

Consolidated Financial Statements  
(In Canadian dollars)

# **AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST**

Years ended December 31, 2017 and 2016



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## INDEPENDENT AUDITORS' REPORT

To the Unitholders of Agellan Commercial Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Agellan Commercial Real Estate Investment Trust, which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, the consolidated statements of income and comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

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

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

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



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*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Agellan Commercial Real Estate Investment Trust as at December 31, 2017 and 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

*KPMG LLP*

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Chartered Professional Accountants, Licensed Public Accountants

March 5, 2018  
Toronto, Canada

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

December 31, 2017 and 2016

	2017	2016
<b>Assets</b>		
Non-current assets:		
Investment properties (note 5)	\$ 808,875	\$ 759,494
Other assets (note 6)	2,570	–
<b>Total non-current assets</b>	<b>811,445</b>	<b>759,494</b>
Current assets:		
Other assets (note 6)	8,609	7,662
Derivative instruments (note 15)	807	–
Accounts receivable	2,388	2,111
Cash and cash equivalents	9,519	7,746
<b>Total current assets</b>	<b>21,323</b>	<b>17,519</b>
<b>Total assets</b>	<b>\$ 832,768</b>	<b>\$ 777,013</b>

## Liabilities and Unitholders' Equity

Non-current liabilities:		
Mortgages payable (note 8)	\$ 229,993	\$ 301,472
Loans facility (note 9)	91,594	103,037
Class B LP Units (note 10)	10,401	–
Deferred income tax liability (note 16)	19,011	23,294
<b>Total non-current liabilities</b>	<b>350,999</b>	<b>427,803</b>
Current liabilities:		
Current portion of mortgages payable (note 8)	70,432	9,483
Tenant rental deposits and prepaid rent	9,343	6,804
Derivative instruments (note 15)	–	854
Accounts payable and accrued liabilities (note 7)	24,908	19,461
Distributions payable	2,122	1,805
Finance costs payable	1,039	1,108
<b>Total current liabilities</b>	<b>107,844</b>	<b>39,515</b>
<b>Total liabilities</b>	<b>458,843</b>	<b>467,318</b>
<b>Unitholders' equity</b>	<b>373,925</b>	<b>309,695</b>
<b>Total liabilities and unitholders' equity</b>	<b>\$ 832,768</b>	<b>\$ 777,013</b>

Commitments and contingencies (note 22)  
Subsequent events (note 25)

See accompanying notes to consolidated financial statements.

The consolidated financial statements were approved by the Board on March 5, 2018 and signed on its behalf by:

"Rafael Lazer" \_\_\_\_\_ Trustee      "Glen Ladouceur" \_\_\_\_\_ Trustee

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2017 and 2016

	2017	2016
Revenue:		
Minimum rent	\$ 62,463	\$ 54,128
Recoveries from tenants	36,330	31,490
Other income	2,806	2,984
	<u>101,599</u>	<u>88,602</u>
Expenses:		
Property operating	27,540	24,485
Property taxes	13,770	12,803
General and administrative (note 13)	20,053	5,421
Deferred income taxes (recovery) (note 16)	(2,846)	2,745
Fair value adjustment on:		
Investment properties (note 5)	(24,186)	11,628
IFRIC 21 adjustment on		
investment properties (note 3(b))	551	139
Class B LP Units (note 10)	279	–
Investment in limited partnership	(84)	–
Loss on sale of investment properties (note 4)	571	487
	<u>35,648</u>	<u>57,708</u>
Income before finance costs	65,951	30,894
Finance costs (note 14)	13,308	11,119
Net income	52,643	19,775
Other comprehensive loss:		
Reclassified subsequently to income when		
specific conditions are met:		
Unrealized gain on translation of		
U.S. dollar denominated foreign operations	(17,123)	(5,357)
Comprehensive income	<u>\$ 35,520</u>	<u>\$ 14,418</u>

See accompanying notes to consolidated financial statements.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2017 and 2016

	Amounts of unit capital (note 11)	Accumulated distributions	Cumulative net income	Other comprehensive income (loss)	Total
Unitholders' equity, January 1, 2016	\$ 213,338	\$ (51,146)	\$ 62,816	\$ 45,721	\$ 270,729
Unit issued, incentive fee	242	–	–	–	242
Unit issued, net of issuance costs	43,490	–	–	–	43,490
Net income	–	–	19,775	–	19,775
Other comprehensive loss	–	–	–	(5,357)	(5,357)
Distributions	–	(19,599)	–	–	(19,599)
Distribution reinvestment plan	415	–	–	–	415
Unitholders' equity, December 31, 2016	257,485	(70,745)	82,591	40,364	309,695
Units issued, incentive fee	509	–	–	–	509
Unit issued, net of issuance costs	52,591	–	–	–	52,591
Net income	–	–	52,643	–	52,643
Other comprehensive loss	–	–	–	(17,123)	(17,123)
Distributions	–	(25,122)	–	–	(25,122)
Distribution reinvestment plan	732	–	–	–	732
Unitholders' equity, December 31, 2017	\$ 311,317	\$ (95,867)	\$ 135,234	\$ 23,241	\$ 373,925

Distributions per unit for the year ended December 31, 2017 - \$0.785 (2016 - \$0.775).

See accompanying notes to consolidated financial statements.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

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

Years ended December 31, 2017 and 2016

	2017	2016
Cash flows from (used in) operating activities:		
Net income	\$ 52,643	\$ 19,775
Adjustments for items not involving cash:		
Straight-line rents adjustment	(1,521)	(631)
Amortization of lease incentive	2,316	1,565
Fair value adjustment on investment properties	(23,635)	11,767
Fair value adjustment on investment limited partnership	(84)	–
ACPI management agreements with the REIT (note 3(a))	8,443	–
Fair value adjustment to Class B LP Units (note 10)	279	–
Finance costs (note 14)	13,327	10,865
Loss on sale of investment properties (note 4)	571	487
Change in non-cash working capital items:		
Other assets	(1,607)	322
Accounts receivable	(330)	453
Tenant rental deposits and prepaid rent	2,692	347
Deferred income tax liability	(2,846)	2,745
Accounts payable and accrued liabilities	8,808	176
	59,056	47,871
Cash flows from (used in) financing activities:		
Proceeds from issuance of units (note 11)	52,591	43,490
Proceeds from mortgages payable (note 8)	29,844	12,264
Proceeds from loans facility (note 9)	91,825	79,936
Financing fees paid	(1,000)	(1,045)
Principal payments (note 8)	(6,410)	(5,105)
Repayment of loans facility (note 9)	(102,489)	(65,907)
Repayment of mortgage (note 8)	(11,687)	–
Interest paid	(16,889)	(14,049)
Distributions paid	(24,073)	(18,889)
Distributions paid on Class B LP Units	(56)	–
	11,656	30,695
Cash flows from (used in) investing activities:		
Acquisition of investment properties (note 3(b))	(58,010)	(43,957)
Proceeds from disposition on investment properties (note 4)	36,917	8,494
Additions to investment properties	(46,665)	(40,780)
Additions to other assets	(20)	–
Change in restricted cash	271	(3,146)
Distributions from (investment in) limited partnership	(847)	–
	(68,354)	(79,389)
Effect of exchange rates on cash	(585)	(569)
Increase (decrease) in cash and cash equivalents	1,773	(1,392)
Cash and cash equivalents, beginning of year	7,746	9,138
Cash and cash equivalents, end of year	\$ 9,519	\$ 7,746
Supplemental cash flow information:		
Units issued under distribution reinvestment plan (note 11)	\$ 732	\$ 415
Deferred compensation expense (note 12)	102	91
Units issued under incentive fee (note 11))	509	242
Mortgages assumed on acquisition, including mark-to-market adjustment of nil (2016 - \$2,032)	–	45,690
Class B LP Units issued on acquisition and internalization (note 3(a))	10,122	–
Other assets acquired on acquisition and internalization (note 3(a))	(1,679)	–

See accompanying notes to consolidated financial statements.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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Agellan Commercial Real Estate Investment Trust (the "REIT") is an open-ended real estate investment trust established under, and governed by, the laws of the Province of Ontario, pursuant to a declaration of trust ("Declaration of Trust") dated November 1, 2012, when one trust unit was issued for ten dollars cash. The Declaration of Trust was subsequently amended and restated on January 24, 2013. The REIT commenced operations on January 25, 2013 when it issued units for cash pursuant to an initial public offering ("IPO").

The REIT was created for the purpose of acquiring and owning industrial, office and retail properties in the United States and Canada. The units of the REIT ("Units") trade on the Toronto Stock Exchange ("TSX") under the symbol ACR.UN. The registered office of the REIT is 156 Front Street West, Suite 303, Toronto, Ontario, Canada M5J 2L6. The Declaration of Trust provides that the REIT may make cash distributions to the unitholders of the REIT.

## 1. Basis of preparation:

### (a) Statement of compliance:

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

### (b) Basis of consolidation:

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

The REIT's wholly owned subsidiaries are noted in note 19. All intercompany transactions and balances between the REIT and the subsidiary entities have been eliminated upon consolidation. The financial statements of the subsidiaries are prepared for the same reporting year as the REIT, using consistent accounting policies. All intra-group balances, transactions, unrealized gains and losses resulting from intra-group transactions and distributions are eliminated in full.



# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 1. Basis of preparation (continued):

### (c) Basis of measurement and foreign currency translation:

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

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

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

### (d) Key sources of estimation uncertainty:

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 1. Basis of preparation (continued):

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

Investment properties:

The significant estimates used when determining the fair value of investment properties are capitalization rates and discount rates. The capitalization rates and discount rates applied are reflective of the characteristics of the property, location and market of each investment property noted in note 5.

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

### (e) Significant judgements:

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

#### (i) Accounting for acquisitions:

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

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 1. Basis of preparation (continued):

### (ii) Income taxes:

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

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

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 1. Basis of preparation (continued):

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

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

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

## 2. Significant accounting policies:

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

### (a) Investment properties:

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

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

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

### (b) Derivative instruments:

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

### (c) Revenue recognition:

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

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

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

### (d) Finance costs:

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

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

### (e) Leasing costs:

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 2. Significant accounting policies (continued):

### (f) Financial instruments:

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

	Classification	Measurement
Financial assets:		
Accounts receivable	Loans and receivables	Amortized cost
Cash and cash equivalents	Loans and receivables	Amortized cost
Other receivables	Loans and receivables	Amortized cost
Investment in limited partnership	FVTPL	Fair value
Financial liabilities:		
Mortgages payable	Other liabilities	Amortized cost
Loans facility	Other liabilities	Amortized cost
Tenant rental deposits and prepaid rent	Other liabilities	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Class B LP Units	FVTPL	Fair value
Finance costs payable	Other liabilities	Amortized cost
Derivative instruments	FVTPL	Fair value
Distributions payable	Other liabilities	Amortized cost

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

### (g) Units:

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

### (h) Class B LP Units:

The Class B LP Units of the REIT's subsidiary, Agellan Management Limited Partnership ("Management LP"), are exchangeable into Units (on a one-for-one basis, subject to customary anti-dilution adjustments) at the option of the holder. The Class B LP Units are entitled to distributions per unit in an amount equal to the distributions per unit declared in respect of the Units. The Class B LP Units are puttable and are required to be classified as financial liabilities at FVTPL. The distributions paid on the Class B LP Units are accounted for as interest expense recorded in finance costs.

### (i) Fair value measurements:

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



# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

### (j) Levies:

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

### (k) Unit-based compensation:

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

### (l) Accounting standards implemented in 2017:

#### IAS 7, Statement of Cash Flows ("IAS 7"):

On January 7, 2016, the International Accounting Standards Board ("IASB") issued Disclosure Initiative (Amendments to IAS 7); these amendments apply for annual periods beginning on January 1, 2017. The amendments require additional disclosure for a user of the financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The REIT implemented these amendments in the first quarter of 2017. The REIT has disclosed a reconciliation of financial liabilities, including both cash and non-cash changes in notes 8 and 9.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

### (m) Future accounting standards:

A number of new standards, amendments to standards and interpretations have been issued but are not yet effective for the year ended December 31, 2017 and, accordingly, have not been applied in preparing these consolidated financial statements.

### (i) IFRS 9, Financial Instruments - Classification and Measurement ("IFRS 9"):

The REIT will adopt IFRS 9 which replaces IAS 39, Financial Instruments - Recognition and Measurement ("IAS 39"), in the consolidated financial statements beginning on January 1, 2018, the mandatory effective date. The adoption of IFRS 9 will generally be applied retrospectively, without restatement of comparative information.

IFRS 9 contains a new classification and measurement approach which requires financial assets to be classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income and fair value through profit or loss, and eliminates the existing IAS 39 categories of held to maturity, loans and receivables and available for sale.

For impairment of financial assets, IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model. The new impairment model will apply to financial assets measured at amortized cost or fair value through other comprehensive income, except for investments in equity instruments, and to contract assets.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, under IAS 39 all fair value changes of liabilities designated as fair value through profit or loss are recognized in profit or loss, whereas under IFRS 9 the amount of change in fair value attributable to changes in the credit risk of the liability is presented in other comprehensive income, and the remaining amount of change in fair value is presented in profit or loss.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. The REIT does not currently apply hedge accounting.

The REIT is completing the evaluation of the impact of adopting IFRS 9, including the impact on financial instruments held through equity accounted investments. The status of management's evaluation of the impact of IFRS 9 is as follows:

- The new classification requirements are not expected to have a material impact on the accounting for existing financial assets and liabilities.
- The new impairment model is not expected to have a material impact on the REIT's existing financial assets measured at amortized cost, which include cash and cash equivalents, accounts receivable, and other receivables.
- The REIT is still assessing the potential impact on non-substantial modifications made to financial instruments measured at amortized cost. Under IFRS 9, the amortized cost is recalculated on modification which results in the recognition of a gain or loss, whereas under IAS 39 no gain or loss was recorded.
- Class B LP Units will continue to be classified as financial liabilities at fair value through profit or loss and there will be no material impact on adoption of IFRS 9 related to these financial liabilities.

### (ii) IFRS 15, Revenue from Contracts with Customers ("IFRS 15"):

IFRS 15 is effective for annual periods beginning on or after January 1, 2018, and will replace all existing guidance in IFRS related to revenue, including (but not limited to) IAS 11, Construction Contracts, IAS 18, Revenue, and IFRIC 15, Agreements for the Construction of Real Estate.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

IFRS 15 contains a single, control-based model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. IFRS 15 also includes additional disclosure requirements for revenue accounted for under the standard.

The REIT will adopt IFRS 15 in the consolidated financial statements for the annual period beginning January 1, 2018. The REIT plans to adopt IFRS 15 using the cumulative effect method, with the effect of initially applying this standard recognized at January 1, 2018. As a result, the REIT will not apply the requirements of IFRS 15 to the comparative period presented. Management does not expect that the adoption of IFRS 15 will have a material impact on the consolidated financial statements. However, additional disclosure requirements may result in separate disclosure of revenue for service components that are part of a lease (i.e. a non-lease component).

### (iii) IFRS 16, Leases ("IFRS 16"):

IFRS 16 will replace existing lease guidance in IFRS and related interpretations, and requires lessees to bring most leases on-balance sheet. Lessor accounting remains similar to the current standard. The new standard is effective for years beginning on January 1, 2019.

The REIT is still evaluating the impact of IFRS 16. In particular, the REIT is assessing how the new standard may impact the identification of lease and non-lease components, including the allocation of consideration to each lease and non-lease component. The standard requires this allocation to be completed in accordance with the guidance in IFRS 15, that is, on the basis of relative standalone selling prices.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 2. Significant accounting policies (continued):

### (iv) IFRIC Interpretation 23, Uncertainty over Income Tax Treatments ("IFRIC 23"):

On June 7, 2017, the IASB issued IFRIC Interpretation 23 Uncertainty over Income Tax Treatments. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The Interpretation is applicable for annual periods beginning on or after January 1, 2019 with early adoption permitted. The Interpretation requires: (a) the REIT to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution; (b) determine if it is probable that the tax authorities will accept the uncertain tax treatment; and (c) if it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty.

The REIT intends to adopt the Interpretation in their consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 3. Acquisitions:

### (a) Business combination:

On November 13, 2017 ("Closing"), the REIT through its subsidiary, "Management LP" acquired all the requisite assets of Agellan Capital Partners Inc. ("ACPI") and internalized the REIT's asset management function (the "Acquisition and internalization"). Concurrently with the Acquisition and internalization, all the executives and other employees of ACPI became employees of the REIT or Management LP.

The aggregate consideration to ACPI comprised of: (i) Issuance of 871,080 Class B LP Units, and (ii) Cash consideration of up to \$3,000 payable to ACPI contingent on certain performance hurdles to be met in fiscal years 2018 and 2019. On Closing, the fair value of the Class B LP Units was \$10,122 and fair value of the contingent cash considerations was determined to be nil.

The Acquisition and internalization transaction has been recognized as a business combination and transaction costs of \$422 have been expensed. The REIT recognized all identifiable assets acquired which were measured at their respective fair values on Closing as follows:

ACPI management agreements with the REIT	\$ 8,443
Acquired assets:	
Intangible assets - third-party management agreement	1,639
Fixed assets	40
<b>Total fair value</b>	<b>\$ 10,122</b>
Fair value of Class B LP Units issued	\$ 10,122
Contingent cash considerations	-
<b>Fair value of consideration</b>	<b>\$ 10,122</b>

The portion of purchase price allocated to ACPI's management agreement with the REIT has been expensed in general and administrative.

As at December 31, 2017, the fair value of the contingent cash consideration was determined to be nil.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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### 3. Acquisitions (continued):

#### (b) Asset acquisitions:

On April 25, 2017, the REIT acquired a 100% interest in one property located in Flint, Michigan for a total purchase price of \$21,877 (including acquisition costs and closing adjustments of \$130). The REIT assumed a net working capital liability of \$60, comprising costs related to deferred revenue of \$60. The transaction has been recognized as an asset acquisition. In consideration, the REIT paid cash. This property was previously managed by the REIT's external manager ACPI and certain principals of ACPI had an interest in the property.

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Investment property (includes acquisition costs and closing adjustments of \$130) <sup>(1)</sup>	\$ 21,877
Working capital assumed, net	(60)
<b>Net assets acquired</b>	<b>\$ 21,817</b>
Consideration paid	\$ 21,817

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<sup>(1)</sup> IFRIC 21 adjustment of \$147 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.

On June 27, 2017, the REIT acquired a 100% interest in eight properties located in Chicago Illinois for a total purchase price of \$37,118 (including acquisition costs and closing adjustments of \$192). The REIT assumed a net working capital liability of \$925, comprising costs related to tenant rental deposits and prepaid rent of \$196, accounts payable and accrued liabilities of \$345 and deferred revenue of \$384. Consideration was paid in cash using proceeds from obtaining new financing of \$19,782 and the remaining from cash on hand.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

### 3. Acquisitions (continued):

Investment properties (includes acquisition costs and closing adjustments of \$192) <sup>(i)</sup>	\$ 37,118
Working capital assumed, net	(925)
<b>Net assets acquired</b>	<b>\$ 36,193</b>
Consideration paid	\$ 36,193

<sup>(i)</sup> IFRIC 21 adjustment of \$404 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.

On December 6, 2016, the REIT acquired a 100% interest in one property located in Sarasota, Florida for a total purchase price of \$69,927 (including acquisition costs and closing adjustments of \$162 and a mark-to-market adjustment on the mortgage of \$2,032). The REIT assumed a net working capital liability of \$170, comprising costs related to tenant rental deposits and prepaid rent of \$34, deferred revenue of \$572 offset by prepaid expenses of \$436. In addition, the REIT has also deposited certain amounts in restricted cash relating to interest payments on the assumed mortgage and deposits for \$1,992 and \$474, respectively. The transaction has been recognized as an asset acquisition. In consideration, the REIT assumed a mortgage of \$45,690 (including a mark-to-market adjustment of \$2,032) and paid the remainder in cash.

Investment property (includes acquisition costs and closing adjustments of \$162 and mark-to-market adjustment on mortgage of \$2,032) <sup>(i)</sup>	\$ 69,927
Other assets	2,466
Assumed mortgage, including mark-to-market adjustment of \$2,032	(45,690)
Working capital assumed, net	(170)
<b>Net assets acquired</b>	<b>\$ 26,533</b>
Restricted cash	\$ 2,466
Consideration paid	24,067
<b>Consideration paid</b>	<b>\$ 26,533</b>

<sup>(i)</sup> IFRIC 21 adjustment of \$56 related to U.S. property taxes liability assumed on acquisitions is recorded as an offset to investment properties.



# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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### 3. Acquisitions (continued):

On September 8, 2016, the REIT acquired 100% interest in two properties located in Atlanta, Georgia for a total purchase price of \$20,380 (including acquisition costs and closing adjustments of \$35). The REIT assumed a net working capital liability of \$490 comprising costs related to tenant rental deposits and prepaid rent of \$138, accounts payable and accrued liabilities of \$365, deferred revenue of \$104 and accounts receivable of \$117. The transaction has been recognized as an asset acquisition. Consideration was paid using proceeds from mortgage financing of \$12,264 and the remaining with cash available from the public unit offering.

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Net assets acquired:		
Investment properties, including acquisition costs and closing adjustments of \$35 <sup>(i)</sup>	\$	20,380
Working capital assumed		(490)
<b>Net assets acquired</b>	<b>\$</b>	<b>19,890</b>
Consideration paid	\$	19,890

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<sup>(i)</sup> IFRIC 21 adjustment of \$83 related to U.S. property taxes liability assumed on acquisition is recorded as an offset to investment properties.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 4. Disposition:

On July 27, 2016, the REIT entered into agreements with certain arm's-length private purchasers to sell the REIT's partnership interest in a limited partnership created by the REIT to own a car dealership and corporate head office pursuant to a lease agreement with the tenant. On September 29, 2017, the REIT disposed of its interest in the limited partnership for a gross sale price of \$42,276, as detailed below:

Gross sale price	\$ 42,276
Selling costs (2016 - \$52)	(571)
Other transaction and working capital adjustments	(1,810)
Other receivable in escrow for construction holdbacks and remaining development work (note 6)	(2,978)
<b>Net proceeds</b>	<b>\$ 36,917</b>

On May 3, 2016, the REIT disposed of one investment property for an adjusted sale price of \$8,929. Selling costs incurred on the transaction were \$337 and are recognized as a loss on sale of investment properties. The proceeds received net of selling costs and working capital adjustments were \$8,494.

## 5. Investment properties:

	2017	2016
Balance, beginning of year	\$ 759,494	\$ 662,296
Acquisition of investment properties (note 3(b))	58,995	90,307
Additions - capital expenditures <sup>(i)</sup>	25,528	32,338
Additions - leasing costs, net of amortization of lease incentives of \$2,316 (2016 - \$1,565)	18,821	6,883
Straight-line rents adjustment	1,521	631
Fair value adjustment	24,186	(11,628)
Disposition of investment properties (note 4) <sup>(ii)</sup>	(39,585)	(8,929)
Foreign exchange impact on translation of U.S. operations	(40,085)	(12,404)
<b>Balance, end of year</b>	<b>\$ 808,875</b>	<b>\$ 759,494</b>

(i) Includes interest capitalized on a qualifying development project of \$1,469 (2016 - \$657) (note 14).

(ii) The fair value reflects the gross sale price of \$42,276, net of certain other transaction adjustments and remaining costs on the development of \$2,691 at the date of disposition (note 4).

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 5. Investment properties (continued):

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

### (a) External appraisals:

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

The aggregate appraised value of properties externally appraised during the year ended December 31, 2017, including appraisals obtained in conjunction with acquisitions totalled \$395,129 (2016 - \$353,067).

### (b) Internal valuations:

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 5. Investment properties (continued):

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

2017	Canada	United States
Discount rates - range	7.25%	7.00% - 12.00%
Discount rate - weighted average	7.25%	8.64%
Terminal capitalization rates - range	7.00%	6.50% - 11.50%
Terminal capitalization rate - weighted average	7.00%	7.88%

2016	Canada	United States
Discount rates - range	7.50% - 7.50%	7.50% - 9.50%
Discount rate - weighted average	7.50%	8.69%
Terminal capitalization rates - range	7.00% - 7.25%	7.00% - 8.75%
Terminal capitalization rate - weighted average	7.24%	7.97%

The fair values of the REIT's investment properties are sensitive to changes in the key valuation assumptions. Changes in the terminal capitalization rates and discount rates would result in a change to the fair value of the REIT's investment properties calculated using the discounted cash flow method as set out in the following table:

	2017	2016
Weighted average discount rate:		
25-basis points increase	\$ (14,222)	\$ (15,693)
25-basis points decrease	14,558	11,407
Weighted average terminal capitalization rate:		
25-basis points increase	(14,882)	(15,708)
25-basis points decrease	15,909	12,006

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 6. Other assets:

	2017	2016
Current:		
Prepaid expenses	\$ 1,571	\$ 1,606
Restricted cash	4,416	4,653
Deposits in escrow	906	1,258
Other receivables in escrow (note 4)	1,716	145
	<u>8,609</u>	<u>7,662</u>
Non-current:		
Investment in limited partnership	871	–
Third-party management agreements (note 3(a))	1,639	–
Fixed assets (note 3(a))	60	–
	<u>2,570</u>	<u>–</u>
	<u>\$ 11,179</u>	<u>\$ 7,662</u>

Restricted cash can only be used for specified purposes. The REIT's restricted cash represents cash held in escrow by lenders pursuant to certain lender agreements and deposits held in trust relating to certain development plans.

On April 18, 2017, the REIT acquired a 9% non-controlling interest in a limited partnership that holds a property located in Tampa, Florida for a purchase price of \$859. Consideration was paid in cash. The investment has been recognized as a financial asset at FVTPL and included in other assets.

## 7. Accounts payable and accrued liabilities:

	2017	2016
Trade payable	\$ 1,598	\$ 1,050
Realty tax payable	7,842	7,258
Other payables and accruals	15,468	11,153
	<u>\$ 24,908</u>	<u>\$ 19,461</u>

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 8. Mortgages payable:

	2017	2016
Current:		
Mortgages payable	\$ 69,771	\$ 8,358
Unamortized mark-to-market premium	1,109	1,749
Unamortized financing fees	(448)	(624)
	<u>70,432</u>	<u>9,483</u>
Non-current:		
Mortgages payable	230,936	301,173
Unamortized mark-to-market premium	335	1,579
Unamortized financing fees	(1,278)	(1,280)
	<u>229,993</u>	<u>301,472</u>
	<u>\$ 300,425</u>	<u>\$ 310,955</u>

The mortgages payable are secured by charges on 42 investment properties. Mortgages payable include financing fees and a mark-to-market premium which are amortized into finance costs over the terms of the related mortgages, using the effective interest rate method. At December 31, 2017, the consolidated statements of financial position included financing fees of \$2,996 (2016 - \$3,209) and accumulated amortization of \$1,270 (2016 - \$1,305). The mortgages carry a weighted average interest rate of 4.46% (2016 - 4.30%) and mature at various dates between 2018 and 2027.

Included in mortgages payable is one Canadian dollar denominated mortgage of \$2,011 (2016 - \$2,199) which is at a variable interest rate. Interest is charged at 250-basis points over the 90-day Canadian Dollar Offered Rate.

Included in mortgages payable are U.S. dollar denominated mortgages of \$298,696 (U.S. \$238,100) (2016 - \$307,332 (U.S. \$228,891)). Of these mortgages, \$43,915 (U.S. \$35,005) (2016 - \$59,913 (U.S. \$44,641)) have a variable interest rate. The REIT has entered into interest rate swap contracts to limit its exposure to fluctuations in interest rates (note 14).

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 8. Mortgages payable (continued):

The following table shows the change in mortgages payable from January 1, 2017 to December 31, 2017:

Opening balance, beginning of year	\$ 310,955
Proceeds from mortgages payable	29,844
Repayments of mortgages payable	(11,687)
Principal payments	(6,410)
Financing fees paid	(697)
Amortization of mark-to-market premium	(1,726)
Amortization of financing fees	681
Foreign exchange impact	(20,535)
<b>Closing balance, end of year</b>	<b>\$ 300,425</b>

Future principal repayments at December 31, 2017 are as follows:

	Scheduled principal payments	Debt maturing during the year	Total mortgages payable	Scheduled interest payments	Total debt service	Weighted average interest rate of debt maturing
2018	\$ 5,931	\$ 63,840	\$ 69,771	\$ 11,984	\$ 81,755	5.34%
2019	5,419	42,435	47,854	9,886	57,740	3.97%
2020	3,841	40,541	44,382	6,726	51,108	3.89%
2021	3,793	-	3,793	6,278	10,071	-
2022	3,235	46,473	49,708	4,663	54,371	5.31%
Thereafter	4,405	80,794	85,199	5,458	90,657	3.93%
Face value	<u>\$ 26,624</u>	<u>\$ 274,083</u>	300,707	<u>\$ 44,995</u>	<u>\$ 345,702</u>	
Unamortized mark-to-market premium			1,444			
Unamortized financing fees			(1,726)			
			<b>\$ 300,425</b>			

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 9. Loans payable:

The REIT has a revolving credit facility, secured by charges on one Canadian property. The maximum amount available to the REIT under this facility is \$120,000, and the facility matures on January 25, 2019. Amounts can be drawn under the facility in both United States and Canadian dollars. The facility bears interest at bankers' acceptance/LIBOR plus 2.00% or prime/U.S. base rate plus 1.00%. As at December 31, 2017, the amount drawn on the facility was \$91,800 (2016 - \$87,640).

The interest rate on \$60,000 drawn on the facility has been economically fixed at 3.42% using an interest rate swap (note 15).

On July 27, 2016, the REIT had secured a non-revolving construction facility, as an addition under the original agreement, secured by charges on one Canadian property. The maximum amount available to the REIT under this construction facility was \$48,000 and the facility was set to mature at the earlier of January 25, 2018 or the closing of the sale transaction. The facility bears interest at bankers' acceptance plus 2.00% or prime plus 1.00%. On September 29, 2017, the outstanding balance of the construction facility of \$32,005 was repaid and extinguished on closing of the sale transaction (note 4) (2016 - \$15,731).

Financing fees of \$1,560 (2016 - \$1,257) were incurred to obtain the revolving credit facility and non-revolving construction facility and are being amortized over the remaining term. As at December 31, 2017, the unamortized financing fees totalled \$206 (2016 - \$334). The financing related to the construction facility was fully amortized (2016 - \$144).

The following table shows the change in loans payable from January 31, 2017 to December 31, 2017:

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Opening balance, beginning of year	\$	103,037
Proceeds from loans facility		91,825
Repayment of loan facility		(102,489)
Financing fees paid		(303)
Amortization of financing fees		431
Foreign exchange impact		(907)
Closing balance, end of year	\$	91,594

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# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 10. Class B LP Units:

	2017		2016	
	Units	Amount	Units	Amount
Class B LP Units, January 1	–	\$ –	–	\$ –
Units issued, Acquisition and internalization	871,080	10,122	–	–
Fair value adjustment	–	279	–	–
<b>Class B LP Units, December 31</b>	<b>871,080</b>	<b>\$ 10,401</b>	<b>–</b>	<b>\$ –</b>

On November 13, 2017, the REIT's subsidiary, Management LP, issued 871,080 Class B LP Units for a total fair value of \$10,122, equal to \$11.62 per unit, the price of the Units on closing of the Acquisition and internalization transaction (note 3 (a)).

The Management LP is authorized to issue unlimited number of Class B LP Units. Each Class B LP Units issued is accompanied by a Special Voting Unit issued by the REIT which entitles the holder of record to one vote at meetings of the Unitholders of the REIT. The Class B LP Units are economically equivalent on a one-to-one basis to Units, receive distributions equal to the distributions paid on the Units, and are exchangeable, at the holder's option, to Units.

## 11. Unitholders' equity:

	2017		2016	
	Units	Amount	Units	Amount
Unitholders' capital, January 1	27,947,350	\$ 257,485	23,395,139	\$ 213,338
Additional shares issued under the DRIP program	64,565	732	40,471	415
Units issued, incentive fee	44,513	509	26,740	242
Units issued, net of issuance costs of \$2,449 (2016 - \$2,479)	4,807,000	52,591	4,485,000	43,490
<b>Unitholders' capital, December 31</b>	<b>32,863,428</b>	<b>\$ 311,317</b>	<b>27,947,350</b>	<b>\$ 257,485</b>

### (a) Units:

On February 27, 2017, the REIT issued 4,807,000 Units at \$11.45 per unit for total proceeds of \$55,040. Costs relating to the offering, including issuance costs of \$2,449, have been charged directly to unitholders' equity.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 11. Unitholders' equity (continued):

On August 4, 2016, the REIT issued 4,485,000 Units at \$10.25 per unit for total proceeds of \$45,971. Costs relating to the offering, including underwriting fees of \$2,479, have been charged directly to unitholders' equity.

The REIT is authorized to issue an unlimited number of Units. Each unit represents a single vote at any meeting of the unitholders and entitles the unitholder to receive a prorated share of all distributions.

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

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

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

For the year ended December 31, 2017, the REIT issued 64,565 (2016 - 40,471) Units under the DRIP for a stated average value of \$11.33 (2016 - \$10.26) per unit.

DRIP was suspended on August 10, 2015 when the normal course issuer bid was launched by the REIT. On April 7, 2016, the REIT announced the reinstatement of the DRIP with the amendment to remove the provision of the 3% discount previously available to unitholders.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 12. Deferred Unit Incentive Plan:

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

The Board of Trustees are able to receive their annual retainer and meeting fees for the fiscal year in the form of DTUs. DTUs issued to trustees in lieu of their annual retainer and meeting fees will vest immediately. However, in no event shall the exercise of the trustees' DTUs issued in lieu of their annual retainer and meeting fees occur prior to the third anniversary of the grant date, except in the instance of termination of service.

For the year ended December 31, 2017, 7,984 DTUs were granted to trustees for services rendered (2016 - 6,868). These amounts are recognized in accounts payable and accrued liabilities and general and administrative expenses.

The following is a summary of DTUs granted under the DUIP:

	Units	
	2017	2016
Balance, January 1	17,966	10,085
DTUs granted for services rendered	7,984	6,868
DTUs granted through distributions	1,379	1,013
Balance, December 31	27,329	17,966

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 12. Deferred Unit Incentive Plan (continued):

The movement of the DUIP liability balance was as follows:

	2017	2016
Balance, January 1	\$ 178	\$ 87
DUIP liability adjustment	102	91
<b>Balance, December 31</b>	<b>\$ 280</b>	<b>\$ 178</b>

Total compensation expense recognized for the year ended December 31, 2017 was \$460 (2016 - \$91). These amounts are recognized in accounts payable and accrued liabilities and general and administrative expenses.

## 13. General and administrative:

	2017	2016
Acquisition and internalization (note 3(a))	\$ 8,865	\$ –
Proxy matter (note 20(a))	5,115	–
Asset management fee (note 20(b))	2,832	2,639
Incentive fee (note 20(c))	614	686
Salaries and benefits	462	–
Director fees	246	199
Corporate tax	257	575
Others expenses	1,662	1,322
	<b>\$ 20,053</b>	<b>\$ 5,421</b>

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 14. Finance costs:

	2017	2016
Interest:		
Loans facility	\$ 3,391	\$ 3,324
Mortgages payable	13,565	10,918
Amortization of financing fees	1,112	622
Amortization of mark-to-market premium	(1,726)	(1,016)
Unrealized gain on derivative instrument - interest rate swap	(621)	(670)
Unrealized gain on derivative instrument - foreign currency exchange hedge	(1,038)	(1,656)
Distributions on Class B LP Units	113	-
Capitalized interest	(1,469)	(657)
	13,327	10,865
Realized loss (gain) on foreign currency exchange hedge	(19)	254
	\$ 13,308	\$ 11,119

Interest is capitalized to a qualifying development project, based on the REIT's weighted average rate of borrowings. The weighted average interest rate used was approximately 3.78%.

## 15. Derivative instruments:

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

- (a) The REIT entered into interest rate swap agreements relating to its loans facility whereby, the REIT has agreed to exchange, at specified intervals, the difference between the fixed and variable interest amounts calculated by reference to a notional amount of \$60,000 maturing July 27, 2018 as outlined in note 9. The valuation of this interest rate swap contract was computed using Level 2 inputs, as outlined in note 24.

The REIT has entered into swap agreements to fix mortgages payable of U.S. \$7,557 at 3.95%, U.S. \$19,193 at 3.99%. U.S. \$5,924 at 3.935% and U.S. \$2,332 at 3.95% for terms maturing in 2019.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 15. Derivative instruments (continued):

The REIT recognized an unrealized gain of \$621 (2016 - unrealized gain of \$670) for the year ended December 31, 2017, which has been recorded as finance costs.

The fair value of the interest rate swap instruments outstanding as at December 31, 2017 is an asset of \$293 (2016 - liability of \$330).

- (b) Under the terms of the foreign currency forward lock contract agreement, the REIT exchanges a fixed amount of U.S. dollars for Canadian dollars each month. The valuation of the foreign currency forward lock contract agreement was computed using Level 2 inputs, as outlined in note 24.

The total notional value of the forward contracts outstanding as of December 31, 2017 is U.S. \$12,587 (2016 - U.S. \$12,587) and have a weighted average forward exchange rate of \$1.29 (2016 - \$1.30) Canadian dollars per U.S. dollar. The contracts have terms maturing to in 2019.

The REIT recognized an unrealized gain of \$1,038 (2016 - unrealized gain of \$1,656) for the year ended December 31, 2017, which has been recorded as finance costs.

The REIT recognized a realized gain on the settlement of foreign currency forward contracts of \$19 (2016 - \$254 loss) for the year ended December 31, 2017, which has been recorded as finance costs.

The fair value of the foreign currency forward lock contract instrument as at December 31, 2017 is an asset of \$514 (2016 - liability of \$524).

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 16. Income taxes:

	2017	2016
Net income	\$ 52,643	\$ 19,775
Deferred income taxes (recovery)	(2,846)	2,745
<b>Net income before deferred income taxes (recovery)</b>	<b>\$ 49,797</b>	<b>\$ 22,520</b>
Income tax computed at the Canadian statutory rate of nil applicable to the REIT	\$ –	\$ –
Deferred income taxes due to difference between the U.S. and Canadian tax rate	8,273	2,745
Impact of U.S. tax reform	(11,119)	–
<b>Deferred income taxes (recovery)</b>	<b>\$ (2,846)</b>	<b>\$ 2,745</b>

The REIT has certain subsidiaries in the United States that are subject to tax on their taxable income at a rate of approximately 37.22% (2016 - 37.00%). The foreign exchange impact of the deferred tax liability of \$1,437 (2016 - \$590) is recorded in other comprehensive loss.

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

	2017	2016
<b>Deferred tax assets:</b>		
Net operating losses and deferred interest deductions	\$ 770	\$ 446
U.S. income tax credits	446	–
	<b>1,216</b>	<b>446</b>
<b>Deferred tax liabilities:</b>		
Investment properties	17,230	20,788
Other liabilities	2,997	2,952
	<b>20,227</b>	<b>23,740</b>
<b>Deferred income tax liability</b>	<b>\$ 19,011</b>	<b>\$ 23,294</b>

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 16. Income taxes (continued):

At December 31, 2017, the REIT's U.S. subsidiaries had accumulated net operating losses and deferred interest deductions available for carryforward for U.S. income tax purposes of \$3,250 (2016 - \$1,210).

The net operating losses will expire between 2034 and 2037. The deferred interest deductions and the deductible temporary differences do not generally expire under current tax legislation.

During 2017, \$175 (2016 - \$179) of withholding taxes with respect to distributions from the U.S. subsidiaries have been recorded in general and administrative expenses.

During 2017, \$146 (2016 - \$143) of U.S. state franchise taxes incurred by the U.S. subsidiaries have been recorded in property operating expenses, as these taxes are recoverable from tenants.

During 2017, (\$4) (2016 - \$46) of U.S. state franchise taxes incurred by the U.S. subsidiaries have been recorded in general and administrative expenses, as these taxes are not recoverable from tenants.

During 2017, \$86 (2016 - \$350) of U.S. alternative minimum taxes incurred by the U.S. subsidiaries have been recorded in general and administrative expenses.

On December 22, 2017, new U.S. tax legislation was enacted, commonly referred to as the TaxCuts and Jobs Act of 2017 ("U.S. Tax Reform"). This legislation is broad and complex and introduces multiple changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35 percent to 21 percent; (2) eliminating the corporate alternative minimum tax ("AMT") and changing how existing AMT credits can be realized; (3) creating a new limitation on deductible interest expense (new Code section 163(j)); (4) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017; and (5) creating the base erosion anti-abuse, a new minimum tax.



# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## **16. Income taxes (continued):**

For the year ended December 31, 2017, the REIT has re-measured the deferred taxes to reflect the reduced federal rate of 21% effective January 1, 2018 which will apply in future years when these deferred taxes are settled or realized. The impact of the reduced federal tax rate was a reduction in deferred tax of \$11,119.

## **17. Capital management:**

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

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 17. Capital management (continued):

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

- (a) a Debt to Gross Book Value ratio of not more than 65%;
- (b) a Debt Service Coverage Ratio of not less than 1.50; and
- (c) a minimum equity of not less than the aggregate of: (i) \$150,000; and (ii) 75% of net proceeds received in connection with any future equity offerings.

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

The REIT complied with all financial covenants as at December 31, 2017.

## 18. Segmented disclosure:

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

Non-current assets:

	2017	2016
Canada	\$ 224,333	\$ 213,491
United States	587,112	546,003
	<b>\$ 811,445</b>	<b>\$ 759,494</b>

Revenue:

	2017	2016
Canada	\$ 29,011	\$ 28,269
United States	72,588	60,333
	<b>\$ 101,599</b>	<b>\$ 88,602</b>

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 18. Segmented disclosure (continued):

The REIT has two tenants in its portfolio that account for 9.47% and 9.44% (2016 - 10.95% and 11.19%) of its total revenue. The tenants' leases will expire in 2020 and 2023, respectively.

## 19. Subsidiaries:

The REIT is the ultimate Canadian parent entity.

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

- Agellan Commercial REIT Holdings Inc.;
- Agellan Commercial REIT U.S. Inc.;
- Agellan Commercial REIT G.P. Inc.;
- Agellan Commercial REIT U.S. L.P.;
- Agellan Warrenville G.P. Inc.;
- Agellan Warrenville L.P.;
- Agellan Management Limited Partnership;
- Norcross Springs LP;
- Norcross Springs GP LLC;
- 6100 McIntosh LP;
- 6100 McIntosh GP LLC;
- 6100 McIntosh Vacant LP;
- Continental Drive LP;
- ACR US GP LLC;
- 1820 Massaro Boulevard LP; and
- Chicago Industrial Properties 1 LP.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 20. Transactions with related parties:

Prior to Acquisition and internalization, related parties included ACPI and its principals, who are related due to their ownership of Units, as well as due to certain common ownership interests in ACPI and the REIT. The REIT entered into an agreement with ACPI to internalize its asset management function. The below related party transactions with ACPI are reflected up to the period of Acquisition and internalization on November 13, 2017 (note 3(a)).

Related parties also include Elad Canada Inc. ("ELAD") and Sandpiper Group Inc. ("Sandpiper") due to their ownership interest in the REIT and in their capacity as Trustees of the REIT.

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

- (a) On November 13, 2017, the REIT entered into a strategic settlement agreement with ELAD and Sandpiper relating to the proxy contest, and as part of the agreement, Sandpiper withdrew its previously announced Unitholder meeting requisition. The REIT agreed to reimburse expenses incurred by ELAD of \$1,885 and Sandpiper of \$1,102. The amounts relating to the settlement agreement have been recorded in general and administrative expenses.
- (b) The REIT had engaged ACPI or its related parties to perform asset management services for a fee of 0.4% of the gross book value, as defined in the asset management agreement (the "External Management Agreement") between the REIT and ACPI. The costs of these services, aggregating \$2,832 (2016 - \$2,639) for the period up to the Acquisition and internalization (note 3(a)) were charged to general and administrative expenses. The REIT has also reimbursed ACPI for certain costs incurred for general and administrative as well as property related expenses in the amount of \$132 (2016 - \$85).

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

## 20. Transactions with related parties (continued):

- (c) ACPI shall be paid an incentive equal to the product of (i) 15% of any excess adjusted funds from operation ("AFFO") per unit for the applicable fiscal year greater than 103% of the forecast AFFO per unit as set forth in the IPO prospectus (the "Incentive Fee Target") and (ii) the weighted average number of issued and outstanding Units over the applicable fiscal year. The incentive fee will be measured and paid in Units, calculated based on the volume weighted average closing price of Units on the stock exchange on which the Units are then listed for the 20 trading days immediately preceding March 31 of the applicable year. If payment of the incentive fee in Units creates a taxable event for ACPI, a portion of the incentive fee may be paid in cash upon approval of the Board of Trustees. The Incentive Fee Target will increase annually by 50% of the increase in the weighted average Canadian and United States consumer price indices (weighted based on the gross book value of the REIT's properties located in each jurisdiction). In accordance with the terms of the Acquisition and internalization ACPI shall be paid its incentive fee for the fiscal year ended December 31, 2017. An amount of \$614 has been recognized for the year ended December 31, 2017 (2016 - \$689).
- (d) The REIT engaged ACPI or its related parties to perform property management services for fees as defined in the property management agreements. The costs of these services, aggregating \$504 (2016 - \$563) for the period up to the Acquisition and internalization (note 3(a)), were charged to property operating expenses.
- (e) Included in accounts payable and accrued liabilities is \$112 (2016 - \$227) payable to ACPI for asset management fees, \$622 (2016 - \$689) payable for incentive fees, and \$23 (2016 - \$45) payable to ACPI or its related entities for property management fees. The amount accrued of \$689 related to incentive fees in 2016 was paid in units during the year.

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

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

	2017	2016
Trustee fees	\$ 460	\$ 197
Salaries and benefits	107	–
	\$ 567	\$ 197

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
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Years ended December 31, 2017 and 2016

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## 21. Property operations:

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

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

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2018	\$	63,572
2019		57,624
2020		46,664
2021		35,514
2022		26,499
Thereafter		52,558
		<hr/>
	\$	282,431

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## 22. Commitments and contingencies:

(a) The REIT has entered into a long-term lease agreement with a tenant in 2014, whereby the REIT was obligated to construct a built-to-suit automobile dealership and office space on existing lands at the REIT's Consumers Road complex in Toronto, Ontario. On July 28, 2017, the REIT received an occupancy permit from the City of Toronto and on the same day the tenant took possession of the dealership. The REIT is required to complete certain remaining development work in accordance with the lease agreement and terms of closing of the sale transaction (note 4).

As at December 31, 2017, the REIT has two outstanding letters of credit totalling \$4,800 (2016 - \$4,800) relating to the site development.

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 22. Commitments and contingencies (continued):

- (b) The REIT has entered into a lease agreement for its corporate office with a term expiring on August 31, 2021.
- (c) The REIT is involved in litigation and claims in relation to the investment properties that arise from time to time in the normal course of business. In the opinion of management, none of these, individually or in aggregate would result in the recognition of a liability that would have a significant adverse effect on the consolidated statements of financial position of the REIT.

## 23. Risk management:

In the normal course of business, the REIT is exposed to a number of risks that can affect its operating performance. These risks and the actions taken to manage them are as follows:

### (a) Market risk:

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

The REIT is subject to the risks associated with debt financing, including the risk that the interest rate on floating rate debt may rise before long-term fixed rate debt is arranged and that the mortgages payable will not be able to be refinanced on terms similar to those of the existing indebtedness.

The REIT's objective of managing interest rate risk is to minimize the volatility of earnings. The REIT staggers the maturities of its fixed rate mortgages in order to minimize the exposure to future interest rate fluctuations. The REIT has also entered into certain hedging arrangements to manage the risks on variable rate mortgages and loans. The REIT has \$33,811 (2016 - \$45,570) of variable interest rate debt at December 31, 2017 which has not been economically hedged. A 1% change in interest rates will change the annual finance costs by \$338 (2016 - \$455).

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## **23. Risk management (continued):**

### (b) Credit risk:

Credit risk is the risk that: (i) one party to a financial instrument will cause a financial loss for the REIT by failing to discharge its obligations; and (ii) the possibility that tenants may experience financial difficulty and be unable to meet their rental obligations.

The REIT is exposed to credit risk on all financial assets and its exposure is generally limited to the carrying amount on the consolidated statements of financial position. The REIT monitors its risk exposure regarding obligations with counterparties through the regular assessment of counterparties' credit positions.

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

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

### (c) Liquidity risk:

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



# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## 23. Risk management (continued):

### (d) Foreign currency risk:

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

At December 31, 2017, a one-cent change in the exchange rate will have approximately a \$1,403 (2016 - \$1,035) impact on net assets with an offsetting adjustment to other comprehensive income and an approximate \$181 (2016 - \$82) impact on net income.

## 24. Fair value measurements:

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

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
(In thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2017 and 2016

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## **24. Fair value measurements (continued):**

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

The fair value of investment properties is outlined in note 5.

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

The fair value of the REIT's mortgages payable and loans facility are determined using present value calculations based on market-observable interest rates for mortgages and loans with similar terms and conditions (Level 2). The fair value of the REIT's mortgages payable at December 31, 2017 is \$300,512 (2016 - \$311,888). The loans payable balance, bearing interest at variable interest rates, approximates its fair value.

The fair value of the Class B LP Units and DUIP liability is determined based on the unit price at each reporting period (Level 1). The fair value of the investment in limited partnership was determined by using the discounted cash flow method (Level 3).

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

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
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Years ended December 31, 2017 and 2016

## 24. Fair value measurements (continued):

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

2017	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment properties	\$ –	\$ –	\$ 808,875	\$ 808,875
Investment in limited partnership	–	–	871	871
Derivative instruments	–	807	–	807
	\$ –	\$ 807	\$ 809,746	\$ 810,553
<b>Liabilities:</b>				
DUIP liability	\$ 280	\$ –	\$ –	\$ 280
Class B LP Units	10,401	–	–	10,401
	\$ 10,681	\$ –	\$ –	\$ 10,681
<b>2016</b>				
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment properties	\$ –	\$ –	\$ 759,494	\$ 759,494
<b>Liabilities:</b>				
Derivative instruments	\$ –	\$ 854	\$ –	\$ 854
DUIP liability	178	–	–	178
	\$ 178	\$ 854	\$ –	\$ 1,032

# AGELLAN COMMERCIAL REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements (continued)  
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Years ended December 31, 2017 and 2016

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## **25. Subsequent events:**

- (a) The REIT declared distributions of \$0.0675 per unit on January 22, 2018 and February 16, 2018 to untholders of record as at January 31, 2018 and February 28, 2018, respectively.
- (b) The REIT amended the credit facility on February 28, 2018 to extend the maturity date to January 25, 2020 and increased the maximum amount available to \$140,000.