LANESBOROUGH REIT

CONSOLIDATED FINANCIAL STATEMENTS

DECMEBER 31, 2012

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.

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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.

MNP LLP

Winnipeg, Manitoba
March 13, 2013

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"*

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

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

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.

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.

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.

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.

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.

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.

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.

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

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).

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

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

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)

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.

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

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

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.

12 Long-term debt (continued)

(a) Mortgage loans

	Weighted average interest rates December 31 2012	Weighted average interest rates December 31 2011	December 31 2012	December 31 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.

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.

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

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).

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)
	$ -	$ -

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	$ -

16 Per unit calculations

Per unit calculations reflect the following:

	Year Ended December 31 2012	Year Ended December 31 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	Year Ended December 31 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

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.

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.

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.

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.

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.

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

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.

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	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.

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

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.