Income per unit from discontinued operations:		
Basic	**$ 1.049**	$ 0.149
Diluted	**$ 1.044**	$ 0.148
Income per unit:		
Basic	**$ 1.079**	$ 0.273
Diluted	**$ 1.073**	$ 0.272

The accompanying notes are an integral part of these financial statements

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Year Ended December 31 2012	2011
Issued capital (Note 17)		
Balance, beginning of year	**$107,860,241**	$107,860,241
Issue of units on exercise of warrants	**160,195**	-
Units purchased under normal course issuer bid	**(41,735)**	-
Balance, end of year	**107,978,701**	107,860,241
Contributed surplus		
Balance, beginning of year	**17,108,697**	6,936,834
Value of deferred units granted	**75,000**	75,000
Value of unit options granted	**56,318**	12,921
Maturity of Series F debentures	**-**	3,507,495
Maturity of Series G debentures	**-**	6,167,055
Issue of warrants	**-**	334,874
Warrants exercised	**(28,945)**	-
Debentures purchased under normal course issuer bid	**-**	74,518
Balance, end of year	**17,211,070**	17,108,697
Equity component of debentures		
Balance, beginning of year	**-**	9,749,068
Debentures purchased under normal course issuer bid	**-**	(74,518)
Maturity of Series F debentures	**-**	(3,507,495)
Maturity of Series G debentures	**-**	(6,167,055)
Balance, end of year	**-**	-
Cumulative earnings		
Balance, beginning of year	**22,991,910**	17,956,679
Income and comprehensive income	**20,098,308**	5,035,231
Balance, end of year	**43,090,218**	22,991,910
Cumulative distributions to unitholders		
Balance, beginning and end of year	**(67,450,035)**	(67,450,035)
Total equity	**$100,829,954**	$ 80,510,813

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31 2012	2011
Operating activities		
Income and comprehensive income	**$ 20,098,308**	$ 5,035,231
Adjustments to reconcile income to cash flows		
Fair value gains	**(10,308,723)**	(11,612,337)
Profit on sale of properties	**(15,949,842)**	(487,095)
Fair value adjustment of Parsons Landing	**3,500,000**	-
Forgiveness of debt	**(859,561)**	-
Accrued rental revenue	**371,443**	(553,953)
Unit-based compensation	**131,318**	87,921
Deferred income tax expense	**(5,368,399)**	70,695
Interest income	**(969,607)**	(328,145)
Interest received	**617,668**	280,422
Interest expense	**37,786,525**	36,887,718
Interest paid	**(31,195,083)**	(32,007,967)
Cash from operations	**(2,145,953)**	(2,627,510)
Decrease (increase) in rent and other receivables	**669,456**	(373,842)
Decrease (increase) in deposits and prepaids	**396,039**	(186,671)
Increase (decrease) in tenant deposits	**(757,585)**	793,051
Increase (decrease) in trade and other payables	**(2,700,569)**	828,784
	(4,538,612)	(1,566,188)
Cash provided by (used in) financing activities		
Proceeds of mortgage loan financing	**105,649,377**	51,050,000
Repayment of mortgage loans on refinancing	**(96,804,315)**	(32,558,438)
Repayment of long-term debt	**(8,574,301)**	(9,488,410)
Prepayment of mortgage loans	**(10,435,000)**	-
Proceeds of revolving loan commitment	**34,943,629**	11,850,000
Repayment of revolving loan commitment	**(41,918,629)**	(7,200,000)
Proceeds of Shelter Canadian Properties Limited advances	**16,169,000**	4,765,000
Repayment of Shelter Canadian Properties Limited advances	**(17,352,000)**	(3,582,000)
Expenditures on transaction costs	**(3,258,692)**	(4,200,857)
Exercise of warrants	**131,250**	-
Units purchased and cancelled under normal course issuer bid	**(41,732)**	-
Debentures purchased and cancelled under normal course issuer bid	**(351,000)**	(299,000)
Proceeds (repayment) of line of credit	**-**	(2,960,000)
Proceeds of mortgage bond financing	**-**	3,363,000
Repayment of debentures	**-**	(13,598,000)
	(21,842,413)	(2,858,705)
Cash provided by (used in) investing activities		
Capital expenditures on investment properties	**(2,906,894)**	(2,288,861)
Capital expenditures on property and equipment	**(38,368)**	(86,344)
Decrease (increase) in defeasance assets	**142,823**	145,241
Proceeds of sale	**21,927,121**	52,120
Change in restricted cash	**7,736,373**	6,679,560
	26,861,055	4,501,716
Cash increase (decrease)	**480,030**	76,823
Add (deduct) decrease (increase) in cash from discontinued operations (Note 11)	**(396,371)**	168,750
	83,659	245,573
Cash, beginning of year	**1,170,619**	925,046
Cash, end of year	**$ 1,254,278**	$ 1,170,619

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

1 *Organization*

Lanesborough Real Estate Investment Trust ("the Trust") is a closed-end real estate investment trust, which was created under the laws of the Province of Manitoba by a Declaration of Trust dated April 23, 2002 and amended on June 12, 2006, June 18, 2008 and December 9, 2009.

The registered office for the Trust is located at 2600 Seven Evergreen Place, Winnipeg, Canada. The Trust is listed on the Toronto Stock Exchange ("TSX"). The following schedule reflects securities of the Trust, which trade on the TSX and the related trading symbol:

Units	LRT.UN
Series G Debentures	LRT.DB.G
Mortgage Bonds	LRT.NT.A
Trust unit purchase warrants expiring March 9, 2015	LRT.WT
Trust unit purchase warrants expiring December 23, 2015	LRT.WT.A

The Trust and its subsidiaries earn income from real estate investments in Canada.

2 *Basis of presentation and continuing operations*

The consolidated financial statements of the Trust for the year ended December 31, 2012 ("Financial Statements"), have been prepared in accordance with International Accounting Standards ("IFRS"). The Financial Statements were authorized for issue in accordance with a resolution of the Board of Trustees on March 13, 2013.

The Financial Statements of the Trust reflect the operations of the Trust and LREIT Holdings 36 Corporation (formerly Riverside Terrace Inc.), LREIT Holdings 32 Corporation and LREIT Holdings 39 Corporation, which are wholly owned operating subsidiaries under its control. The Financial Statements have been prepared on a historical cost basis except for investment properties and certain financial instruments that are measured at fair value. The Financial Statements have been prepared on a going concern basis and have been prepared in Canadian dollars.

The Financial Statements do not give effect to adjustments that would be necessary should the Trust be required to realize its assets in other than the normal course of business. The use of IFRS applicable to a going concern may be inappropriate as a result of the potential inability of the Trust to continue as a going concern. The Trust generated income from investment properties of $551,782 for the year ended December 31, 2012 (2011 - $2,290,740); and the Trust incurred a cash deficiency from operating activities of $4,538,612 for the year ended December 31, 2012 (2011 - $1,566,188). In addition, the Trust has a working capital deficit of $4,462,801 as at December 31, 2012 (December 31, 2011 - $13,510,274) and the Trust is in breach of debt service and other covenant requirements on three mortgage loans and one swap mortgage loan (2011 - seven mortgage loans and one swap mortgage loan).

The Trust is in breach of the 1.2 times debt service coverage requirement of a first mortgage loan and a second mortgage loan totaling $69,406,719, on three properties in Fort McMurray, Alberta. The Trust is also in breach of the 1.1 times debt service coverage requirement of a $11,430,588 first mortgage loan on a property in Fort McMurray, Alberta with the same lender. The three mortgage loans in breach of debt coverage requirements, in the aggregate amount of $80,837,307 have matured. A forbearance extension to March 31, 2013 has been obtained for the three mortgage loans.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

2 Basis of presentation and continuing operations (continued)

The Trust is in breach of a 1.15 debt service coverage requirement of a $16,414,032 swap mortgage loan on a property in Fort McMurray, Alberta. The Trust has notified the lender of the breach and is providing operating information to the lender on a monthly basis.

The breaches of the debt service coverage requirements on three mortgage loans and one swap mortgage loan, as noted above, are a result of the slowdown of development activities in the oil sands industry experienced in 2009 and the associated decline in the rental market conditions in Fort McMurray. Notwithstanding that there has been a substantial improvement in the occupancy rate in the Fort McMurray properties of the Trust, all or some of the covenant breaches may continue for the next 12 months. There can be no assurance that the covenant breaches will be remedied.

The Trust was in breach of net operating income achievement, debt service coverage and other covenant requirements on seven mortgage loans and a swap mortgage loan during 2010, 2011, and the first six months of 2012.

There are no cross-default covenants between the mortgage loans noted above and the other mortgage loans, mortgage bonds or debentures of the Trust.

Continuation of operations is contingent upon improving cash flows from operations and in particular, the operating cash flows from the Fort McMurray portfolio, the continuation of the divestiture program, the continued ability of the Trust to renew or refinance its debt and the continued support of related parties in the form of the renewal of the revolving loan commitment, the provision of advances and the deferral of fees.

Management believes that the going concern assumption is appropriate for the Financial Statements as the increasing economic activity in Fort McMurray has resulted in improved occupancy levels, the Trust has successfully sold 21 properties, including 3 properties during the year ended December 31, 2012, the Trust has successfully renewed mortgage loans at maturity and/or obtained forbearance arrangements, the Trust has extended the maturity date for the Series G debentures to 2015 and the Trust has successfully eliminated covenant breaches on four mortgage loans through refinancing and/or improved operations.

If the going concern assumption is inappropriate, adjustments would be necessary to the carrying values of assets and liabilities and reported revenues and expenses used in these Financial Statements.

Statement of compliance
The Financial Statements of the Trust have been prepared in accordance with International Financial Reporting Standards (IFRS). The Trust follows accounting policies under IFRS as disclosed in Note 3. The Financial Statements are based on IFRS standards issued and effective as at March 13, 2013.

3 Significant accounting policies

(a) Principles of consolidation

The Financial Statements comprise the Financial Statements of the Trust and its subsidiaries. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Trust obtains control, and continue to be consolidated until the date that such control ceases. The Financial Statements of the subsidiaries are prepared for the same reporting period as the Trust, using consistent accounting policies.

All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Where property is acquired through the acquisition of corporate interests, management considers the substance of the assets and activities of the acquired entity in determining whether the acquisition represents the acquisition of a business.

Where an acquisition is not judged to be an acquisition of a business, it is not treated as a business combination and the cost to acquire the entity is allocated between the identifiable assets and liabilities of the entity based on their relative fair values at the acquisition date. Accordingly, no goodwill or additional deferred taxation arises. When an acquisition represents the acquisition of a business, the acquisition is accounted for as a business combination.

(b) Investment Properties

The Trust has adopted IAS 40 "Investment Properties" and has chosen the fair value method of presenting investment properties in the Financial Statements.

Investment properties comprise completed properties and properties under construction or re-development held to earn rentals or for capital appreciation or both.

Investment properties are measured initially at cost including transaction costs. Transaction costs include transfer taxes, professional fees for legal services, initial leasing commissions to bring the property to the condition necessary for it to be capable of operating and similar costs. The carrying amount also includes the cost of replacing part of an existing investment property at the time that the cost is incurred if the recognition criteria are met.

Subsequent to initial recognition, investment properties are stated at fair value. Gains or losses arising from changes in the fair values are included in income in the period in which they arise. An investment property is derecognized upon sale.

The fair value of investment properties is determined by the Trust using recognized valuation techniques.

Investment properties held for sale are classified as assets held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

3 Significant accounting policies (continued)

(c) Property and Equipment

Property and equipment are measured at cost less accumulated amortization and any accumulated impairment losses, in accordance with IAS 16 "Property and equipment".

The Trust provides for amortization of property and equipment in order to apply the cost of the assets over the estimated useful lives as follows.

	Method	Rate
Buildings	Straight-line	2.5%
Furniture and equipment	Straight-line	5% - 33.3%

Amortization is not recorded for property and equipment held in discontinued operations.

The Trust assesses at the end of each reporting period whether there is any indication that an asset may be impaired. Property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Assets that do not generate independent cash flows are combined into cash-generating units. Cash generating units are tested for impairment at the end of each reporting period and whenever there is an indication that the cash-generating unit may be impaired. If the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is assessed based on estimated future cash flows discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount and is recorded as an expense.

Assets or cash-generating units that have been impaired in prior periods are tested for possible reversal of impairment whenever events or changes in circumstances indicate that the impairment has reversed. If the impairment has reversed the carrying amount of the asset or cash-generating unit (excluding goodwill) is increased to its recoverable amount but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset in the prior periods. A reversal of an impairment loss is recognized in net income (loss). Impairment losses for goodwill are not reversed.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

3 Significant accounting policies (continued)

(d) Receivables

(i) Rent and other receivables

Rent and other receivables are recognized and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortized cost using the effective interest rate method. Provision is made when there is objective evidence that the Trust will not be able to recover balances in full. Balances are written off when the probability of recovery is assessed as being remote.

(ii) Loans and receivables

Loans and receivables are recognized at amortized cost using the effective interest rate method. Under this method, fees, costs, discounts and premiums directly related to the loans and receivables are recognized in income over the expected life of the loans and receivables. All loans and receivables with maturities greater than 12 months after the Financial Statements date are classified as non-current assets. Provision is made when there is objective evidence that the Trust will not be able to recover balances in full.

(e) Cash

Cash comprises demand and short-term deposits at the bank with an original maturity of twelve months or less.

Cash deposits, which are not available for use by the Trust within a period of twelve months, are carried as restricted cash.

(f) Assets classified as held for sale

Held for sale assets
Investment Property is transferred to assets held for sale when it is expected that the carrying amount will be recovered principally through sale rather than from continuing use. For this to be the case the property must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such property and its sale must be highly probable.

For the sale to be highly probable:

- The Trustees must be committed to a plan to sell the property and an active program to locate a buyer and complete the plan must have been initiated
- The property must be actively marketed for sale at a price that is reasonable in relation to its current fair value
- The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification

3 Significant accounting policies (continued)

(f) Assets classified as held for sale (continued)

Assets classified as held for sale are recorded as follows:

Investment Properties - fair value as stated in subparagraph (b) Investment Properties above
All other assets - lower of carrying value or fair value

Assets classified as held for sale will also be recovered principally through a sale transaction instead of use. Such assets are not depreciated or amortized.

Discontinued operations
A discontinued operation is a part of the Trust's business that:

- Has been disposed of or has been classified as held for sale and that represents a major line of its business or geographic area of operation;
- Is part of a single coordinated plan to dispose of such a line of business or area of operations, or
- Is a subsidiary acquired exclusively with a view to resell.

The results of discontinued operations are presented separately on the Statement of Comprehensive Income and the assets and liabilities are presented separately on the Statement of Financial Position.

(g) Mortgages loans and mortgage bonds

All mortgages loans and mortgage bonds are initially recognized at fair value less directly attributable transaction costs. After initial recognition, interest bearing loans and bonds are subsequently measured at amortized cost using the effective interest rate method. Under the effective interest rate method, any transaction fees, costs, discounts and premiums directly related to the loans and bonds are recognized in the Statement of Comprehensive Income over the expected life of the borrowings. Interest payable is recognized on an accrual basis. All mortgage loans and mortgage bonds with maturities greater than twelve months are classified as non-current liabilities. Notwithstanding the previous statement, mortgage loans and mortgage bonds with maturities greater than twelve months, but which are in breach of a debt covenant, and the debt becomes payable on demand as a result of said breach at the financial statement date, are classified as current liabilities.

(h) Debentures

Debentures are separated into debt and equity components based on the respective fair values at the date of issue. The value of the debt component is calculated at the estimated fair value of the future interest and principal payments due under the terms of the debentures. The value assigned to the equity component of debentures represents the value of the conversion feature.

Subsequent to initial recognition, the liability component of a debenture is measured at amortized cost using the effective interest method. The equity component of a debenture is not measured subsequent to initial recognition.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

3 Significant accounting policies (continued)

(i) Unit options

The Trust has a unit option plan available for trustees, officers and employees of the Trust, as well as management company employees of the Trust, including Shelter Canadian Properties Limited and consultants retained by the Trust, including investor relations consultants. Consideration paid by option holders on exercise of unit options is credited to Equity. The fair value based method of accounting is applied to all unit-based compensation. The fair value of the unit options granted is estimated on the date of grant using the Black-Scholes option pricing model. At the end of each reporting period, the estimate of unit options expected to vest is revised and compensation expense in regard to options granted to officers, employees and trustees is recognized.

(j) Tenant deposits

Tenant deposits liabilities are initially recognized at fair value. Where the time value of money is material, tenant deposits are carried at amortized cost, using the effective interest rate method. Any difference between the initial fair value and the amortized cost is included as a component of rentals from investment properties and recognized on a straight-line basis over the lease term.

(k) Revenue recognition

Management has determined that all of the leases with tenants are operating leases.

Rents are recognized as revenue over the terms of the related lease agreements. Rental revenue from leases with contractual rent increases is recognized on a straight-line basis over the term of the respective leases. The difference between the rental revenue recognized and the amount contractually due under the lease agreements is recorded to deferred rent receivable. Recoveries from tenants for property operating costs and property taxes are recognized as revenue during the period in which the applicable costs are incurred.

Incentives for lessees to enter into lease agreements are spread evenly over the lease term, even if payments are not made on such a basis. The lease term is the non-cancelable period of the lease together with any further term for which the tenant has the option to continue the lease, where, at the inception of the lease, it is reasonably certain that the tenant will exercise that option.

Premiums received to terminate leases are recognized in the income statement when they arise.

Meal and other revenue is recognized on the delivery of the meal or other service.

Interest income is recognized on an accrual basis using the effective interest method.

A property is regarded as sold and the gain or loss on sale is recognized when the significant risks and returns have been transferred to the buyer, which is normally upon closing on unconditional contracts. For conditional exchanges, sales are recognized only when all the significant conditions are satisfied.

3 Significant accounting policies (continued)

(l) Income taxes

Status of the Trust for income tax purposes
The Trust qualifies as a closed-end mutual fund trust for income tax purposes. Prior to the enactment of legislation relating to the federal income taxation of publicly listed or traded trusts, the Trust was not subject to taxation on its income for a year to the extent that such income was distributed to the unitholders of the Trust, and those unitholders were, and would have been, subject to taxation as appropriate on such distributed income.

New legislation relating to the federal income taxation of specified investment flow-through trusts and partnerships (each a "SIFT") was enacted on June 22, 2007. The legislation and amendments which have been enacted or substantively enacted on or before December 31, 2012, are referred to as the "SIFT Rules". The Trust became a SIFT and subject to the SIFT Rules following a transition period on January 1, 2011. Under the SIFT Rules, certain distributions of income from a SIFT are no longer deductible in computing a SIFT's taxable income, and a SIFT is subject to taxation at a rate that is substantially equivalent to the general income tax rate applicable to a taxable Canadian corporation.

The SIFT Rules do not apply to a "real estate investment trust" that meets certain conditions relating to the nature of its property and revenue (the "REIT Exception"). The REIT Exception contains a number of technical tests related to the property and revenue of a trust which must be monitored on an ongoing basis.

The Trust did not qualify for the REIT Exception, and therefore was subject to the SIFT Rules, in 2011 and 2012. The REIT Exception is applied on an annual basis and accordingly the Trust may be able to qualify for the REIT Exception in 2013 and subsequent years. Prior to the end of 2012, the Trust disposed of certain non-qualifying properties, including its interests in two seniors' housing complexes. As a result of the disposition of the non-qualifying properties and other transactions, the Trust intends to qualify for the REIT Exception in 2013 and subsequent years. If the Trust qualifies for the REIT Exception in a particular year, the SIFT Rules will not apply to the Trust during that year, and the Trust shall not be subject to taxation on its income for that year to the extent that such income is distributed to the unitholders of the Trust. Under such circumstances, the Trust intends to make sufficient distributions to its unitholders so that the Trust will not be subject to taxation.

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of the Trust. The determination as to whether the Trust qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that the Trust will qualify for the REIT Exception in 2013 and subsequent years. There can be no assurance that the Trust will qualify for the REIT Exception and that the Trust will not be subject to income taxes imposed by the SIFT Rules in 2013 or any subsequent year.

3 Significant accounting policies (continued)

(l) Income taxes (continued)

Current taxes
Current tax assets and liabilities for the current and prior periods are measured at amounts expected to be recovered from or paid to the taxation authorities, including interest. The tax rates and tax laws used to compute those amounts are the tax rates and tax laws which have been enacted or substantively enacted by the end of the reporting period.

Deferred taxes
Because management believes that the Trust will qualify for the REIT Exception in 2013 and subsequent years, deferred tax assets and liabilities are recognized only in respect of unused tax losses and temporary differences between the accounting and tax bases of assets and liabilities of the Trust's subsidiary corporations.

Deferred tax assets are recognized only to the extent that it is probable that the benefits of the unused tax losses and the deductible temporary differences can be realized. The recoverability of deferred tax assets is reassessed by management at the end of each reporting period.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the periods when the assets are realized or the liabilities are settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

(m) Provisions

Provisions are recognized when the Trust has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will occur; and where a reliable estimate can be made of the amount of the obligation.

Where the effect of discounting is material, provisions are determined by discounting the expected future cash flows. The discount rate used is a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

The amount recognized as a provision is the best estimate at the reporting date of the expenditure required to settle the obligation.

(n) Per unit calculations

Basic per unit information is calculated using the weighted average number of units outstanding for the period, including vested deferred units. Diluted per unit information is calculated based on the weighted average diluted number of units for the period after considering the dilutive effect of unvested deferred units, the potential exercise of outstanding unit options to the extent that the unit options are dilutive and the potential exercise of trust purchase warrants to the extent that the warrants are dilutive. The diluted weighted average number of units is calculated assuming the proceeds that arise from the exercise of the outstanding options are used to purchase units of the Trust at their average market price for the period.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

3 *Significant accounting policies (continued)*

(o) Financial instruments

Financial instruments are measured at fair value on initial recognition. The measurement in subsequent periods and classification of financial assets and liabilities is dependent on the purpose for which the instruments were acquired or issued, their characteristics and the Trust's designation of such instruments. Financial assets and financial liabilities classified as fair value through profit and loss are subsequently measured at fair value with gains and losses recognized in net income (loss). Financial assets classified as held to maturity, loans and receivables, and other liabilities are subsequently measured at their amortized cost, using the effective interest method. Available for sale financial assets are subsequently measured at fair value with unrealized gains and losses recognized in other comprehensive income until disposition of the financial asset.

Financial instruments are derecognized when the Trust no longer controls the contractual rights that comprises a financial asset or when the obligation under a financial liability has been discharged, concluded or expired.

Based on the purpose for which assets and liabilities are acquired, the Trust has designated its financial instruments, as follows:

Financial Statement Item	Classification	Measurement
Loans and receivables	Loans and receivables	Amortized cost
Defeasance assets	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Cash	Loans and receivables	Amortized cost
Rent and other receivables	Loans and receivables	Amortized cost
Deposits	Loans and receivables	Amortized cost
Long term debt		
Mortgage loans	Other liabilities	Amortized cost
Mortgage bonds	Other liabilities	Amortized cost
Debentures	Other liabilities	Amortized cost
Swap mortgage loan	Fair value through profit and loss	Fair value
Defeased liability	Other liabilities	Amortized cost
Mortgage guarantee fees	Other liabilities	Amortized cost
Trade and other payables	Other liabilities	Amortized cost
Deposits from tenants	Other liabilities	Amortized cost

The Trust assesses impairment of all financial assets, except those classified as held-for-trading. Management considers whether there has been a breach in contract, such as a default or delinquency in interest or principal payments in determining whether objective evidence of impairment exists. Impairment is measured as the difference between the asset's carrying value and its fair value. Impairment is included in income.

3 *Significant accounting policies (continued)*

(p) Future changes to significant accounting policies

The following new or amended standards have been issued by the IASB:

- IFRS 9 - replaces IAS 39 - Financial Instruments: Recognition and Measurement, retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value, effective for annual periods beginning on or after January 1, 2015 with earlier application permitted.

- IFRS 10 - Financial Statements - replaces IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities, provides a single consolidation model that identifies control as the basis for consolidation for all types of entities, effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

- IFRS 11 - Joint Arrangements - supersedes IAS 31 Interests in Joint Ventures and SIC-13-Jointly Controlled Entities-Non-monetary Contributions by Venturers, established principles for the financial reporting by parties to a joint arrangement, effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

- IFRS 12 - Disclosure of Interests in Other Entities - combines, enhances and replaces the disclosure requirements for subsidiaries, joint arrangement, associates and unconsolidated structured entities, effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

- In conjunction with IFRS 10, IFRS 11 and IFRS 12, the IASB also issued amended and retitled IAS 27 - Separate Financial Statements and IAS 28 - Investments in Associates and Joint Ventures, effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

- IFRS 13 - Fair Value Measurement - defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements, effective for annual periods beginning on or after January 1, 2013 with earlier application permitted.

The Trust is currently evaluating the impact of these standards on its Financial Statements.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

4 Significant accounting judgments, estimates and assumptions

The preparation of the Financial Statements of the Trust requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent liabilities at the Financial Statements date. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected.

(a) Judgments other than estimates

In the process of applying the accounting policies of the Trust, management has made the following judgments, which have the most significant effect on the amounts recognized in the Financial Statements:

Business combinations

The Trust acquires subsidiaries that own real estate. At the time of acquisition, the Trust considers whether the acquisition represents the acquisition of a business. The Trust accounts for an acquisition as a business combination when an integrated set of activities is acquired in addition to the property. More specifically, the following criteria are considered:

- The extent of the land and buildings owned by the subsidiary
- The extent to which significant processes are acquired and in particular the extent of ancillary services provided by the subsidiary (e.g., maintenance, cleaning, security, bookkeeping, meal services, etc.)
- Whether the subsidiary has allocated its own staff to manage the property and/or to deploy any processes (including all relevant administration such as invoicing, cash collection, provision of management information to the entity's owners and tenant information)

When the acquisition of subsidiaries does not represent a business, it is accounted for as an acquisition of a group of assets and liabilities. The cost of the acquisition is allocated to the assets and liabilities acquired based upon their relative fair values.

Operating lease contracts

The Trust has entered into leases with tenants. The Trust has determined, based on an evaluation of the terms and conditions of the arrangements, that it retains all the significant risks and rewards of ownership of the investment properties and accounts for the leases as operating leases.

Fair value of Parsons Landing

The preparation of the Financial Statements required judgments and estimates concerning the fair value of Parsons Landing in regard to impaired value of the property as a result of the February 2012 fire and reconstruction.

4 Significant accounting judgments, estimates and assumptions (continued)

(b) Estimates

Valuations of property

Investment property is stated at fair value as at the financial statement date. Gains or losses arising from changes in the fair values are included in income in the period in which they arise. The valuations are prepared using recognized valuation techniques to determine the fair value of investment properties. The techniques comprise both the capitalized net operating income method and the discounted cash flow method. In certain cases, the fair values are determined based on recent real estate transactions with similar characteristics and location to those of the assets of the Trust.

Investment property under construction is also valued at fair value as determined by independent real estate valuation experts, except if such values cannot be reliably determined. In the exceptional cases when a fair value cannot be readily determined, such properties are recorded at cost. The fair value of investment properties under construction is determined using either the Discounted Cash Flow Method or the Residual Method.

The determination of the fair value of investment properties requires the use of estimates on future cash flows from assets (considering the implication of lease terms, tenant profiles, anticipated capital expenditures, property conditions and similar variables) and discount rates applicable to those assets. The estimates are based on local market conditions existing at the financial statement date.

Other factors such as the continuing volatility in the global financial system and its effect on real estate markets are reflected in the estimates of market values. Management used their market knowledge and professional judgment and has not relied solely on historic transactional comparables or external appraisals obtained. In these circumstances, there is a greater degree of uncertainty than which exists in a more active market in estimating the market values of investment property.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

4 Significant accounting judgments, estimates and assumptions (continued)

(b) Estimates (continued)

Income Taxes

Management has reviewed the SIFT Rules and the REIT Exception and assessed their application to the property and revenue of the Trust. The determination as to whether the Trust qualifies for the REIT Exception in any year can only be made after the end of that year. While there are uncertainties in the interpretation and application of the SIFT Rules and the REIT Exception, management believes that the Trust will qualify for the REIT Exception in 2013 and subsequent years. There can be no assurance that the Trust will qualify for the REIT Exception and that the Trust will not be subject to income taxes imposed by the SIFT Rules in 2013 or any subsequent year.

If the Trust does not qualify for the REIT Exception, the Trust would need to recognize deferred tax assets and liabilities in respect of its own unused tax losses and temporary differences between the accounting and tax bases of assets and liabilities. The impact on the Trust's Financial Statements is as follows:

- an understatement of deferred tax liabilities at December 31, 2012, in the amount of $935,762;
- an understatement of deferred tax expense for the year ended December 31, 2012, in the amount of $935,762;
- an overstatement of income before discontinued operations and of income and comprehensive income for the year ended December 31, 2012, in the amount of $935,762; and
- an overstatement of cumulative earnings and of total equity at December 31, 2012, in the amount of $935,762.

5 Investment properties

The carrying amount of investment properties is summarized as follows:

	Year Ended December 31 2012	2011
Balance, beginning of year	$451,857,370	$439,300,000
Additions - capital expenditures	2,906,894	2,288,861
Fair value gains	10,308,723	11,612,337
Dispositions (a)	(33,605,187)	(1,343,828)
Fair value adjustment of Parsons Landing (b)	(3,500,000)	-
Balance, end of year	$427,967,800	$451,857,370

The Trust values investment properties at fair value using recognized valuation techniques and, on a periodic basis, external property valuations.

5 *Investment properties (continued)*

Investment properties have been valued using the following methods and key assumptions:

(i) *The capitalized net operating income method.* Under this method, capitalization rates are applied to net operating income. The key assumption is the capitalization rates which are based on reports from external knowledgeable property valuators. The capitalization rate reports provide a range of rates for various geographic regions and for various types and qualities of properties within each region.

The table below provides details of the range of capitalization rates used for valuing the investment properties of the Trust:

	December 31 2012		December 31 2011	
	Low	High	Low	High
Residential properties				
Fort McMurray	7.00 %	7.50 %	7.50 %	7.50 %
Yellowknife	7.50 %	8.75 %	7.50 %	8.75 %
Major Canadian cities	4.75 %	4.75 %	5.25 %	5.25 %
Impaired property	7.00 %	7.00 %	n/a	n/a
Other	6.25 %	8.00 %	6.25 %	8.00 %
Commercial properties	7.00 %	7.50 %	7.50 %	7.50 %

(ii) *The discounted cash flow method*. Under this method, discount rates are applied to the forecasted cash flows reflecting the initial terms of the leases for the specific property and assumptions as to renewal and new leasing activity. The key assumption is the discount rate applied over the useful life of the investment property.

The table below provides details of the range of discount rates used for valuing the investment properties of the Trust:

	December 31 2012		December 31 2011	
	Low	High	Low	High
Residential properties				
Fort McMurray	9.00 %	9.50 %	8.75 %	8.75 %
Yellowknife	9.50 %	10.75 %	8.75 %	10.00 %
Major Canadian cities	6.75 %	6.75 %	6.25 %	6.25 %
Impaired property	9.00 %	9.00 %	n/a	n/a
Other	8.25 %	10.00 %	7.25 %	9.25 %
Commercial properties	9.00 %	9.50 %	8.50 %	8.50 %

(iii) *Direct comparison*. For properties with condominium title, comparisons to the sale price of similar condominium units establishes gross sales proceeds from which the cost of completing a condominium conversion and sales program are deducted to achieve a property value. The key assumption is the cost of the condominium conversion and sales program. Direct comparison valuation analyses are prepared for Colony Square, Laird's Landing, Lakewood Apartments, Lakewood Townhomes, Millennium Village and Woodland Park.

5 Investment properties (continued)

(iv) *External appraisals and reports.* Independent valuations on all investment properties are carried out in order to reduce the risk that the carrying amount of each investment property does not differ materially from its fair value. The following schedule outlines the expected timetable for completion of appraisals:

Property Value	Number of Properties	Carrying Value at December 31, 2012	Valuation Update Timetable
Greater than $10 Million	10	$ 370,352,100	Three years
Less than $10 Million	12	57,615,700	Five years
	22	$ 427,967,800	

The Trust utilizes capitalization and discount rates within the ranges provided in market reports by knowledgeable property valuators. To the extent that the externally provided capitalization rate and discount rate ranges change from one reporting period to the next; or should another rate within the provided ranges be considered by the Trust to be more appropriate than the rate previously used, the fair value of the investment properties would increase or decrease accordingly.

To assist in the determination of fair value at December 31, 2012, external appraisals were obtained in 2012 for 14 properties having a fair value of $249.7 Million representing 58% of the total carrying value of investment properties. Appraisals were obtained in 2011 for 6 properties having an aggregate fair value of $170.9 Million representing 40% of the total carrying value of investment properties. Appraisals were obtained in 2010 for 2 properties having an aggregate fair value of $7.4 Million representing 2% of the total carrying value of investment properties.

(v) *Property sales*. The sale of properties provides valuable information on market conditions. Projects which are subject to an unconditional sale agreements are valued at the sale price less estimated selling expenses.

The valuation of investment properties considers all of the information generated by the above noted methods and assumptions and also considers any capital expenditures anticipated within the year.

(a) Property dispositions

On May 1, 2012, the Trust sold Siena Apartments for gross proceeds of $30,500,000 resulting in a gain on sale of $346,770. Revenue and expenses of Siena Apartments are carried in "Properties Sold" in the December 31, 2012 Financial Statements and, prior to June 30, 2012, were carried in "Fort McMurray" for segmented reporting purposes.

The following table reflects the results of the sale of condominium units at Lakewood Townhomes:

	Year Ended December 31	
	2012	2011
Units sold	9	4
Gross proceeds	$4,396,400	$1,927,100
Gain on sale	$568,761	$487,095

5 Investment properties (continued)

(b) Fair value adjustment of Parsons Landing

On September 1, 2008, the Trust acquired possession of Parsons Landing for a total cost of $63,200,000, including GST.

The permanent mortgage financing for the purchase of Parsons Landing is uncompleted and, as a result, the builder agreed to several extensions of the closing date under the purchase agreement, with a requirement for LREIT to make additional payments on the balance owing of $500,000 on May 12, 2009, $2 Million on February 17, 2012 and $3 Million at closing. The builder also agreed to accept interest payments of $300,000 per month to the closing date and to forgive interest in excess of $300,000 per month, for the period from January 1, 2010 to the closing date, provided the acquisition is completed on the closing date, as extended. As of December 31, 2012, interest in excess of $300,000 per month amounted to $20,478,331.

On closing, the builder has agreed to provide a second mortgage, to a maximum amount of $12,000,000, for a 3 year term with interest at 8% for the first 30 months, 12% for the next 4 months and 24% thereafter. On closing, the builder has also agreed to provide a credit of $1,440,000 for furniture purchased by the Trust. The Trust may also elect, at any time, to surrender possession of Parsons Landing, along with the furniture, to the builder for the amount of $1. In addition, 2668921 Manitoba Ltd. agreed to maintain the revolving loan commitment with the Trust, in the amount of $8,800,000, until closing.

In February 2012, a fire occurred at Parsons Landing which destroyed one wing of the property and resulted in substantial damage to the other two wings. In June 2012, an agreement was reached with the builder under which the builder agreed to reconstruct the property and attend to the recovery of the insurance claims for property damage and revenue losses. The cost of reconstruction is expected to be fully covered under the insurance policy. All damaged materials have been removed from the property, the construction manager has been appointed and reconstruction work has commenced.

In June 2012, the purchase agreement was also amended to provide for an extension of the closing date to the date which is 90 days following the date on which an occupancy permit is issued for the last residential units to be reconstructed. In addition, under the terms of the amended agreement, insurance proceeds for revenue losses shall be for the benefit of the Trust. To the extent that insurance proceeds for revenue losses are less than the interest payment during the reconstruction period, the shortfall shall be forgiven. The payment of $300,000 monthly interest will be funded from insurance proceeds as noted above.

As of December 31, 2012, the balance owing in regard to the acquisition of Parsons Landing, including GST and excluding accrued interest, is $45,720,000.

5 *Investment properties (continued)*

(b) Fair value adjustment of Parsons Landing (continued)

Impact on Financial Statements
The Financial Statements reflect the following:

Fair value adjustment of Parsons Landing
Parsons Landing is classified as an investment property and is carried at fair value. The carrying value of the property at December 31, 2011 was $47,800,000.

During the first quarter of 2012 and in the absence of an agreement with the builder to reconstruct the property in a coordinated manner with the insurer, the investment property was written down from the carrying value of $47,800,000 at December 31, 2011 to $20,000,000 at March 31, 2012, which represented the fair value of the investment property after accounting for the loss in value resulting from the fire.

As a result of the commitment by the builder to reconstruct the property and pursue recovery of all construction costs from the insurer, the estimated fair value of the property at December 31, 2012 has increased to $44,300,000 which represents the estimated fair value at closing, discounted at 9% for the estimated time period of reconstruction. The increase in fair value of $24,300,000 is reflected in the income of the Trust. The fair value is based on an estimated closing of April 1, 2014.

Insurance proceeds
An insurance policy for the furniture and equipment of the property was arranged by the Trust. As of December 31, 2012, the insurer has agreed to process a cash settlement of $925,355. Insurance proceeds of $925,355 are reflected in the income of the Trust.

Income recovery and interest expense
The Financial Statements reflect operating revenues and expenses of Parsons Landing from January 1, 2012 to the date of the fire on February 5, 2012.

Subsequent to February 5, 2012, the Financial Statements reflect the monthly interest in the amount of $300,000 and the accrued revenue in regard to recovery of insurance proceeds for revenue losses. The accrued revenue is reflected as "Income recovery" in the income of the Trust.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

6 Loans and receivables

	December 31 2012	December 31 2011
Second mortgage loan due May 8, 2014, bearing interest at 12.5%, of which 5% shall be payable monthly and 7.5% shall be capitalized and added to the outstanding principal amount	$ 7,888,320	$ -
Second mortgage loan due October 1, 2014, bearing interest at 5% and providing for monthly payments of interest only arising on the sale of property	500,000	500,000
Second mortgage loan due December 6, 2017, bearing interest at 5% and providing for monthly payments of interest only arising on the sale of property	3,200,000	-
Interest free mortgage loan due on the earlier of the sale date of a condominium unit or the maturity date of May 8, 2014	275,000	-
Note receivable from a previous tenant. The loan bears interest at 12% and is secured by mortgages registered against the titles of recreational properties.	250,000	250,000
	12,113,320	750,000
Current portion of loans and receivables	(250,000)	(250,000)
	$ 11,863,320	$ 500,000

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

7 Defeasance assets and defeased liability

In conjunction with the sale of Woodlily Court on September 1, 2010, an existing $2,818,509 mortgage loan payable was defeased ("Defeased Liability"). The Defeased Liability is due July 1, 2016, bears interest at 5.65%, is repayable in monthly payments of $17,191 and is amortized over 30 years. The Trust purchased Government of Canada bonds, Government of Canada treasury bills and Canada mortgage bonds ("Defeasance Assets") in the amount of $3,338,341 and pledged the Defeasance Assets as security to the debt holder. The Defeasance Assets mature on or before June 1, 2016, have a weighted average interest rate of 3.79% (December 31, 2011 - 3.81%) and have been placed in escrow. The Defeasance Assets and the Defeased Liability will be measured at amortized cost using the effective interest rate method of amortization until July 1, 2016 at which time the debt will be extinguished.

The following table reflects the effect of the Defeasance Assets and the Defeased Liability on income.

		Year Ended December 31	
	Recorded as	2012	2011
Interest income on Defeasance Assets	Interest income	$ 63,475	$ 61,055
Interest expense on Defeased Liability	Interest expense	(152,234)	(155,164)
Amortization of transaction costs	Interest expense	(9,647)	(12,280)
		$ (98,406)	$ (106,389)

The unamortized balance of transaction costs in respect of the Defeased Liability is $33,946 (2011 - $43,592).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

8 Restricted cash

	December 31 2012	December 31 2011
Tenant security deposits	$ 2,393,985	$ 2,792,816
Reserves required by mortgage loan agreements	5,407,263	12,453,784
	$ 7,801,248	$ 15,246,600

9 Rent and other receivables

	December 31 2012	December 31 2011
Rent receivable	$ 247,733	$ 728,258
Less: allowance for uncollectible accounts	(20,051)	(163,553)
	227,682	564,705
Other receivables	444,751	790,264
Deferred rent receivable	351,844	723,287
	1,024,277	2,078,256
Current portion of loans and receivables	250,000	250,000
	$ 1,274,277	$ 2,328,256

10 Deposits and prepaids

	December 31 2012	December 31 2011
Deposits		
Property tax deposits	$ 502,158	$ 522,304
Deposit on potential acquisition	10,000	10,000
Utility deposits	1,380	630
Deposit with Canada Revenue Agency	153,709	250,000
	667,247	782,934
Prepaid expenses	696,483	426,236
	$ 1,363,730	$ 1,209,170

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

11 Assets and liabilities of properties held for sale

The Trust intends to dispose of assets, which do not meet the definition of assets of qualifying REITs as defined by the Income Tax Act (Canada). As a result, the Trust has classified the seniors' housing complexes, which are owned by wholly owned subsidiary companies, as discontinued operations.

Assets and liabilities classified as "held for sale" as at December 31, 2012, are as follows:

	December 31 2012	December 31 2011
ASSETS		
Assets in discontinued operations		
Property and equipment (a)	$ 26,115,114	$ 78,383,871
Cash	784,447	388,076
Restricted cash	40,128	331,149
Rent and other receivables	9,891	33,192
Deposits, prepaids and other	52,975	603,574
Assets classified as held for sale	$ 27,002,555	$ 79,739,862
LIABILITIES		
Liabilities in discontinued operations		
Long term debt (b)	$ 15,278,462	$ 59,543,769
Deferred tax (c)	285,734	5,654,133
Trade and other payables	2,200,048	1,198,018
Deposits from tenants	264,760	620,877
Liabilities classified as held for sale	$ 18,029,004	$ 67,016,797

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

11 Assets and liabilities of properties held for sale (continued)

Income and cash flow information relating to discontinued operations are as follows.

	Year Ended December 31 2012	2011
Rental income	$ 12,948,869	$ 15,371,667
Property operating expenses	7,319,163	8,849,075
Net operating income	5,629,706	6,522,592
Interest expense (d)	4,525,056	3,724,725
Profit on sale	15,034,311	-
Current tax expense (recovery)	1,960,834	81,078
Deferred tax expense (recovery)	(5,368,399)	(27,702)
Income from discontinued operations	$ 19,546,526	$ 2,744,491
Cash inflow from operating activities	$ 2,230,109	$ 2,880,803
Cash outflow from financing activities	(55,016,150)	(2,891,903)
Cash inflow (outflow) from investing activities	53,182,412	(157,650)
Increase (decrease) in cash from discontinued operations	$ 396,371	$ (168,750)

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

11 Assets and liabilities of properties held for sale (continued)

(a) Property and equipment

On May 9, 2012, Clarington Seniors' Residence was sold for gross proceeds of $24,000,000 resulting in a gain on sale of $1,904,697.

On December 6, 2012, Riverside Terrace was sold for gross proceeds of $44,000,000 resulting in a gain on sale of $13,129,614.

December 31, 2012	Cost, Beginning of Year	Additions/ Disposals	Accumulated Amortization	Net Book Value
Land	$ 6,098,190	$ (1,966,090)	$ -	$ 4,132,100
Buildings and improvements	71,782,003	(48,815,761)	(3,050,825)	19,915,417
Furniture, equipment and appliances	1,570,198	(1,112,796)	(280,546)	176,856
	79,450,391	(51,894,647)	(3,331,371)	24,224,373
Valuation adjustment	2,264,851	(374,110)	-	1,890,741
	$ 81,715,242	$ (52,268,757)	$ (3,331,371)	$ 26,115,114

December 31, 2011	Cost, Beginning of Year	Additions/ Disposals	Accumulated Amortization	Net Book Value
Land	$ 6,098,190	$ -	$ -	$ 6,098,190
Buildings and improvements	71,697,286	84,717	(3,050,825)	68,731,178
Furniture, equipment and appliances	1,549,743	20,455	(280,546)	1,289,652
	79,345,219	105,172	(3,331,371)	76,119,020
Valuation adjustment	2,264,851	-	-	2,264,851
	$ 81,610,070	$ 105,172	$ (3,331,371)	$ 78,383,871

11 Assets and liabilities of properties held for sale (continued)

(a) Property and equipment (continued)

The carrying value in property and equipment is comprised of the following:

	Year Ended December 31 2012	2011
Balance, beginning of year	$ 78,383,871	$ 78,278,699
Additions - capital expenditures	38,368	105,172
Disposals	(52,307,125)	-
Balance, end of year	$ 26,115,114	$ 78,383,871

(b) Long term debt

	December 31 2012	2011
Secured debt		
Mortgage loans	$ 15,295,629	$ 60,152,797
Unamortized transaction costs	(17,167)	(609,028)
Total long term debt	$ 15,278,462	$ 59,543,769

Certain of the mortgage loans are subject to covenants, including debt service coverage requirements. As of December 31, 2012, the Trust was in compliance with all mortgage covenants.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

11 Assets and liabilities of properties held for sale (continued)

(c) Deferred tax

Deferred tax liabilities consist of the following:

	December 31 2012	December 31 2011
Temporary differences between the accounting and tax bases of property and equipment	$ -	$ 5,663,279
Temporary differences between the accounting and tax bases of transaction costs	-	(9,146)
Temporary differences between the accounting and tax bases of investments held by subsidiaries	285,734	-
	$ 285,734	$ 5,654,133

At December 31, 2012, the Trust has deductible temporary differences and unused tax losses related to discontinued operations for which no deferred tax asset is recognized as follows:

Deductible temporary differences:

	December 31 2012	December 31 2011
Property and equipment	$ 517,576	$ 3,738,010
Transaction costs	$ 48,832	$ 347,623

Unused tax losses expiring in:

2026	$ 102,771	$ 102,771
2027	402,868	2,354,011
2028	549,398	2,510,247
2029	572,355	2,397,735
2030	179,698	1,858,141
2031	104,821	928,264
2032	271,451	-
	$ 2,183,362	$ 10,151,169

(d) Interest expense

	Year Ended December 31 2012	Year Ended December 31 2011
Mortgage loan interest	$ 2,658,578	$ 3,340,258
Mortgage prepayment penalty	1,289,083	-
Amortization of transaction costs	577,395	384,467
	$ 4,525,056	$ 3,724,725

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

12 Long-term debt

	December 31 2012	December 31 2011
Secured debt		
Mortgage loans (a)	$ 247,654,245	$ 254,863,171
Swap mortgage loan (b)	17,888,836	42,942,356
Mortgage bonds (c)	14,458,831	14,058,307
Debentures (d)	24,961,000	25,312,000
Defeased liability	2,701,511	2,755,325
Total secured debt	307,664,423	339,931,159
Mortgage guarantee fees	133,864	-
Total debt	307,798,287	339,931,159
Accrued interest payable	1,746,367	2,019,182
Unamortized transaction costs		
Mortgage loans	(1,531,326)	(731,004)
Swap mortgage loan	(108,024)	(95,187)
Mortgage bonds	(1,033,704)	(1,269,679)
Debentures	(613,105)	(849,554)
Defeased liability	(33,946)	(43,592)
Total unamortized transaction costs	(3,320,105)	(2,989,016)
	306,224,549	338,961,325
Less current portion		
Mortgage loans	(201,725,598)	(185,523,843)
Swap mortgage loan	(16,414,032)	(21,913,931)
Defeased liability	(56,896)	(53,813)
Mortgage guarantee fees	(42,502)	-
Accrued interest payable	(1,746,367)	(2,019,182)
Transaction costs	1,996,583	1,025,896
Total current portion	(217,988,812)	(208,484,873)
	$ 88,235,737	$ 130,476,452
Current portion of unamortized transaction costs		
Mortgage loans	$ 1,340,398	$ 458,322
Swap mortgage loan	108,024	113,145
Mortgage bonds	278,909	235,975
Debentures	259,240	208,905
Defeased liability	10,012	9,549
	$ 1,996,583	$ 1,025,896

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

12 Long-term debt (continued)

Long-term debt has both fixed and variable interest rates. At December 31, 2012, the contractual weighted average interest rate for variable rate long-term debt was 9.0% and for fixed rate long-term debt was 4.8% (December 31, 2011 - variable - 8.5%, fixed - 5.7%).

Normal principal installments and principal maturities at face value are as follows:

	Mortgage Loans			
Year ending December 31	Normal Principal Installments	Principal Maturities	Debentures and Mortgage Bonds	Swap Mortgage Loan
2013 (1)	$ 1,970,638	$199,754,960	$ -	$16,414,032
2014	937,528	8,762,938	-	-
2015	893,820	5,800,403	40,961,000	-
2016	501,544	10,663,030	-	-
2017	360,388	18,008,996	-	-
	$ 4,663,918	$242,990,327	$ 40,961,000	$16,414,032

Year ending December 31	Defeased Liability	Mortgage Guarantee Fees	Total Long-term Debt	Weighted average interest rate of long-term debt
2013	$ 56,896	$ 42,502	$218,239,028	7.7%
2014	60,155	44,587	9,805,208	5.0%
2015	63,602	46,775	47,765,600	8.7%
2016	2,520,858	-	13,685,432	5.1%
2017	-	-	18,369,384	5.7%
	$ 2,701,511	$ 133,864	$307,864,652	7.5%

(1) Mortgage loans principal maturities and swap mortgage loans principal maturities include mortgage loans which are not in compliance with loan covenants. In accordance with IFRS, $80,837,307 of mortgage loan balances and $16,414,032 in regard to swap mortgage loan balances are included in the balance due in 2013.

The Trust intends to renew or refinance all mortgage debt and debentures at market rates on maturity.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

12 Long-term debt (continued)

(a) Mortgage loans

	Weighted average interest rates December 31 2012	2011	December 31 2012	2011
First mortgage loans				
Fixed rate	4.8%	5.6%	$ 97,891,938	$ 149,648,260
Variable rate	8.9%	8.6%	107,325,680	69,895,499
Total first mortgage loans	7.0%	6.6%	205,217,618	219,543,759
Second mortgage loans				
Fixed rate	N/A	11.4%	-	1,935,000
Variable rate	9.1%	8.3%	42,436,627	33,384,412
Total second mortgage loans	9.1%	8.4%	42,436,627	35,319,412
Total	7.3%	6.9%	$ 247,654,245	$ 254,863,171

Certain of the mortgage loans are subject to covenants, including net operating income achievement, debt service coverage and restrictions on the registration of secondary charges against the title to a property. The Trust is not in compliance with two first mortgage loans and one second mortgage loan totaling $80,837,307, as a result of the breach of covenant requirements in respect of the mortgage loans. In accordance with IFRS the total loan balance of $80,837,307 is included in current portion of long-term debt. A forbearance to March 31, 2013 was obtained for two first mortgage loans and one second mortgage loan in the aggregate amount of $80,837,307. These loans have matured and are payable on demand.

Except for the three mortgage loans in the amount of $80,837,307, all mortgages which have matured prior to March 13, 2013 have been renewed or refinanced.

Mortgage loans are secured by mortgage charges registered against specific investment properties and are secured by assignments of book debts and rents and by repayment guarantees.

On January 30, 2012, a mortgage loan in the amount of $24,811,531 was retired by the application of restricted cash deposits in the amount of $2,701,970 and a cash payment of $21,250,000 resulting in the forgiveness of debt in the amount of $859,561.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

12 Long-term debt (continued)

(b) Swap mortgage loan

The Trust has entered into an interest rate swap arrangement whereby the interest rate on a variable rate mortgage loan, in the amount of $16,414,032, has a fixed rate of 5.82% and matures in 2018.

The swap arrangement is used to hedge the exposure to the variable interest rate payment on a variable rate mortgage loan. The loan and interest rate swap have the same contractual terms. The aggregate fair value of the swap mortgage loan is as follows:

	December 31 2012	December 31 2011
Face value of mortgage loan, subject to swap	$ 16,414,032	$ 40,092,981
Fair value of interest rate swap	1,474,804	2,849,375
	$ 17,888,836	$ 42,942,356

The Trust is not in compliance with a debt service coverage requirement for the swap mortgage loan. In accordance with IFRS the total balance of $16,414,032 is included in current portion of long-term debt.

(c) Mortgage bonds

The face value of the 9% mortgage bonds due December 23, 2015 is $16,000,000 (December 31, 2011 - $16,000,000).

On December 23, 2010 and January 28, 2011, the Trust issued a total of 16,000 five year 9% mortgage bonds in the principal amount of $1,000, due December 23, 2015, and 16,000,000 trust unit purchase warrants for gross proceeds of $16,000,000. Each trust unit purchase warrant entitles the holder to purchase one unit at a price of $0.75 until December 23, 2015. The mortgage bonds are secured by second mortgage charges registered against five investment properties with a fair value of $54,717,000 (December 31, 2011 - $54,398,000).

The carrying value of the mortgage bonds is summarized as follows:

	December 31 2012	December 31 2011
Balance, beginning of year	$ 14,058,307	$ 10,826,910
Value at issue	-	2,910,467
Accretion	400,524	320,930
Balance, end of year	$ 14,458,831	$ 14,058,307

On the issue date, the value of the mortgage bonds was established based on the net present value of future interest and principal payments with an estimated cost of borrowing of 13.0%, a deferred tax liability of $470,623 was identified, and the residual value of $1,346,282 was assigned to the warrants.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

12 Long-term debt (continued)

(d) Debentures

At December 31, 2012, the face value and carrying value of the 9.5% Series G debentures due February 28, 2015 is $24,961,000 (December 31, 2011 - $25,312,000).

Effective October 27, 2011, the Series G convertible debentures were extended as Series G debentures. The Series G debentures are redeemable, subject to notice requirements, and the Trust is required to redeem debentures from the net proceeds of property sales, after repayment of mortgage loan and mortgage bond indebtedness and any amounts owing to 2668921 Manitoba Ltd. under the revolving loan commitment. The debentures are secured by a Personal Property Security Act registration against all of the assets and property of LREIT, subject to existing and future senior debt and permitted encumbrances.

In January 2012, LREIT renewed its normal course issuer bid for the Series G debentures under which, the Trust is entitled to purchase up to $2,529,000 of Series G debentures. The normal course issuer bid commenced January 12, 2012, expired on January 11, 2013, and was not renewed.

During the period from January 1, 2012 to December 31, 2012, the Trust purchased and cancelled Series G debentures with a face value of $351,000 at an average price of $90.58 per $100.00.

The Trust is not required to purchase any debentures under the normal course issuer bid.

13 Trade and other payables

	December 31 2012	December 31 2011
Accounts payable - vendor invoices	$ 1,416,737	$ 2,468,534
Accrued payables	1,114,567	1,139,695
Prepaid rent	764,374	1,390,045
Payable on acquisition of Parsons Landing	45,720,000	47,720,000
Revolving loan from 2668921 Manitoba Ltd.	5,025,000	12,000,000
Interest-free advances from Shelter Canadian Properties Limited	-	1,183,000
	$ 54,040,678	$ 65,901,274

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

14 Interest expense

	Year Ended December 31 2012	2011
Mortgage loan interest	$ 19,386,689	$ 19,468,784
Swap mortgage loan interest	1,465,708	2,353,579
Mortgage prepayment penalties	2,751,548	
Change in fair value of interest rate swaps	(1,027,800)	(745,198)
Mortgage bond interest	1,440,000	1,440,000
Accretion of mortgage bonds	400,524	324,448
Debenture interest	2,371,295	2,159,766
Accretion of the debt component of debentures	-	1,772,441
Amortization of transaction costs	2,873,505	2,789,173
Interest on acquisition payable	3,600,000	3,600,000
	$ 33,261,469	$ 33,162,993

15 Income taxes

The major components of income tax expense (recovery) are as follows:

	Year Ended December 31 2012	2011
Current tax expense (recovery)	$ 186,591	$ -
Benefit from a previously unrecognized tax loss or temporary difference of a prior period used to reduce current tax expense	(136,828)	-
Current tax expense (recovery)	49,763	-
Deferred tax expense relating to the origination and reversal of temporary differences or tax losses	1,228,380	661,154
Benefit from previously unrecognized tax loss or temporary difference of a prior period used to reduce deferred tax expense	-	(569,232)
Deferred tax expense arising from write-down of deferred tax assets	479,035	-
Deferred tax expense arising from the derecognition of deferred tax liabilities	(1,707,415)	-
Deferred tax expense (recovery)	-	91,922
Income tax expense (recovery)	$ 49,763	$ 91,922

The aggregate current and deferred tax relating to items that are charged directly to equity is nil (2011 - $117,659).

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

15 Income taxes (continued)

The income tax expense of the Trust can be reconciled to its income tax expense that would be calculated using the statutory income tax rate as follows:

	Year Ended December 31 2012	2011
Income (loss) before income taxes and discontinued operations	$ 601,544	$ 2,382,662
Combined federal and provincial statutory income tax rate	26%	26%
Income tax expense (recovery) calculated using the combined federal and provincial statutory income tax rate	$ 156,401	$ 619,492
Non-deductible unit-based compensation	34,143	22,859
Non-deductible interest and penalties	21,320	-
Taxable dividends received from wholly owned subsidiary	2,314,715	-
Undistributed income taxed at rate of 46.4%	359,805	-
Dividend tax credits	(768,618)	-
Net interest revenue and fees received from wholly owned subsidiaries	739,103	782,390
Interest revenue received from wholly owned subsidiaries	(160,746)	-
Recognition of previously unrecognized deferred tax assets	(136,828)	(569,232)
Write-down of previously recognized deferred tax assets	479,035	-
Derecognition of previously recognized deferred tax liabilities	(1,707,415)	-
Deferred tax assets and liabilities not recognized during the year	(90,831)	-
Non-taxable/allowable portion of capital (gains) losses	(1,258,468)	(784,910)
Other	68,147	21,323
Income tax expense (recovery)	$ 49,763	$ 91,922

The Trust's deferred tax liabilities (assets) in respect of investment properties are as follows:

	December 31 2012	2011
Temporary differences between the accounting and tax bases of:		
Investment properties	$ -	$ 1,306,711
Transaction costs	-	(479,035)
Debentures and mortgage bonds	-	504,840
Interest rate swaps	-	(220,560)
Unused tax losses	-	(1,111,956)
	$ -	$ -

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

15 Income taxes (continued)

The Trust's deferred tax expense (recovery) recognized in income (loss) from investment properties, in respect of each type of temporary difference or in respect of unused tax losses, is as follows:

	Year Ended December 31 2012	2011
Investment properties	$ (1,306,711)	$ 2,178,854
Transaction costs	479,035	(231,097)
Debentures and mortgage bonds	(504,840)	(547,041)
Unused tax losses	1,111,956	(1,111,956)
Interest rate swaps	220,560	(220,560)
Other	-	23,722
	$ -	$ 91,922

The Trust has deductible temporary differences and unused tax losses related to investment properties for which no deferred tax asset is recognized as follows:

	December 31 2012	2011
Deductible temporary differences:		
Interest rate swaps	$ 1,474,804	$ 2,001,067
Transaction costs	$ 5,051,684	$ -
Taxable temporary differences:		
Investment properties	$ 8,584,403	$ -
Mortgage bonds	$ 1,541,169	$ -

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

16 Per unit calculations

Per unit calculations reflect the following:

	Year Ended December 31 2012	2011
Income (loss) and diluted income (loss) before discontinued operations	$ 551,782	$ 2,290,740
Income and diluted income from discontinued operations	19,546,526	2,744,491
Income and diluted income	$ 20,098,308	$ 5,035,231

	Year Ended December 31 2012	2011
Weighted average number of units:		
Units	17,983,061	17,988,339
Deferred units	647,730	467,433
Total basic	18,630,791	18,455,772
Weighted average diluted number of units	18,736,723	18,493,272

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

17 Units

	Year Ended December 31, 2012		Year Ended December 31, 2011	
	Units	Amount	Units	Amount
Outstanding, beginning of year	17,988,339	$107,860,241	17,988,339	$107,860,241
Units issued on exercise of warrants	175,000	160,195	-	-
Purchased and cancelled under normal course issuer bid	(79,328)	(41,735)	-	-
Outstanding, end of year	18,084,011	$107,978,701	17,988,339	$107,860,241

Units purchased and cancelled under normal course issuer bid
In January 2012, LREIT renewed its normal course issuer bid for Trust units under which the Trust is entitled to purchase up to 1,383,378 units. The normal course issuer bid commenced January 12, 2012, expired on January 11, 2013, and was not renewed.

Units purchased by the Trust under its normal course issuer bid are cancelled. During the year ended December 31, 2012 the Trust purchased and cancelled 79,328 units under the normal course issuer bid at a weighted average price of $0.53 per unit (2011 - nil and nil, respectively).

18 Trust unit purchase warrants

On March 9, 2010, the Trust issued 6,780,000 trust unit purchase warrants. Each warrant entitles the purchaser to purchase one unit at a price of $1.00 until March 9, 2015.

On December 23, 2010 and January 28, 2011, the Trust issued a total of 16,000,000 trust unit purchase warrants. Each warrant entitles the purchaser to purchase one unit at a price of $0.75 until December 23, 2015.

The following schedules reflects the warrants outstanding:

Trust unit purchase warrants expiring March 9, 2015:

	Year Ended December 31	
	2012	2011
Balance, beginning and end of year	6,780,000	6,780,000

Trust unit purchase warrants expiring December 23, 2015:

	Year Ended December 31	
	2012	2011
Balance, beginning of year	16,000,000	12,637,000
Warrants exercised	(175,000)	-
Warrants issued January 28, 2011	-	3,363,000
Balance, end of year	15,825,000	16,000,000

19 Unit option plan

The Trust may grant options to the Trustees, senior officers and consultants of the Trust. The maximum number of units reserved for issuance under the unit option plan will be limited to 5% of the total number of issued and outstanding units. The Trustees shall set the exercise price at the time that an option is granted under the plan, which exercise price shall not be less than the discounted market price of the units as determined under the policies of the TSX on the date of grant. Options granted to Trustees vest immediately. With the exception of options granted on December 19, 2012 and January 15, 2013, which vested immediately, options granted to senior officers and consultants vest on a straight-line basis over five years. The options will have a maximum term of five years from the date of grant.

On December 12, 2011, the Trust granted options to purchase 250,000 units at $0.34 per Trust unit. The options vested immediately and will expire five years from the date they were granted. The fair value of the options issued of $6,324 was calculated using the Black-Scholes option pricing model, assuming a weighted average volatility of 4.6% on the underlying trust units, a dividend yield rate of 0% and the risk free interest rate of 1.31%. The fair value of the options issued was charged to unit-based compensation.

On November 19, 2012, the Trust granted options to purchase 410,000 units at $0.60 per Trust unit. The options vested immediately and will expire five years from the date they were granted. The fair value of the options issued of $56,318 was calculated using the Black-Scholes option pricing model, assuming a weighted average volatility of 22.9% on the underlying trust units, a dividend yield rate 0% and the risk free interest rate of 1.17%. The fair value of the options issued was charged to unit-based compensation.

On January 15, 2013, the Trust granted options to purchase 180,000 units at $0.65 per Trust unit. The options vested immediately and will expire five years from the date they were granted.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

19 Unit option plan (continued)

A summary of the status of the unit options and changes during the period is as follows:

	Year Ended December 31, 2012		Year Ended December 31, 2011	
	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price
Outstanding, beginning of year	571,000	$ 3.05	968,500	$ 5.58
Cancelled, June 8, 2012	(90,000)	5.30	-	-
Issued, November 14, 2012	410,000	0.60	-	-
Cancelled, January 17, 2011	-	-	(22,500)	5.42
Cancelled, July 26, 2011	-	-	(625,000)	5.80
Issued, December 12, 2011	-	-	250,000	0.34
Outstanding, end of year	891,000	$ 1.69	571,000	$ 3.05
Vested, end of year	891,000		542,800	

At December 31, 2012 the following unit options were outstanding:

Exercise price	Options outstanding	Options vested	Expiry date
$ 5.10	231,000	231,000	January 7, 2013
0.34	250,000	250,000	December 12, 2016
0.60	410,000	410,000	November 19, 2017
	891,000	891,000	

Subsequent to December 31, 2012, 231,000 options expired.

20 Deferred unit plan

The Trust has adopted a deferred unit plan, under which, any trustee, officer, employee, or consultant employee of the Trust may elect to have their annual bonus, annual board retainer or board meeting fees payable to that person by the Trust paid, in whole or in part, in the form of deferred units. The number of deferred units received by a participant is determined by dividing the amount of the annual bonus, annual board retainer or board meeting fees, as applicable, to be paid in the form of deferred units on that date by the fair market value of the Trust's units.

Deferred units granted to Trustees shall vest immediately. Deferred units granted to participants other than Trustees shall vest 33% on the first anniversary of grant, 33% on the second anniversary of grant, and 34% on the third anniversary of grant. In the event of any change of control, any unvested deferred units shall vest upon the earlier of the next applicable vesting date and the date that is immediately prior to the date upon which the change of control is completed. The board shall have the discretion to vary the manner in which deferred units vest for any participant.

The deferred units credited to a participant (including deferred units that have not yet vested) shall vest immediately and be redeemable by the participant following termination other than for cause, retirement, or death. In the event that a participant is terminated for cause, only the deferred units that have vested shall be redeemable and any unvested deferred units shall be cancelled.

Whenever cash distributions are paid on the units of the Trust, additional deferred units will be credited to the participant based on the number of deferred units held, the amount of the distribution and the market value of a unit of the Trust on the date of the distribution. Additional deferred units shall vest at the same time and on the same basis as the deferred units in respect of which they are credited.

Deferred units granted to Trustees totaled 127,948 for the year ended December 31, 2012 (2011 - 198,117). Aggregate deferred units outstanding and fully vested at December 31, 2012 were 725,484 (2011 - 597,536).

Unit-based compensation expense of $75,000 for the year ended December 31, 2012 (2011 - $75,000) relating to deferred units granted was recorded to expense the fair value of unit-based compensation. Unit-based compensation is recorded in trust expense.

21 Related party transactions

Related party transactions have occurred in the normal course of operations and are measured at the exchange amount which is the amount established and agreed by the related parties. Shelter Canadian Properties Limited is a related party by virtue of the property management agreement and services agreement with the Trust and 2668921 Manitoba Ltd., the parent company to Shelter Canadian Properties Limited, is a related party as 2668921 Manitoba Ltd. is owned by a family member of an officer and Trustee of the Trust.

Management agreement
The Trust has entered into a property management agreement with Shelter Canadian Properties Limited, the current term of which expires on December 31, 2019. Under the property management agreement, Shelter Canadian Properties Limited will administer the day-to-day operations of the Trust's portfolio of investment properties, except for the seniors' housing complexes. The Trust pays property management fees equal to 4% of gross receipts from the investment properties owned by the Trust. In regard to commercial properties, Shelter Canadian Properties Limited is also entitled to leasing commissions on new leases of 3% to 5% of base rental payments and leasing commissions on renewal of 1 1/2% to 2 1/2% of base rental payments. Shelter Canadian Properties Limited is also entitled to tenant improvement and renovation fees equal to 5% of the total cost of such work. Property management fees are included in property operating costs; leasing fees and tenant improvement fees are capitalized to investment properties; and, during the period of major in-suite renovations or development, renovation fees are capitalized to the cost of buildings and properties under development.

The Trust incurred property management fees payable to Shelter Canadian Properties Limited of $1,547,632 for the year ended December 31, 2012 (2011 - $1,669,318).

The Trust incurred leasing commissions on commercial investment properties payable to Shelter Canadian Properties Limited of nil for the year ended December 31, 2012 (2011 - $8,507).

The Trust incurred renovation fees on commercial investment properties payable to Shelter Canadian Properties Limited of nil for the year ended December 31, 2012 (2011 - $2,759).

Included in trade and other payables at December 31, 2012 is a balance of $29,337 (December 31, 2011 - $13,641), payable to Shelter Canadian Properties Limited in regard to outstanding property management fees.

Services agreement
The Trust has entered into a services agreement with Shelter Canadian Properties Limited, the current term of which expires on December 31, 2019. Under the services agreement, Shelter Canadian Properties Limited provides the Trust management and support services for the administration of the day-to-day activities of the Trust. The Trust pays service fees equal to 0.3% of the gross book value of the assets of the Trust, excluding cash, fair value gains (losses) and defeasance assets.

The Trust incurred service fees of $1,598,895 for the year ended December 31, 2012 (2011 - $1,698,992). Service fees are included in trust expense.

Included in trade and other payables at December 31, 2012 is a balance of nil (December 31, 2011- $425,833) payable to Shelter Canadian Properties Limited in regard to outstanding service fees.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

21 Related party transactions (continued)

Services fee and renovation fee for Lakewood Townhomes condominium sales program
The Trust has entered into an agreement with Shelter Canadian Properties Limited, in regard to the condominium sales program at Lakewood Townhomes. Under the agreement, Shelter Canadian Properties Limited will administer the sales program and the completion of the in-suite renovations. The Trust pays a service fee equal to 5% of the gross sales proceeds and Shelter Canadian Properties Limited is responsible for the payment of a fixed fee to an external real estate broker for providing brokerage services. If it is necessary to increase the fixed fee to the external real estate broker due to market conditions, the fee payable to Shelter Canadian Properties Limited increases by the amount of the increase in the fixed rate. The Trust also pays a renovation fee equal to 5% of the cost of the in-suite upgrade costs for the condominium sales program.

The Trust incurred service fees payable to SCPL of $306,395 for the year ended December 31, 2012 (2011 - $25,589). The Trust incurred renovation fees payable to SCPL of $3,534 for the year ended December 31, 2012 (2011 - nil).

The terms of the condominium sales program, including the service fee and renovation fee, were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the service fee and renovation fee.

Financing
On January 1, 2011, the Trust had a $10 Million revolving loan commitment from 2668921 Manitoba Ltd. for general operating purposes. The loan commitment was increased to $12 Million on June 8, 2011, $15 Million on April 1, 2012 and reduced to $12 Million effective January 1, 2013. The loan bears interest at 9.75%, subject to a maximum interest payment of $162,594 to March 31, 2012, 10% from April 1, 2012 to August 31, 2012, and 12% from September 1, 2012, subject to a maximum interest and fee payment of $650,870 for the period from September 1 to December 31, 2012, (2011 - 14% to June 30 and 11% from July 1 to December 31). The renewals at April 1, 2012 and September 1, 2012 encompassed the payment of extension fees of $75,000, $150,000, and $25,000, respectively. The loan was renewed effective January 1, 2013 with an extension fee of $25,000 at an interest rate of 12% and matures on June 30, 2013, subject to a maximum interest and fee payment of $404,916 for the period from January 1 to June 30, 2013. The loan is secured by mortgage charges against the title to six investment properties, two seniors' housing complexes and the assignment of a mortgage loan receivable in the amount of $7,888,320. As of December 31, 2012, $5,025,000 has been drawn and is included in trade and other payables.

Interest on the revolving loan of $963,422 for the year ended December 31, 2012 (2011 - $1,230,505) is included in interest expense.

Included in accrued interest payable at December 31, 2012 is a balance of nil (2011- $293,943) payable to 2668921 Manitoba Ltd. in regard to outstanding interest on the revolving loan.

During the year ended December 31, 2012, Shelter Canadian Properties Limited advanced $16,169,000 (2011 -$4,765,000) on an interest-free basis as an interim funding measure. The Trust made repayments of $17,352,000, resulting in an outstanding balance of nil at December 31, 2012 (2011 - $1,183,000).

The revolving loan commitment and the interest-free advances from Shelter Canadian Properties Limited were approved by the independent Trustees. Mr. Arni Thorsteinson abstained from voting in regard to all matters concerning the revolving loan commitment and the interest-free advances from Shelter Canadian Properties Limited.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

21 Related party transactions (continued)

Key management compensation
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Trust, directly or indirectly. The Trust does not pay any compensation directly to its key management personnel, other than securities-based compensation under the unit option plan. The services are provided to the Trust by Shelter Canadian Properties Limited pursuant to the Services Agreement. The estimated aggregate compensation for those services under the agreement for the year ended December 31, 2012 was $564,000 (2011 - $554,000). In addition, the Trust granted unit options to its key management personnel with a fair value of $48,076 (2011 - $1,500).

Guarantees
Certain of the mortgage loans payable have been guaranteed by Shelter Canadian Properties Limited and/or its parent company, 2668921 Manitoba Ltd. No fees were charged to the Trust in regard to the guarantees.

22 Financial instruments and risk management

Risk management
In the normal course of business, the Trust is exposed to financial risk that arises from its indebtedness, including fluctuations in interest rates and in the credit quality of its tenants. Management's involvement in operations helps identify risks and variations from expectations. As a part of the overall operation of the Trust, management takes steps to avoid undue concentrations of risk. The Trust manages the risks, as follows:

Liquidity risk - debt covenant requirements
At December 31, 2012, the Trust was in breach of the net operating income achievement and debt service coverage requirements on three mortgage loans and a swap mortgage loan totaling $97,251,339 on properties in Fort McMurray, Alberta. The Trust has obtained a forbearance to March 31, 2013 on three mortgage loans totaling $80,837,307. The Trust is continuing to negotiate with the lenders and management believes that all of the covenant breaches will be resolved. Notwithstanding that recently there has been a substantial improvement in the occupancy rate in the Fort McMurray properties of the Trust, all or some of the covenant breaches may continue for the next 12 months. There can be no assurance that the covenant breaches will be remedied.

There is no assurance that the lenders will not accelerate payment of the mortgage loans.

The Bond Indenture which governs the mortgage bonds of LREIT provides for the bonds to become payable on demand in the event that the Series G debentures or any of the first mortgages on Beck Court, Nova Court, Norglen Terrace, Highland Tower or Westhaven Manor are in default for more than ten days and the default results in the acceleration of debt payments.

There are no others cross-default covenants with respect to other mortgage loans of the Trust.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

22 Financial instruments and risk management (continued)

Liquidity risk - debt maturities (continued)
Liquidity risk arises from the possibility that the Trust will not have sufficient debt or equity capital available to complete the acquisition of Parsons Landing on the agreed date and to refinance its debt as it matures.

The risk associated with the refinancing of maturing debt is mitigated as the maturity dates of the mortgage portfolio are staggered over a number of years.

As at December 31, 2012, the weighted average term to maturity of the fixed rate mortgages on investment properties is 1.8 years (2011 - 2.5 years).

The repayment obligations in regard to the financial liabilities of the Trust, are as follows:

	Mortgage Loans			
Year ending December 31	Normal Principal Installments	Principal Maturities	Debentures and Mortgage Bonds	Swap Mortgage Loan
2013	$ 1,970,638	$199,754,960	$ -	$16,414,032
2014	937,528	8,762,938	-	-
2015	893,820	5,800,403	40,961,000	-
2016	501,544	10,663,030	-	-
2017	360,388	18,008,996	-	-
	$ 4,663,918	$242,990,327	$ 40,961,000	$16,414,032

Year ending December 31	Defeased Liability	Mortgage Guarantee Fees	Other Payables	Total
2013	$ 56,896	$ 42,502	$ 56,469,071	$274,708,099
2014	60,155	44,587	-	9,805,208
2015	63,602	46,775	-	47,765,600
2016	2,520,858	-	-	13,685,432
2017	-	-	-	18,369,384
	$ 2,701,511	$ 133,864	$ 56,469,071	$364,333,723

Other payables include trade and other payables and deposits from tenants.

In accordance with IFRS, the balance of the three mortgage loans and one swap mortgage loan in the amount of $80,837,307 and $16,414,032, respectively, which are not in compliance with covenants, including net operating income achievement and debt service coverage, have been included with amounts due in 2013.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

22 Financial instruments and risk management (continued)

Interest rate risk
Interest rate risk arises from debt financing including the risk that the Trust will not be able to refinance the mortgage loans with terms as favourable as those of existing mortgage loans. The risk is minimized by having mortgage loans on fixed term arrangements. In addition, the maturity dates of the mortgages are staggered over a number of years to reduce the exposure in any one year. At December 31, 2012 the percentage of fixed rate mortgage loans to total mortgage loans was 40% (December 31, 2011 - 59%).

The Trust has variable rate mortgage loans on investment properties totaling $149,762,307, or 60% of the total mortgage loans at December 31, 2012 (December 31, 2011 - 41%). Should interest rates change by 1%, interest expense would change by $1,497,623 per year.

As at December 31, 2012, the Trust has total contractual mortgage principal maturities on investment properties which mature on or prior to December 31, 2015 of $66,223,920 representing 27% of total mortgage loans. Should the amounts be refinanced upon maturity at an interest rate differential of 1%, interest expense would change by $662,239 per year.

With the exception of interest rate swap arrangements, the Trust does not trade in financial instruments.

Credit risk
Credit risk arises from the possibility that tenants may be unable to fulfil their lease commitments. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The Trust has credit policies to address credit risk that include the analysis of financial position and credit history of a prospective tenant and by obtaining security deposits whenever permitted by legislation. An allowance for doubtful accounts or other impairment provisions are established based upon factors surrounding credit risk, historical trends and other information.

Rent is past due when a tenant has failed to make a payment when contractually due. The following is an aging of rent receivable past due but not impaired:

	December 31 2012	December 31 2011
Rent receivable overdue:		
0 to 30 days	$ 149,415	$ 207,365
31 to 60 days	44,760	33,970
More than 60 days	53,558	486,923
	$ 247,733	$ 728,258

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

22 Financial instruments and risk management (continued)

Credit risk (continued)
A reconciliation of allowance for doubtful accounts is as follows:

	December 31 2012	December 31 2011
Balance, beginning of year	$ 163,553	$ 364,685
Amount charged to bad debt expense relating to impairment of rent receivable	85,622	168,400
Amounts written off as uncollectible	(229,124)	(369,532)
Balance, end of year	$ 20,051	$ 163,553
Amount charged to bad debts as a percent of rentals from investment properties	0.22%	0.40%

Market risk
Market risk is the risk that the fair values of financial instruments will fluctuate because of changes in market prices. The Trust does not have financial instruments that are affected by changes in market prices.

Currency risk
Currency risk is the risk that changes in foreign exchange rates may have an effect on future cash flows associated with financial instruments. The Trust does not have any transactions denominated in foreign currency and is not exposed to foreign currency risk.

Other price risk
Other price risk is the risk that changes in market prices, including commodity or equity prices, will have an effect on future cash flows associated with financial instruments. The cash flows associated with the financial instruments of the Trust are not exposed to other price risk.

22 Financial instruments and risk management (continued)

Fair values

Except for the swap mortgage loan which is carried at fair value, a comparison of the carrying amounts and fair value of the financial instruments of the Trust is provided below.

	Carrying Value		Fair Value	
	December 31		December 31	
	2012	2011	2012	2011
Financial assets				
Loans and receivables	11,863,320	500,000	11,109,854	422,400
Defeasance assets	3,025,370	3,168,193	-	-
Restricted cash	7,801,248	15,246,600	7,801,248	15,246,600
Cash	1,254,278	1,170,619	1,254,278	1,170,619
Rent and other receivables	1,274,277	2,328,256	1,274,277	2,328,256
Deposits	667,247	782,934	667,247	782,934
Financial liabilities				
Mortgages loans	247,654,245	254,863,171	247,959,720	255,170,735
Mortgage bonds	14,458,831	14,058,307	14,898,857	14,606,679
Debentures	24,961,000	25,312,000	25,006,654	19,962,452
Defeased liability	2,701,511	2,755,325	-	-
Mortgage guarantee fees	133,864	-	133,864	-
Trade and other payables	54,040,678	65,901,274	54,040,678	65,901,274
Deposits from tenants	2,428,393	2,829,861	2,428,393	2,829,861

The fair value of the financial assets and liabilities are included at an estimate of the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- Cash, rent and other receivables, deposits, trade and other payables and deposits from tenants approximate their carrying amounts due to the short-term maturities of these instruments.
- Loans and receivables and restricted cash are estimated by discounting expected future cash flows using current market interest rates.
- The fair value of the defeasance assets and the defeased liability have a fair value of nil on a net basis as there was no cash flow impact to the Trust from the defeasance assets or defeased liability.
- In regard to mortgages loans, mortgage bonds, debentures and mortgage guarantee fees:
  - The fair value of floating rate borrowings is estimated by discounting future cash flows using rates currently available for debt or similar terms and remaining maturities. Given the variable interest rate, the fair value approximates the carrying value before deducting unamortized transaction costs.
  - The fair value of the fixed rate borrowings is estimated by discounting expected future cash flows using current market interest rates and yield curve over the remaining term of the instrument.
  - The fair value of debt component of debentures are based on quoted market prices.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

22 Financial instruments and risk management (continued)

Fair value hierarchy

The fair value of the swap mortgage loan has been determined using Level 2 of the fair value hierarchy whereby the Trust makes use of a model with inputs (other than quoted prices included in level 1) that are directly or indirectly observable market data.

23 Management of capital

The capital structure of the Trust is comprised of the following:

	December 31 2012	December 31 2011
Mortgage loans	$246,122,919	$254,132,167
Swap mortgage loan	17,780,812	42,847,169
Mortgage bonds	13,425,127	12,788,628
Debentures	24,347,895	24,462,446
Equity	100,829,954	80,510,813
	$402,506,707	$414,741,223

The Trust manages capital in order to safeguard its ability to continue as a going concern and to ensure an appropriate balance of risk and return.

The overall capital management strategy addresses the following considerations:

- The equity component of acquired properties is primarily funded from the proceeds of trust units, debentures or other securities of the Trust.
- Mortgage debt financing is arranged to optimise the leveraged returns from the real estate portfolio.
- Total mortgage debt financing is maintained within the overall debt limits as established by the Declaration of Trust. The Declaration of Trust provides for mortgage indebtedness of the Trust up to 75% of the appraised value of all properties.
- Whenever possible, the Trust will utilize fixed rate debt financing.
- Mortgage due dates are structured to reflect the properties being financed and debt maturity dates will be staggered, to the extent possible, in order to reduce refinancing risk.
- The Trust is undertaking a divestiture program targeting the sale of assets in order to reduce total debt including debenture debt.

The Trust monitors capital from time-to-time using a variety of measures. Monitoring procedures are performed as a part of the overall management of operations and are performed with the goal of enhancing the ability of the Trust to access capital and/or reduce the cost of capital.

In order to maintain or adjust the capital structure the Trust may (i) issue units, debentures or mortgage debt and other securities, such as trust unit purchase warrants; (ii) adjust the amount of distributions (if any) paid to unitholders; (iii) return capital to unitholders; (iv) purchase units, debentures or trust unit purchase warrants; and/or (v) reduce debt.

Market requirements for attracting capital may vary in ways that the Trust may not be able to accurately predict.

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

24 Segmented financial information

Operating segments are established on a geographic basis comprised of properties located in Fort McMurray and properties located in other areas ("Other Investment Properties").

Commencing in the first quarter of 2012, an Impaired Property segment was established to disclose the operations of Parsons Landing.

Commencing in the second quarter of 2012, a Properties Sold segment was established to disclose the operations of the investment properties which have been sold under the divestiture program.

Revenue is primarily derived from the operations of residential real estate comprised of multi family rental properties.

Year ended December 31, 2012:

	Investment Properties					
	Fort McMurray	Other Investment Properties	Properties Sold	Impaired Property	Trust	Total
Rental revenue	22,965,656	14,254,048	796,861	394,427	-	38,410,992
Property operating costs	8,768,905	6,821,025	97,450	294,383	-	15,981,763
Net operating income	14,196,751	7,433,023	699,411	100,044	-	22,429,229
Interest income	30,232	73,969	70,200	1,719	793,487	969,607
Interest expense	12,738,240	6,704,267	227,472	3,600,011	9,991,479	33,261,469
Income (loss) before discontinued operations	9,561,586	4,257,305	1,188,910	(2,891,357)	(11,564,662)	551,782
Cash from operating activities	3,014,865	3,825,827	(7,274)	(1,547,736)	(12,054,403)	(6,768,721)
Cash from financing activities	(3,353,744)	(3,330,590)	(12,192,263)	1,281,000	50,769,334	33,173,737
Cash from investing activities	561,664	(389,493)	12,002,267	289,799	(38,785,594)	(26,321,357)
Total assets excluding assets held for sale at December 31, 2012	265,210,801	124,345,591	-	44,342,231	20,651,400	454,550,023

Year ended December 31, 2011:

	Investment Properties					
	Fort McMurray	Other Investment Properties	Properties Sold	Impaired Property	Trust	Total
Rental revenue	21,068,980	14,084,247	2,672,453	4,027,046	-	41,852,726
Property operating costs	8,122,304	6,200,438	217,003	1,583,590	-	16,123,335
Net operating income	12,946,676	7,883,809	2,455,450	2,443,456	-	25,729,391
Interest income	27,447	31,389	673	5,993	262,643	328,145
Interest expense	13,764,376	3,993,730	775,960	3,600,038	11,028,889	33,162,993
Income (loss) before discontinued operations	5,654,927	7,071,485	2,280,163	725,530	(13,441,365)	2,290,740
Cash from operating activities	(248,836)	4,345,126	1,481,624	(1,144,807)	(8,880,098)	(4,446,991)
Cash from financing activities	3,464,344	(3,555,425)	(1,491,694)	1,300,092	315,881	33,198
Cash from investing activities	(3,173,692)	(885,775)	(18,000)	(174,231)	8,911,064	4,659,366
Total assets excluding assets held for sale at December 31, 2011	265,001,883	120,661,605	30,473,992	46,374,100	12,968,628	475,480,208

LANESBOROUGH REAL ESTATE INVESTMENT TRUST

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012

25 Commitments

Management Contracts

The Trust has retained the following third party managers to provide on-site management services to the seniors' housing complexes:

Property	Manager	Term Expiring
Chateau St. Michael's	Integrated Life Care Inc.	September 30, 2015
Elgin Lodge	Kingsway Arms Management Inc.	May 31, 2016

26 Contingencies

In the normal course of operations, the Trust will become subject to a variety of legal and other claims. Management and legal counsel evaluate all claims on their apparent merits, and accrue management's best estimate of the estimated costs to satisfy such claims. Although the outcome of legal and other claims are not reasonably determined, management believes that any such outcome will not be material.

27 Subsequent events

Revolving loan
Subsequent to December 31, 2012, the Trust received advances of $5,597,000 and repaid advances of $3,200,000 against the revolving loan, resulting in a balance of $7,322,000 as of the date of the Financial Statements.

Mortgage financing
Subsequent to December 31, 2012, a 12% first mortgage loan in the amount of $20,400,000 was retired from proceeds of a first mortgage loan of $21,000,000 bearing interest of 4.99%.

Subsequent to December 31, 2012, a mortgage loan was paid down by $2,000,000 from working capital.

Mortgage loans receivable
Subsequent to December 31, 2012, a mortgage loan receivable in the amount of $3,200,000 was paid and the proceeds increased working capital.

28 Comparative figures

For comparative purposes, certain of the prior year figures have been reclassified.

UNITHOLDER INFORMATION

Trustees and Officers

The investment policies and operations of LREIT are subject to the control of the trustees, pursuant to the terms of a Declaration of Trust. The Declaration of Trust provides for a minimum of three trustees and a maximum of ten trustees and requires that the majority of trustees be independent trustees. The Declaration of Trust provides Shelter Canadian Properties Limited with the right to appoint one trustee.

The current trustees of LREIT are Mr. Charles Loewen, Mr. Earl Coleman, Ms. Cheryl Barker, CA and Mr. Arni Thorsteinson, CFA. Mr. Loewen is the Chief Executive Officer of Online Business Systems and serves as Chairman of LREIT. Mr. Coleman is the President of Big Freight Systems Inc. Ms. Barker was the President, MTS (Manitoba) prior to her retirement in February 2006. Mr. Thorsteinson is the President of Shelter Canadian Properties Limited and serves as Chief Executive Officer of LREIT. Mr. Thorsteinson is the appointee of Shelter Canadian Properties Limited.

The Executive Vice President of LREIT is Mr. Douglas N. Wells, Chief Investment Officer for Shelter Canadian Properties Limited.

The Chief Financial Officer and Secretary of LREIT is Mr. Kenneth Dando, CA, Senior Manager of Corporate Reporting and Administration for Shelter Canadian.

Administrator of the Trust

Shelter Canadian has been appointed by the Trustees, pursuant to the terms of a Services Agreement, to administer the daily affairs of LREIT and to perform the accounting and reporting functions of LREIT.

Property Management

Shelter Canadian has been appointed by the Trustees, pursuant to the terms of the Property Management Agreement, to act as the Property Manager for all of the investment properties in the LREIT portfolio. Shelter Canadian manages all of the investment properties except for the seniors' housing complexes, where the Trust has retained third party property managers to provide on-site management services, due to the nature of the operations.

Office Address

Lanesborough Real Estate Investment Trust
c/o Shelter Canadian Properties Limited
2600 Seven Evergreen Place
Winnipeg, Manitoba R3L 2T3
Telephone: (204) 475-9090
Facsimile: (204) 452-5505
Email: info@lreit.com
Website: www.lreit.com

Unit Listing

Toronto Stock Exchange (TSX)

Unit trading symbol:	LRT.UN
Debenture trading symbol:	LRT.DB.G
Mortgage bond trading symbol:	LRT.NT.A
Trust unit purchase warrants trading symbols:	LRT.WT
	LRT.WT.A

Unitholder and Investor Contact

Mr. Gino Romagnoli, CGA
Manager, Investor Services
Shelter Canadian Properties Limited
Telephone: (204) 475-9090, Ext. 208
Facsimile: (204) 452-5505
Email: gromagnoli@lreit.com

Transfer Agent and Registrar

Canada Stock Transfer Company Inc.
as administrative agent for CIBC Mellon Trust Company
600, 333 - 7th Avenue S.W.
Calgary, Alberta T2P 2Z1

Auditors

MNP LLP
Chartered Accountants
2500 - 201 Portage Avenue
Winnipeg, Manitoba R3B 3K6

Legal Counsel

Aikins MacAulay & Thorvaldson LLP
30th Floor, Commodity Exchange Tower
360 Main Street
Winnipeg, Manitoba R3C 4G1