



**H&R Real Estate Investment Trust and H&R Finance Trust
2012 Annual Report
Including Combined MD&A and Financial Statements**



The Bow, Calgary



Scotia Plaza, Toronto



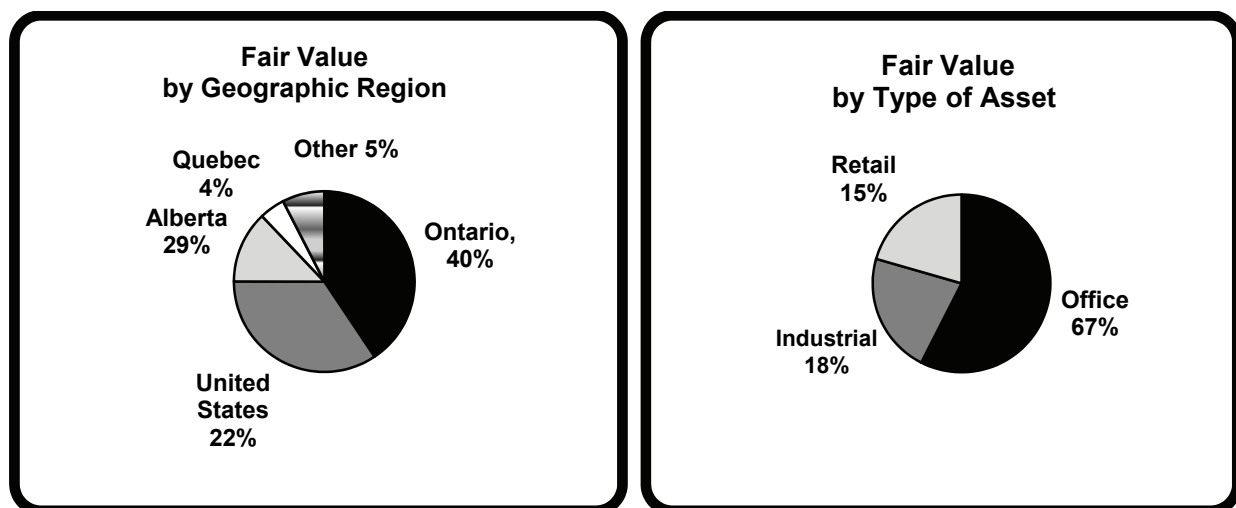
Corus Quay, Toronto

H&R Profile

H&R Real Estate Investment Trust (“H&R REIT”) is an open-ended real estate investment trust, which owns and manages a North American portfolio of 42 office, 115 industrial and 138 retail properties comprising over 45 million square feet and two development projects, with a fair value of approximately \$10 billion at December 31, 2012.

H&R Finance Trust is an unincorporated investment trust, which primarily invests in notes issued by a subsidiary of H&R REIT. The units of H&R REIT trade together with the units of H&R Finance Trust as “Stapled Units” on the Toronto Stock Exchange listed under the symbol HR.UN. In this annual report, we refer to the combination of these two trusts as “H&R” or “the Trusts”.

Additional information regarding H&R REIT and H&R Finance Trust is available at www.hr-reit.com and on www.sedar.com.



Primary Objectives

H&R strives to achieve two primary objectives: to provide unitholders with stable and growing cash distributions generated by revenues derived from a diversified portfolio of investment properties, and to maximize the value of units through active management of H&R’s assets, acquisition of additional properties, and the development of new projects which are pre-leased to creditworthy tenants. We are committed to maximizing returns to unitholders while maintaining prudent risk management and conservative use of financial leverage.

Stability and Growth through Discipline

Since inception in 1996, H&R has executed a disciplined and proven strategy that has provided stable cash flow and adjusted funds from operations. We achieve our primary objectives and mitigate risks through long-term property leasing and financing, combined with conservative management of assets and liabilities.

2012 Highlights

- Maintained portfolio occupancy rate at nearly 100% for 16th consecutive year
- Invested \$703 million in acquisition of 12 properties, (including 186M in 100% ownership of Corus Quay, and \$422M in one-third ownership of Scotia Plaza, both in Toronto); acquisitions were partially financed by \$373 million of mortgages (weighted average term to maturity 9.2 years, interest rate 3.64% per annum)
- Invested \$188 million in construction of The Bow office complex in Calgary, which reached practical completion in December
- Raised over \$1 billion of capital (including issuance of \$500M of first mortgage bonds secured by The Bow, \$217M of first mortgage bonds secured by Scotia Plaza, \$175M of unsecured debentures, \$150M of stapled units, and \$141M from sales of non-strategic assets)
- Redeemed \$31 million of 6.65% 2013 and 6.75% 2014 convertible debentures prior to maturity to reduce interest costs
- Increased annual distributions per stapled unit by 19%

	2012	2011 ⁽¹⁾
Average term to maturity of leases (years)	12.5	11.0
Average term to maturity of mortgages payable (years)	7.7	7.7
Gross leasable area (millions of sq.ft.)	45	43
Portfolio occupancy rate	98.7%	99.1%
Rentals from investment properties (millions)	\$835	\$657
Net income/(loss) (millions)	\$508	\$338
Funds from operations ("FFO")(millions) ⁽²⁾	\$329	\$261
FFO per Stapled Unit (basic)	\$1.74	\$1.64
Cash provided by operations (millions)	\$551	\$405
Cash distributions paid (millions) ⁽³⁾	\$165	\$119
Distributions per Stapled Unit	\$1.18	\$0.98
Payout ratio per Stapled Unit (distributions/FFO)	67.8%	59.8%
Assets (billions)	\$10.2	\$9.0
Debt-to-gross book value of total assets ⁽⁴⁾	48.3%	47.1%
Debt-to-fair market value of total assets	51.6%	53.6%
Equity market capitalization (billions)	\$4.7	\$4.0
<small>(1) 2011 figures have been adjusted to reflect 2012 changes in accounting policy where applicable. (2) Readers are encouraged to review, in H&R's MD&A, reconciliations of: net income (loss) to FFO; FFO to AFFO; and AFFO to cash provided by operations. (3) Cash distributions paid exclude distributions reinvested in units pursuant to H&R's unitholder distribution reinvestment plan and include the distributions paid to the Class B Limited Partnership unitholders who can exchange their units for Stapled Units. (4) Calculated in accordance with the REIT's Declaration of Trust</small>		

First Quarter 2013 Highlight of Subsequent Event

- Increased distributions in January by 8% to \$1.35 per stapled unit
- Agreed to acquire (together with KingSett Capital-led consortium) Primaris REIT and 26 of its high-quality retail properties (approximately 8.7 million sq.ft., 98.4% occupancy rate, \$3.1 billion fair value), to be funded by assumption of approximately \$1.4 billion in debt, \$100 million of cash on hand, and balance by issuance of approx. 65 million H&R stapled units per Primaris unit; transformational transaction expected to close in April, be accretive to H&R FFO by \$0.02/unit, reduce leverage from 51.6% to 51.1%, increases liquidity for unitholders, make H&R the largest and most diversified REIT in Canada; H&R increases gross leasable area by 19%, last-12-months net operating income by 31%, asset fair value by 47%, market capitalization by 34% (\$1.6B); H&R Net Operating Income becomes more diversified – by region and by type of asset – contributions from office properties decreasing from 65% to 51% and retail increasing from 17% to 34%; H&R acquires experienced Primaris retail management with similar business practices

President's Message to Unitholders

Commercial real estate owners have enjoyed excellent commercial property fundamentals over the past 12 months in Canada and a much improved real estate environment in the United States, as well as low financing costs. This has allowed H&R REIT to increase both the size and quality of its property portfolio and to record improved financial results. In 2013, we foresee ongoing favourable market conditions boding well for the REIT as we continue to execute on our long-term, conservative strategy of providing our unitholders with *stability and growth through discipline*.

2012 Financial Results

Our portfolio was once again characterized by very high occupancy rates and rising rental rates in 2012. Capitalizing on abundant access to relatively low-cost debt, we have continued to acquire and develop high-quality properties on an accretive basis and reduced the REIT's financing costs. Our capital investments of \$891 million were partly financed by \$717 million of first mortgage bonds secured by The Bow and Scotia Plaza, and \$325 million from the issuance of debentures and Stapled Units. At year end, with cash of \$134 million and approximately \$553 million available from our operating facilities, we have ample liquidity to continue to pay down higher-cost debt as it matures and to finance further acquisitions. Last year, we paid out to unitholders 19% more in distributions per unit, and the price of H&R's Stapled Unit closed at \$24.10. The overall return on investment to our unitholders including capital gain and distributions was 9% in 2012. Since inception in 1996, the compound average annual return has been approximately 15%.

Strategic Investments

Last year, we invested strategically in three, high-quality office properties.

Corus Quay, Toronto

In the first quarter, we purchased this 485,000 square foot, state-of-the-art office building for \$186 million, leased triple-net, with contracted rental escalations throughout the 20-year term, to investment grade tenant Corus Entertainment Inc., an industry leader with a market capitalization of approximately \$2 billion. We secured this LEED Gold, harbourfront property with two non-recourse pari-passu mortgages: \$60-million, interest-only mortgage for a term of 20 years at an interest rate of 4.91%, and a \$37-million first mortgage for a term of 10 years at a rate of 4.14%. Completed in 2009, Corus Quay is only minutes from the financial core. The eight-storey building is one of the most technically sophisticated facilities of its kind, and is an anchor project for the revitalization of downtown Toronto's East Bayfront area.

Scotia Plaza, Toronto

In the second quarter, H&R invested \$422 million for a one-third interest in Scotia Plaza – securing a strategic foothold on King and Bay – the recognized corner of Canada's financial capital. We partially financed this milestone investment with a \$217-million first mortgage bond at an interest rate of 3.21% for a 7-year term. The iconic office complex comprises two million square feet of high-quality office and retail space and is directly linked to Toronto's PATH pedestrian system, one subway stop away from the Union Station transit hub. The complex has been certified with the LEED Gold designation. Upon acquisition, the weighted average lease term for Scotia Plaza's 66 tenants was 10.6 years with 61% leased by Scotiabank for an average lease term of 13.5 years. As one of North America's premier financial institutions and Canada's most international bank, Scotiabank has a credit rating of AA. We are pleased to have added this marquee complex to our portfolio, further bolstering H&R's growing reputation as one of Canada's top office landlords.

The Bow, Calgary

The Bow is a world-class, nearly two-million-square-foot, downtown office complex located in Calgary's financial district. The Class AAA skyscraper is fully leased on a triple-net basis for a term of 25 years to Encana Corporation, which has recently moved into the new premises of its worldwide headquarters. This iconic landmark is the largest Canadian office tower west of Toronto, with a striking design that crowns Calgary's skyline, and the keystone of our property portfolio. By year end 2012, H&R had invested approximately \$1.7 billion in the 58-storey project (including capitalized interest costs). We partially financed the property by issuing two \$250-million first mortgage bonds, for terms of 9 and 10 years, at a 3.69% interest rate. The Bow is expected to generate annualized net operating income of approximately \$93.5 million. Rental rates will escalate 0.75% per annum on the office space and 1.5% per annum on the parking space during the 25-year lease.

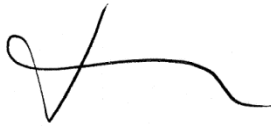
Outlook

Looking at the year ahead, we anticipate that commercial real estate fundamentals will remain favourable in our North American markets. Barring further economic turbulence in the U.S. and Europe, we foresee high occupancy rates and stable or rising rental rates. These market conditions should allow us to increase our rental income and significantly reduce our interest costs with mortgage maturities.

With ready access to historically low-cost debt capital, we expect to add more high-quality properties to our portfolio both in Canada and the U.S. Moreover, limited construction of new premises and continuing rising demand for stable cash flow will continue to compress capitalization rates, thereby increasing the overall market value of our portfolio and the price of our units.

There is increasingly strong demand from both institutional and retail investors for investment vehicles that provide minimal stock price volatility, higher and rising yields, and steadier capital appreciation. We are confident that the underlying demand for the stability in a tax advantaged and inflation protected investment will make commercial real estate more appealing and competitive, thereby increasing the value of our high-quality, diversified and stable portfolio.

On behalf of our management team, I thank H&R's investors, trustees and employees for their trust and dedication to the REIT's success over the past year. With your continuing support, we look forward to further delivering ***stability and growth through discipline.***

A handwritten signature in black ink, consisting of a large, stylized initial 'V' followed by a horizontal line that tapers to the right.

President and Chief Executive Officer
March 28, 2013

**COMBINED MANAGEMENT'S DISCUSSION
AND ANALYSIS OF H&R REAL ESTATE
INVESTMENT TRUST AND H&R FINANCE TRUST**

For the Year ended December 31, 2012

Dated: March 8, 2013

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SECTION I

BASIS OF PRESENTATION

Financial data included in this Management's Discussion and Analysis ("MD&A") of combined results of operations and combined financial position of H&R Real Estate Investment Trust (the "REIT") and H&R Finance Trust ("Finance Trust" and together with the REIT, the "Trusts") for the year ended December 31, 2012 includes material information up to March 8, 2013. Financial data provided has been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). This MD&A should be read in conjunction with the combined financial statements of the REIT and Finance Trust and appended notes for the years ended December 31, 2012 and 2011 (the "Combined Financial Statements"). All amounts in this MD&A are in thousands of Canadian dollars, except where otherwise stated. Historical results, including trends which might appear, should not be taken as indicative of future operations or results. Certain prior period items have been reclassified to conform with the presentation adopted in the current period.

FORWARD-LOOKING DISCLAIMER

Certain information in this MD&A contains forward-looking information within the meaning of applicable securities laws (also known as forward-looking statements) including, among others, statements made or implied under the headings "Discussion of Operations", "Liquidity and Capital Resources", "Outlook", "Risks and Uncertainties" and "Subsequent Events" relating to the Trusts' objectives, strategies to achieve those objectives, the Trusts' beliefs, plans, estimates, projections and intentions, and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts including, in particular, the acquisition of Primaris by the Trusts (as defined below). Forward-looking statements generally can be identified by words such as "outlook", "objective", "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "should", "plans", "project", "budget" or "continue" or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect the Trusts' current beliefs and are based on information currently available to management.

Forward-looking statements are provided for the purpose of presenting information about management's current expectations and plans relating to the future and readers are cautioned that such statements may not be appropriate for other purposes. These statements are not guarantees of future performance and are based on the Trusts' estimates and assumptions that are subject to risks and uncertainties, including those described below under "Risks and Uncertainties" and those discussed in the Trusts' materials filed with the Canadian securities regulatory authorities from time to time, which could cause the actual results and performance of the Trusts to differ materially from the forward-looking statements contained in this MD&A. Those risks and uncertainties include, among other things, risks related to: the completion of the acquisition of Primaris Real Estate Investment Trust ("Primaris") credit risk and tenant concentration; interest and other debt-related risk; construction risks; lease rollover risk; currency risk; environmental risk; unit price risk; availability of cash for distributions; ability to access capital markets; tax risk; dilution; unitholder liability; redemption right risk and risks relating to debentures. Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements include that the general economy is stable; local real estate conditions are stable; interest rates are relatively stable; and equity and debt markets continue to provide access to capital. The Trusts caution that this list of factors is not exhaustive. Although the forward-looking statements contained in this MD&A are based upon what the Trusts believe are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements.

Readers are also urged to examine the REIT and Finance Trust's materials filed with the Canadian securities regulatory authorities from time to time as they may contain discussions on risks and uncertainties which could cause the actual results and performance of the REIT and Finance Trust to differ materially from the forward-looking statements contained in this MD&A. Neither Finance Trust nor any of its trustees or officers, assumes any responsibility for the completeness of the information contained in the REIT's materials filed with the Canadian securities regulatory authorities or for any failure of the REIT or its trustees or officers to disclose events or facts which may have occurred or which may affect the significance or accuracy of any such information. Neither the REIT nor any of its trustees or officers, assumes any responsibility for the completeness of the information contained in Finance Trust's materials filed with the Canadian securities regulatory authorities or for any failure of Finance Trust or its trustees or officers to disclose events or facts which may have occurred or which may affect the significance or accuracy of any such information.

All forward-looking statements in this MD&A are qualified by these cautionary statements. These forward-looking statements are made as of March 8, 2013 and the Trusts, except as required by applicable law, assume no obligation to update or revise them to reflect new information or the occurrence of future events or circumstances.

NON-GAAP FINANCIAL MEASURES

Property operating income, same-asset property operating income, funds from operations (“FFO”), adjusted funds from operations (“AFFO”) and gross book value (“GBV”) are all supplemental financial measures used by management to track the Trusts’ performance. Such measures are not recognized under IFRS or Canadian Generally Accepted Accounting Principles (“GAAP”) and therefore do not have standardized meanings prescribed by GAAP. Management believes that these non-GAAP financial measures are a meaningful measure of operating performance as they reject the assumption that the value of real estate investments diminishes predictably over time. These non-GAAP financial measures should not be construed as alternatives to comparable financial measures calculated in accordance with GAAP. Further, the Trusts’ method of calculating such supplemental financial measures may differ from the methods of other real estate investment trusts or other issuers and accordingly, such supplemental financial measures used by management may not be comparable to similar measures presented by other real estate investment trusts or other issuers. See “Funds from Operations” and “Adjusted Funds from Operations” for a reconciliation of GAAP measures to non-GAAP measures.

OVERVIEW

The REIT is an unincorporated open-ended trust created by a declaration of trust (the “REIT Declaration of Trust”) and governed by the laws of the Province of Ontario. Unitholders are entitled to have their REIT units comprising part of the Stapled Units redeemed at any time on demand payable in cash (subject to monthly limits) and/or *in specie*, provided that the corresponding Finance Trust units are being contemporaneously redeemed.

Finance Trust is an unincorporated investment trust. Finance Trust was established pursuant to a Plan of Arrangement (the “Plan of Arrangement”) on October 1, 2008, as described in the REIT’s information circular dated August 20, 2008, as an open-ended limited purpose unit trust pursuant to its declaration of Trust (the “Finance Trust Declaration of Trust”). Each issued and outstanding Finance Trust unit is “stapled” to a unit of the REIT on a one-for-one basis such that Finance Trust units and the REIT units trade together as stapled units (“Stapled Units”), and such Stapled Units are listed and posted for trading on the Toronto Stock Exchange (“TSX”). Apart from provisions necessary to achieve such stapling, each REIT unit and Finance Trust unit retains its own separate identity and is separately listed (but not posted for trading) on the TSX (unless there is an event of uncoupling, in which case Finance Trust units will cease to be listed on the TSX).

The REIT has two primary objectives:

- to provide unitholders with stable and growing cash distributions, generated by the revenue it derives from investments in income producing real estate assets; and
- to maximize unit value through ongoing active management of the REIT’s assets, acquisition of additional properties and the development and construction of projects which are pre-leased to creditworthy tenants.

The REIT’s strategy to accomplish these two objectives is to accumulate a diversified portfolio of high quality investment properties in Canada and the United States occupied by creditworthy tenants on a long-term basis. The REIT does not have any specific allocation targets as to property type, but rather focuses on creditworthy tenants with long-term leases.

The primary purpose of Finance Trust is to be a flow-through vehicle to allow the REIT to indirectly access the capital markets in a tax-efficient manner by indirectly borrowing money from the REIT’s unitholders. Finance Trust’s primary activity is to hold debt issued by H&R REIT (U.S.) Holdings Inc. (“U.S. Holdco”), a wholly owned U.S. subsidiary of the REIT. As at December 31, 2012, Finance Trust holds U.S. \$162.5 million of aggregate principal amount of notes payable by U.S. Holdco (“U.S. Holdco Notes”). Subject to cash flow requirements, Finance Trust intends to distribute to its unitholders, who are also unitholders of the REIT, all of its cash flow, consisting primarily of interest paid by U.S. Holdco, less administrative and other expenses and amounts to satisfy liabilities.

Mechanics of “Stapling” the Units of Finance Trust and the REIT

Pursuant to the provisions of the Declarations of Trust for Finance Trust and the REIT at all times each REIT unit must be “stapled” to a Finance Trust unit (and each Finance Trust unit must be “stapled” to a REIT unit) unless there is an “event of uncoupling” (as described below). As part of the Plan of Arrangement, the REIT and Finance Trust entered into a support agreement (the “Support Agreement”) which provided, among other things, for the co-ordination of the declaration and payment of all distributions so as to provide for simultaneous record dates and payment dates; for co-ordination so as to permit the REIT to perform its obligations pursuant to the REIT’s Declaration of Trust, Unit Option Plan, Distribution Reinvestment Plan and Unit Purchase Plan (“DRIP”) and

Unitholder Rights Plan; for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable and permit the REIT to perform its obligations arising under any security issued by the REIT (including securities convertible, exercisable or exchangeable into Stapled Units); for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable the REIT to perform its obligations or exercise its rights under its convertible debentures; and for Finance Trust to take all such actions and do all such things as are necessary or desirable to issue Finance Trust units simultaneously (or as close to simultaneously as possible) with the issue of REIT units and to otherwise ensure at all times that each holder of a particular number of REIT units holds an equal number of Finance Trust units, including participating in and cooperating with any public or private distribution of Stapled Units by, among other things, executing prospectuses or other offering documents.

In the event that the REIT issues additional REIT units, pursuant to the Support Agreement, the REIT and Finance Trust will coordinate so as to ensure that each subscriber receives both REIT units and Finance Trust units, which shall trade together as Stapled Units. Prior to such event, the REIT shall provide notice to Finance Trust to cause Finance Trust to issue and deliver the requisite number of Finance Trust units to be received by and issued to, or to the order of, each subscriber as the REIT directs. In consideration of the issuance and delivery of each such Finance Trust unit, the REIT (solely as agent for and on behalf of the purchaser) or the purchaser, as the case may be, shall pay (or arrange for the payment of) a purchase price equal to the fair market value (as determined by Finance Trust in consultation with the REIT) of each such Finance Trust unit at the time of such issuance. The remainder of the subscription price for Stapled Units shall be allocated to the issuance of REIT units by the REIT. The proceeds received by Finance Trust from any such issuance shall be invested in additional notes of the same series as the U.S. Holdco Notes or distributed to unitholders of Finance Trust.

An event of uncoupling (“Event of Uncoupling”) shall occur only: (a) in the event that unitholders of the REIT vote in favour of the uncoupling of units of Finance Trust and units of the REIT such that the two securities will trade separately; or (b) at the sole discretion of the trustees, but only in the event of the bankruptcy, insolvency, winding-up or reorganization (under an applicable law relating to insolvency) of the REIT or U.S. Holdco or the taking of corporate action by the REIT or U.S. Holdco in furtherance of any such action or the admitting in writing by the REIT or U.S. Holdco of its inability to pay its debts generally as they become due.

Investment Restrictions

Under Finance Trust Declaration of Trust, the assets of Finance Trust may be invested only in:

- (a) U.S. Holdco Notes; and
- (b) temporary investments in cash, term deposits with a Canadian chartered bank or trust company registered under the laws of a province of Canada, short-term government debt securities, or money market instruments (including banker’s acceptances) of, or guaranteed by, a Schedule 1 Canadian bank (“Cash Equivalents”), but only if each of the following conditions are satisfied: (a) if the Cash Equivalents have a maturity date, the trustees hold them until maturity; (b) the Cash Equivalents are required to fund expenses of Finance Trust, a redemption of units, or distributions to unitholders, in each case before the next distribution date; and (c) the purpose of holding the Cash Equivalents is to prevent funds from being non-productive, and not to take advantage of market fluctuations.

The Finance Trust Declaration of Trust provides that Finance Trust shall not make any investment, take any action or omit to take any action which would result in the units of Finance Trust not being considered units of a “mutual fund trust” for purposes of the Income Tax Act (Canada) (the “Tax Act”) or that would disqualify Finance Trust as a “fixed investment trust” under the Internal Revenue Code of 1986 as amended (the “Code”) and the applicable regulations. In order to qualify as a “fixed investment trust” under the Code, Finance Trust generally may not acquire assets other than the U.S. Holdco Notes or certain investments in cash or cash equivalents.

FINANCIAL HIGHLIGHTS

(in thousands of Canadian dollars except per unit amounts)	December 31, 2012	December 31, 2011
Total assets	\$10,171,807	\$9,002,482
Debt to GBV of total assets (per the REIT Declaration of Trust) ⁽¹⁾⁽²⁾	48.3%	47.1%
Debt to fair market value of total assets (per the Combined Financial Statements) ⁽¹⁾	51.6%	53.6%
Stapled Units outstanding	194,677	172,554
Exchangeable units of H&R Limited Partnership outstanding	5,438	5,438
	Three months ended December 31, 2012	Three months ended December 31, 2011
Property rental revenue	\$230,496	\$178,174
Property operating income	152,825	118,203
FFO ⁽¹⁾	85,228	67,750
Weighted average number of basic Stapled Units for FFO	195,469	167,691
FFO per basic Stapled Unit ⁽¹⁾	0.44	0.40
Distributions paid per Stapled Unit	0.31	0.26
Payout ratio per Stapled Unit as a % of FFO ⁽¹⁾	70.5%	65.0%

Net income is reconciled to FFO which is reconciled to AFFO. AFFO is reconciled to cash provided by operations, being the most comparable GAAP financial measure to these non-GAAP financial measures. See pages 25-28.

(1) These are non-GAAP measures.

(2) In Q4 2012, the REIT elected to fair value its real estate assets and per the REIT Declaration of Trust, this is now considered to be its GBV.

KEY PERFORMANCE DRIVERS

OPERATIONS		Office	Industrial	Retail	Total*
<i>Occupancy as at December 31</i>	2012	98.6%	98.6%	99.1%	98.7%
	2011	99.1%	98.9%	99.9%	99.1%
<i>Occupancy – same asset as at December 31⁽¹⁾</i>	2012	98.0%	98.5%	100.0%	98.7%
	2011	99.2%	98.8%	99.9%	99.1%
<i>Average contractual rent per square foot for the three months ended December 31⁽²⁾</i>	2012	\$25.62	\$5.70	\$13.60	\$13.43
	2011	\$22.33	\$5.85	\$13.27	\$11.64

* weighted average total

(1) Same asset refers to those properties owned by the REIT for the 24-month period ended December 31, 2012.

(2) This does not include assets held for sale.

	December 31, 2012	December 31, 2011
Average remaining term to maturity of leases (in years)	12.5	11.0
Average remaining term to maturity of mortgages payable (in years)	7.7	7.7

PORTFOLIO OVERVIEW

The geographic diversification of the REIT's portfolio as at December 31, 2012 is outlined in the charts below:

NUMBER OF PROPERTIES	Ontario	United States	Alberta	Quebec	Other	Total
Office	25	7	5	1	4	42
Industrial	47	17	19	12	20	115
Retail	33	92	5	5	3	138
Total	105	116	29	18	27	295

Square Feet (in thousands)*	Ontario	United States	Alberta	Quebec	Other	Total
Office	7,244	2,024	3,430	452	884	14,034
Industrial	8,955	6,364	2,810	2,978	1,280	22,387
Retail	1,937	5,156	515	498	524	8,630
Total	18,136	13,544	6,755	3,928	2,688	45,051

* Square feet (in thousands) is based on the REIT's pro-rata ownership share of net leasable area.

MORTGAGES PAYABLE	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2013	\$125,896	\$107,821	\$233,717	5.7%	7.5%
2014	135,272	182,632	317,904	7.8%	6.2%
2015	136,590	215,776	352,366	8.6%	5.4%
2016	134,764	288,147	422,911	10.3%	5.3%
2017	132,746	336,595	469,341	11.4%	5.5%
Thereafter			2,307,039	56.2%	
			4,103,278	100%	
Financing costs and mark-to-market adjustment arising on acquisitions ⁽¹⁾			(7,363)		
Total			\$4,095,915		

⁽¹⁾ Mark-to-market adjustment represents the difference between the actual mortgages assumed on property acquisitions and the fair value of the mortgages at the date of purchase and is recognized in finance cost over the life of the applicable mortgage using the effective interest rate method. Financing costs are deducted from the REIT's mortgages payable balances and are recognized in finance costs over the life of the applicable mortgage.

TOP TWENTY SOURCES OF REVENUE BY TENANT

	Tenant	% of rentals from income properties⁽¹⁾	Number of locations	REIT owned sq.ft. (in 000's)	Average lease term to maturity (in years)⁽²⁾
1.	Encana Corporation	13.7	2	2,041	25.0
2.	Bell Canada	6.1	4	1,734	12.9
3.	TransCanada Pipelines Limited	4.8	2	950	8.3
4.	Hess Corporation	4.6	1	845	(4)
5.	Bell Mobility	3.6	2	775	12.9
6.	Telus Communications	3.5	2	943	9.7
7.	New York City Department of Health	3.1	1	670	17.9
8.	Bank of Nova Scotia	2.7	2	405	12.9
9.	Rona Inc.	2.6	15	2,406	7.0
10.	Royal Bank of Canada	2.2	3	494	6.5
11.	Canadian Tire Corp.	2.1	4	2,189	13.5
12.	Corus Entertainment Inc.	2.0	1	472	19.2
13.	Canadian Imperial Bank of Commerce	1.9	7	512	11.0
14.	Versacold Logistics Canada Inc.	1.4	12	1,733	19.6
15.	Ontario Realty Corporation and other Ontario Agencies ⁽³⁾	1.4	1	341	4.2
16.	Nestle Canada Inc.	1.2	1	170	6.7
17.	Shell Oil Products	1.2	18	249	9.5
18.	Public Works of Canada	1.2	3	300	4.1
19.	Purolator Courier	1.1	12	1,071	9.4
20.	Finning International	1.1	16	893	9.2
	Total	61.5%	109	19,193	

(1) The percentage of rentals from investment properties is based on estimated annualized gross revenue excluding straight-lining of contractual rent, capital expenditure recoveries and investment properties held for sale.

(2) Average lease term to maturity is based on net rent.

(3) Other Ontario agencies include: Legal Aid Ontario, Ontario Lottery and Gaming Corporation, Liquor Control Board of Ontario, and Hydro One Networks.

(4) Due to the confidentiality under the tenant lease, the term is not disclosed.

LEASE EXPIRIES	Office		Industrial		Retail		Total	
	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry	% of sq.ft.	Rent per sq.ft. (\$) on expiry
2013	0.7	19.92	1.0	6.81	0.2	20.28	1.9	13.06
2014	1.6	19.16	2.7	4.82	0.3	27.77	4.6	11.30
2015	0.7	28.02	1.8	6.17	0.4	27.56	2.9	14.39
2016	1.9	21.04	5.3	4.00	0.3	20.59	7.5	8.98
2017	0.9	19.98	0.4	5.58	1.3	10.15	2.6	12.85
	5.8	21.06	11.2	4.85	2.5	17.11	19.5	11.25

SUMMARY OF SIGNIFICANT 2012 ACTIVITY

During 2012, the REIT acquired 12 properties in Canada and the United States for an aggregate purchase price of \$702.9 million. The following is a summary of the significant acquisitions:

- (i) a newly constructed LEED Gold office building in downtown Toronto for \$186.0 million at a capitalization rate of 6.4% leased to Corus Entertainment Inc. for 20 years;
- (ii) a one-third interest in the iconic Scotia Plaza Complex (“Scotia Plaza”) in downtown Toronto for approximately \$422.2 million, at a capitalization rate of 5.2%, with the Bank of Nova Scotia as the anchor tenant leasing approximately 61% of Scotia Plaza, for an average term of 13.5 years; and
- (iii) eight grocery anchored retail properties totalling 551,982 square feet in Florida for approximately \$91.3 million, at an average capitalization rate of 6.9%.

The REIT partially funded the 2012 acquisitions with mortgages totalling \$372.5 million. The weighted average remaining term of these mortgages is 9.2 years and the weighted average interest rate is 3.64% per annum.

During 2012, the REIT sold four retail properties, three industrial properties, and a portion of one office property being sold as separate condominium units encompassing over 1.8 million square feet, for gross proceeds of \$122.1 million. The REIT also sold a parcel of land held for development for \$18.4 million.

In 2012, the REIT refinanced 17 mortgages totalling \$250.4 million which had an average interest rate of 6.4% per annum with 17 new mortgages totalling \$358.7 million at an average interest rate of 4.1% per annum for an average term of 9.8 years. The REIT is expected to benefit from the low interest rate environment with \$107.8 million of mortgages maturing in 2013 at a weighted average interest rate of 7.5% per annum. In addition, in July 2012, the REIT redeemed all of the remaining 6.65% 2013 convertible debentures and all of the remaining 6.75% 2014 convertible debentures for \$29.8 million and \$1.3 million, respectively.

OUTLOOK

With limited commercial construction underway, shrinking vacancies and rising rents, the fundamentals for Canadian real estate are promising. These factors, together with the current low interest rate environment in Canada, and access to capital markets continue to compress capitalization rates. In the United States, the economic recovery in commercial real estate and capital markets, has been much slower, resulting in higher capitalization rates as compared to equivalent Canadian properties.

Primaris Acquisition:

The REIT has recently announced its intention to acquire 25 high quality Canadian shopping centres, 14 of which are enclosed shopping centres, along with Primaris’ operating platform. These shopping malls have historically maintained high occupancy levels and are popular shopping destinations in their respective regions.

The total value of these assets is approximately \$3.1 billion which will be partially funded by the assumption of approximately \$1.4 billion in debt and cash on hand of approximately \$100 million. The balance will be funded by the issuance of Stapled Units to the Primaris unitholders. This transaction is expected to be accretive to FFO by \$0.02 per unit and will also reduce the Trusts’ debt to fair value from 52.1% to 51.1%.

The increased market capitalization of approximately \$1.6 billion will substantially enhance liquidity for unitholders. Through this transaction, the REIT will achieve broader diversification by geographic region, asset class and tenant base. The REIT is thrilled to be able to diversify into this asset class at a time when U.S. and international retailers are expanding into Canada. Target will be opening in 7 of the enclosed shopping centres during 2013 which should lead to higher traffic, sales and rents in these centres.

The Bow

The REIT has reached practical completion on the construction of a two million square foot office building in Calgary, Alberta (the “Bow”), which is fully pre-leased to Encana Corporation for a 25-year term. Floors 3 to 57 were delivered to Encana Corporation in tranches between May 2, 2012 and February 22, 2013. The 25-year lease term is expected to commence on March 15, 2013 upon the anticipated delivery of the final two floors to Encana Corporation. Rent escalations will be at 0.75% per annum on the office space and 1.5% per annum on the parking income for the full 25-year term. The REIT estimates a further \$48.2 million in costs will

be incurred to complete this project, including capitalized interest. As at December 31, 2012, the total cost incurred on the project amounted to \$1.67 billion (December 31, 2011 - \$1.48 billion). This amount includes the costs for construction of 1,358 parking stalls. Encana Corporation is entitled to a 60-day free rent fixturing period and a rent credit equal to the delay penalty of approximately \$32.5 million. As at December 31, 2012, the unused portion of the rent credit balance relating to the delay penalty was approximately \$15.2 million. This rent free period, combined with the interest expense that was no longer capitalized as tranches of the project became available for their intended use, resulted in an FFO loss of \$1.3 million and an AFFO loss of \$31.0 million in 2012 as shown in the table below. The table below also provides an estimate of FFO and AFFO for the first three quarters in 2013.

In Millions	Actual		Estimate ⁽²⁾		
	Q4 2012 ⁽¹⁾	Total 2012	Q1 2013	Q2 2013	Q3 2013
Basic rent	\$ -	\$ -	\$2.2	\$22.4	\$23.3
Straight-lining of contractual rent	15.4	29.7	22.6	2.7	1.9
Interest no longer capitalized ⁽³⁾	(14.0)	(25.1)	(3.1)	(4.3)	(4.3)
Mortgage interest	(3.4)	(5.9)	(4.4)	(4.6)	(4.6)
Expected Bow impact on FFO	(2.0)	(1.3)	17.3	16.2	16.3
Expected Bow impact on AFFO	(17.4)	(31.0)	(5.3)	13.5	14.4

⁽¹⁾ Results varied from previously reported estimates due to a delay in the projected completion date.

⁽²⁾ This information is being provided so that investors are able to understand the expected impact of the Bow to the REIT's operations. This information may not be appropriate for other purposes.

⁽³⁾ The estimates for Q1 and Q2 2013 supersede the estimates previously provided by the Trusts since, in particular, the interest no longer capitalized is now being compared to Q4 2012's capitalized interest whereas it had previously been compared to 2011's.

There are two series of first mortgage bonds secured by "The Bow" office complex in Calgary, Alberta, comprised of: (a) \$250.0 million, 9-year term (maturing June 14, 2021), semi-annual interest only bonds with an interest rate of 3.69% and (b) \$250.0 million, 10-year term (maturing June 14, 2022), semi-annual 30-year amortizing bonds with an interest rate of 3.69%.

SECTION II

SELECTED ANNUAL INFORMATION

The following table summarizes certain financial information of the REIT for the years indicated below:

(in thousands of Canadian dollars except per unit amounts)	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010 ⁽¹⁾
Rentals from investment properties	\$835,303	\$656,911	\$617,427
Finance income	1,872	1,051	2,589
Net income	508,860	338,043	496,600
Comprehensive income	493,861	344,066	490,438
Total assets	10,171,807	9,002,482	5,998,640
Mortgages payable	4,095,915	3,163,593	2,706,707
Debentures payable	1,203,791	1,370,917	965,828
Cash distributions per unit	\$1.18	\$0.98	\$0.79

⁽¹⁾ The 2010 figures have not been adjusted for the 2012 changes in accounting policies. See "Changes in Accounting Policies" below.

For a discussion on the above variances between the 2012 and 2011 figures, please see pages 9 to 24.

CHANGES IN ACCOUNTING POLICY

In Q4 2012, the REIT elected to record real estate assets at fair value. This change in accounting policy has been applied on a retrospective basis. The REIT no longer depreciates investment properties but continues to amortize deferred leasing expenses and tenant inducements. Additionally, accrued rent receivable is no longer recorded as a separate asset as it is considered to be implicit in the fair value of investment properties.

The quantitative impact of the REIT retrospectively applying this change in accounting policy can be found in note 3 of the Combined Financial Statements.

DISCUSSION OF OPERATIONS

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	% Change	2012	2011	% Change
Property operating income:						
Rentals from investment properties	\$230,496	\$178,174	29	\$835,303	\$656,911	27
Property operating costs	(77,671)	(59,971)	30	(272,562)	(219,997)	24
	152,825	118,203	29	562,741	436,914	29
Finance costs:						
Finance income	409	239	71	1,872	1,051	78
Finance cost – operations	(66,593)	(49,551)	34	(239,455)	(181,012)	32
Gain (loss) on extinguishment of debt	(45)	158	(128)	10,151	9,310	9
Gain (loss) on change in fair value	17,730	(69,191)	(126)	(7,736)	(108,378)	(93)
	(48,499)	(118,345)	(59)	(235,158)	(279,029)	(16)
Amortization of leasing expenses	(1,437)	(1,016)	41	(5,525)	(4,445)	24
Trust expenses	(1,660)	(5,463)	(70)	(15,220)	(15,366)	(1)
Fair value adjustment on real estate assets	30,652	38,324	(20)	253,101	199,870	27
Loss on sale of real estate assets	(1,080)	(26)	4,054	(137)	(541)	(75)
Net gain (loss) on foreign exchange	1,535	(4,165)	(137)	(7,007)	3,738	(287)
Transaction costs on issuance of convertible debentures	-	(2,813)	(100)	-	(2,813)	(100)
Net income before income taxes	132,336	24,699	436	552,785	338,328	63
Income tax expense	(29,701)	(73)		(43,925)	(285)	
Net income	102,635	24,626		508,860	338,043	
Other comprehensive income (loss):						
Unrealized gain (loss) on translation of U.S. denominated foreign operations	6,752	(11,016)		(15,399)	5,638	
Transfer of realized loss on cash flow hedges to net income	101	98		400	385	
	6,853	(10,918)		(14,999)	6,023	
Total comprehensive income all attributable to unitholders	\$109,488	\$13,708		\$493,861	\$344,066	

The increase in net income for the three months and year ended December 31, 2012 as compared to the respective 2011 periods is primarily due to property operating income increasing due to acquisitions over the last 24 months and the gain (loss) on change in fair value. Offsetting these increases to income were increases in finance costs and deferred income tax expense.

Rentals from Investment Properties

Rentals from investment properties (“rentals”) include all amounts earned from tenants related to lease agreements, including basic rent, parking income, operating cost and realty tax recoveries.

Rentals from Investment Properties (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Same-asset - current rentals	\$156,106	\$154,673	\$1,433	\$604,352	\$604,802	(\$450)
Same-asset - straight-lining of contractual rent	(1,793)	(1,742)	(51)	(7,204)	(1,770)	(5,434)
Same-asset - rent amortization of tenant inducements	(371)	(278)	(93)	(1,467)	(1,022)	(445)
Acquisitions - current rentals, rent amortization of tenant inducements	51,010	20,663	30,347	174,758	38,720	136,038
Acquisitions - straight-lining of contractual rent	2,600	1,073	1,527	9,768	1,532	8,236
Assets held for sale and properties sold	1,192	3,785	(2,593)	12,435	14,649	(2,214)
The Bow - current rentals	6,364	-	6,364	12,988	-	12,988
The Bow - straight-lining of contractual rent	15,388	-	15,388	29,673	-	29,673
Total rentals	\$230,496	\$178,174	\$52,322	\$835,303	\$656,911	\$178,392

The increase in same-asset current rentals of \$1.4 million for Q4 2012 as compared to Q4 2011 is primarily due to the following:

- an increase of \$0.9 million in contractual rent step-ups;
- a decrease of \$0.4 million due to higher vacancies and lower rents;
- higher tenant recoveries of \$1.6 million which resulted from higher regular property operating expenses;
- an increase of \$0.2 million in sundry income which was received in Q4 2012;
- a decrease of \$0.3 million in additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements; and
- a decrease of \$0.5 million due to the weakening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the three months ended December 31, 2012 was Canadian \$1.00 for each U.S. \$1.00 (Q4 2011 - \$1.02).

The decrease in the same-asset straight-lining of contractual rent for Q4 2012 as compared to Q4 2011 includes a one-time smoothing adjustment to one property of \$0.9 million in Q4 2011. Without this one-time adjustment, the decrease would have been \$0.9 million.

The decrease in same-asset current rentals of \$0.5 million for the year ended December 31, 2012 as compared to the same 2011 period is primarily due to the following:

- an increase of \$5.5 million in contractual rent step-ups;
- a decrease of \$3.3 million due to higher vacancies and lower rents;
- lower tenant recoveries of \$7.7 million which resulted from lower regular property operating expenses;
- a decrease of \$1.0 million in sundry income received in 2012 compared to 2011;
- an increase of \$4.8 million in additional rent recoverable from tenants in accordance with their leases for items which were capitalized to building improvements; and

- an increase of \$1.0 million due to the strengthening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the year ended December 31, 2012 was Canadian \$1.00 for each U.S. \$1.00 (December 31, 2011 - \$0.99).

The decrease of \$5.4 million in the same-asset straight-lining of contractual rent for the year ended December 31, 2012 as compared to the same 2011 period includes a one-time smoothing adjustment to two properties of \$0.8 million in 2012, offset by a one-time smoothing adjustment to one property of \$0.9 million in 2011. Without these one-time adjustments, the decrease would have been \$5.5 million.

Rentals from acquisitions including current rentals, rent amortization and straight-lining of contractual rent increased by \$31.9 million in Q4 2012 compared to Q4 2011 and \$144.3 million for the year ended December 31, 2012 as compared to the respective 2011 period. The increase is due to the 23 property acquisitions between January 1, 2011 and December 31, 2012.

Property Operating Costs

For Q4 2012, realty taxes, maintenance, utilities and property management fees represented 53.0%, 26.7%, 10.6% and 4.2%, respectively, of total property operating costs (Q4 2011 – 48.9%, 31.3%, 9.1% and 6.1%). For the year ended December 31, 2012, realty taxes, maintenance, utilities and property management fees represented 51.3%, 27.7%, 11.0% and 5.0%, respectively, of total property operating costs (December 31, 2011 – 51.2%, 26.9%, 12.3% and 5.7%). Maintenance includes costs relating to such items as cleaning, interior and exterior building repairs and maintenance, elevator, HVAC, security and wages and benefits.

Property Operating Costs (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Same-asset property operating costs	\$51,634	\$51,798	(\$164)	\$192,182	\$202,177	(\$9,995)
Acquisitions	19,475	7,388	12,087	65,085	14,266	50,819
Assets held for sale and properties sold	458	785	(327)	2,729	3,554	(825)
The Bow	6,104	-	6,104	12,566	-	12,566
Total property operating costs	\$77,671	\$59,971	\$17,700	\$272,562	\$219,997	\$52,565

The decrease in same-asset property operating costs of \$0.2 million for Q4 2012 as compared to Q4 2011 is due primarily to the following reasons:

- higher regular property operating expenses of \$1.6 million;
- lower management fees of \$0.7 million due primarily to an increase of \$0.9 million in management fees being capitalized to leasing expenses, offset by a higher incentive fee of \$0.2 million payable to the Property Manager;
- lower major repair expenditures of \$1.0 million; and
- lower U.S. dollar operating costs of \$0.1 million due to the weakening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the three months ended December 31, 2012 was Canadian \$1.00 for each U.S. \$1.00 (Q4 2011 - \$1.02).

The decrease in same-asset property operating costs of \$10.0 million for the year ended December 31, 2012 as compared to the year ended December 31, 2011 is due primarily to the following reasons:

- lower regular property operating expenses of \$7.7 million;
- lower management fees of \$0.9 million due primarily to an increase of \$1.8 million in management fees being capitalized to leasing expenses, offset by a higher incentive fee of \$0.9 million payable to the Property Manager;
- lower major repair expenditures of \$1.4 million; and

- higher U.S. dollar operating costs of \$0.2 million due to the strengthening of the U.S. dollar when converted into Canadian dollars. The average exchange rate for the year ended December 31, 2012 was Canadian \$1.00 for each U.S. \$1.00 (December 31, 2011 - \$0.99).

Same-Asset Property Operating Income (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Same-asset current rentals and straight-lining of contractual rent	\$154,313	\$152,931	\$1,382	\$597,148	\$603,032	(\$5,884)
Same-asset - property operating costs	51,634	51,798	(164)	192,182	202,177	(9,995)
Total same-asset - property operating income	102,679	101,133	1,546	404,966	400,855	4,111
Total same-asset - property operating income excluding straight-lining of contractual rent	\$104,472	\$102,875	\$1,597	\$412,170	\$402,625	\$9,545

Included in same-asset property operating income are the following items which although they occur regularly, can be a source of significant variances between different periods:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Additional recoveries net of capital expenditures	\$4,873	\$4,180	\$693	\$12,661	\$6,421	\$6,240
Sundry income	205	7	198	870	1,919	(1,049)
Effect on same-asset -property operating income	\$5,078	\$4,187	\$891	\$13,531	\$8,340	\$5,191

Additional recoveries for capital expenditures vary from period to period as many of the REIT's properties are single-tenant buildings with triple net leases, which allows for certain items to be recovered from tenants even if the cost of the work is capitalized to investment properties. Sundry income typically includes one-time, non-recurring items.

Significant Contractual Rental Step-Ups in 2013

The chart below lists contractual rental step-ups greater than \$0.1 million for the REIT occurring over the next 12 months:

Property	Square Feet	Rent increase (\$ psf)	Effective date of increase	Annualized rental increases (in thousands of dollars)
1020 Dawson Rd., Thunder Bay, ON	98,847	\$2.23	Oct 2013	\$220
10450-42 nd St., Edmonton, AB	150,457	0.96	Oct 2013	144
1595 North Service Rd., Oakville, ON	254,891	0.55	Nov 2013	140
2611-3 rd Ave., Calgary, AB*	47,613	1.75	Nov 2013	83

* Square feet and annualized rental increases are based on the REIT's pro-rata share of ownership.

Finance Cost - Operations (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Contractual interest on mortgages payable	\$51,589	\$45,646	\$5,943	\$200,568	\$171,193	\$29,375
Contractual interest on debentures payable	14,993	16,468	(1,475)	62,815	61,262	1,553
Interest on construction loans	993	2,536	(1,543)	6,766	7,235	(469)
Effective interest rate accretion	626	121	505	1,557	908	649
Bank interest and charges	1,020	1,680	(660)	5,506	4,389	1,117
Exchangeable unit distributions	1,699	1,428	271	6,389	5,302	1,087
	70,920	67,879	3,041	283,601	250,289	33,312
Capitalized interest	(4,327)	(18,328)	14,001	(44,146)	(69,277)	25,131
Finance cost - operations	\$66,593	\$49,551	\$17,042	\$239,455	\$181,012	\$58,443

The increase in contractual interest on mortgages payable for the three months and year ended December 31, 2012 compared to the respective 2011 periods is primarily due to new mortgages assumed or secured on acquisitions during 2011 and 2012. Also included in mortgage interest for the year ended December 31, 2012 is a \$1.3 million one-time pre-payment penalty for early discharge of an existing \$129.6 million mortgage bearing interest at a rate of 6.93% per annum in order to refinance a new \$200.0 million mortgage bearing interest at 4.00% per annum for a 10-year term which occurred in Q3 2012.

The change in contractual interest on debentures payable for the three months and year ended December 31, 2012 of (\$1.5 million) and \$1.6 million compared to the respective 2011 periods is mainly due to the following: (i) an increase of \$2.9 million and \$12.9 million, respectively, resulting from the REIT issuing \$100 million of senior debentures in October 2011, \$75 million of convertible debentures in November 2011 and \$175 million of senior debentures in April 2012; and (ii) a decrease of \$4.3 million and \$11.8 million, respectively, resulting from the conversion and redemption of all the 2013 and 2014 convertible debentures into Stapled Units.

The amount of capitalized interest decreased for the three months and year ended December 31, 2012 as compared to the respective 2011 periods due to the delivery of the Bow tranches to Encana Corporation throughout 2012.

Finance Cost - Gain (Loss) on Extinguishment of Debt (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Gain (loss) on extinguishment of debt	(\$45)	\$158	(\$203)	\$10,151	\$9,310	\$841

In May 2012, the REIT was legally released from mortgages on its two Great Atlantic & Pacific Tea Company properties following the lender selling the properties in a foreclosure. As a result, the investment properties, mortgages and accrued interest on the mortgages were all derecognized, resulting in a gain on extinguishment of debt of \$10.2 million for the year ended December 31, 2012.

In March 2011, the REIT was legally released from its mortgages on two Bruno's Supermarkets LLC properties and two Boscov's Department Stores properties upon the lender accepting title to the properties. In July 2011, the REIT was legally released from its mortgage on the final Boscov's Department Store. As a result, the investment properties, the mortgages and the accrued interest on the mortgages were all derecognized resulting in a gain on extinguishment of debt of \$9.3 million for the year ended December 31, 2012.

Finance Cost – Gain (Loss) on Change in Fair Value

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Gain (loss) on fair value of convertible debentures	\$11,868	(\$58,608)	\$70,476	\$4,696	(\$84,670)	\$89,366
Gain (loss) on fair value of exchangeable units	5,927	(12,180)	18,107	(4,350)	(21,043)	16,693
Net gain (loss) on derivative instruments	(65)	1,597	(1,662)	(8,082)	(2,665)	(\$5,417)
Finance cost – gain (loss) on change in fair value	\$17,730	(\$69,191)	\$86,921	(\$7,736)	(\$108,378)	\$100,642

The REIT has elected to measure the outstanding convertible debentures at fair value. For each period end until December 31, 2011 the fair value of these convertible debentures was measured based on the ask price of each series of convertible debentures. Beginning January 1, 2012, the REIT early adopted IFRS 13, *Fair Value Measurement*, which allows the REIT to use the quoted prices instead of the ask prices to fair value each series of convertible debentures. The fluctuation in fair value between each period is recorded as a gain (loss) in changes in fair values in comprehensive income.

Under IFRS, the exchangeable units are considered puttable instruments which are valued and classified as a financial liability. The gain (loss) on fair value of exchangeable units is due to the change in the exchangeable unit fair value during the respective quarter. At the end of each quarter, the fair value of each exchangeable unit is measured based on the quoted prices of the Stapled Units noted above. The quoted price of Stapled Units was \$24.10 as at December 31, 2012 (December 31, 2011 - \$23.30).

Refer to the “Derivative Instruments” table under “Liabilities” for a financial summary of all derivative instruments held by the REIT.

Amortization Of Leasing Expenses

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Amortization of leasing expenses	\$1,437	\$1,016	\$421	\$5,525	\$4,445	\$1,080

Leasing expenses are primarily comprised of commissions and tenant inducements which are deferred and amortized on a straight-line basis over the terms of the related leases.

Trust Expenses

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Unit-based compensation	(\$509)	\$3,346	(\$3,855)	\$6,122	\$7,600	(\$1,478)
Other expenses	2,169	2,117	52	9,098	7,766	1,332
Trust expenses	\$1,660	\$5,463	(\$3,803)	\$15,220	\$15,366	(\$146)

Other expenses are primarily comprised of salaries, professional fees, trustee fees and overhead expenses. Included in trust expenses are tax planning and reorganization costs of \$0.1 million for the three months ended December 31, 2012 (Q4 2012 - \$nil) and \$1.1 million for the year ended December 31, 2012 (December 31, 2011 - \$nil).

The REIT’s Unit Option Plan is considered to be cash-settled under IFRS 2, *Share-based Payments* and as a result, is measured at each reporting period and settlement date at its fair value as defined by IFRS 2. The impact of the fair value adjustment to unit-based compensation is as follows:

Unit-based Compensation

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Unit-based compensation	\$804	\$537	\$267	\$3,128	\$2,034	\$1,094
Fair value adjustment to unit-based compensation	(1,313)	2,809	(4,122)	2,994	5,566	(2,572)
As reported under IFRS	(\$509)	\$3,346	(\$3,855)	\$6,122	\$7,600	(\$1,478)

Fair Value Adjustment on Real Estate Assets (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Fair value adjustment on real estate assets	\$30,652	\$38,324	(\$7,672)	\$253,101	\$199,870	\$53,231

In Q4 2012, the REIT elected to record investment properties at fair value. This change in accounting policy has been applied on a retrospective basis. The change in fair value of investment properties from period to period is recorded as a fair value adjustment on real estate assets. Additionally, accrued rent receivable is no longer recorded as a separate asset as it is considered to be implicit in the fair value of real estate assets.

Loss on Sale of Real Estate Assets (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Loss on sale of real estate assets	(\$1,080)	(\$26)	(\$1,054)	(\$137)	(\$541)	\$404

In Q4 2012, the REIT sold the following four U.S. retail properties: 10580 Duke Dr., Alpharetta, GA, 4855 Stone Mountain Hwy., Lilburn, GA, 575 Moly Lane, Woodstock, GA and 2650 Dallas Hwy., Marietta, GA, as well as one industrial property, 940 Gateway Dr., in Burlington, ON. The REIT also sold two office condominium units in 2780-2800 Skymark Ave., Mississauga, ON and a portion of a parcel of land held for development in Caledon, ON.

In addition to the land held for development and properties sold noted above, the REIT also sold two other industrial properties in 2012: 901 Guelph Line, Burlington, ON and 1 Academy Dr., Jeffersonville, GA, as well as several other office condominium units in 2780-2800 Skymark Ave., Mississauga, ON.

For the year ended December 31, 2011, the REIT sold the following four Ontario industrial properties: 880 Milner Ave., 5230 Orbitor Dr., 738 Polymore Dr. and 51 Kelfield St.

Net Gain (Loss) on Foreign Exchange (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Net gain (loss) on foreign exchange	\$1,535	(\$4,165)	\$5,700	(\$7,007)	\$3,738	(\$10,745)

The net gain (loss) on foreign exchange is made up of the following items:

- (i) A foreign exchange gain (loss) of \$1.5 million for the three months ended December 31, 2012 (Q4 2011 - (\$4.2 million)) and (\$4.5 million) for the year ended December 31, 2012 (December 31, 2011 - \$3.7 million) which were recorded in the financial statements of Finance Trust due to a difference in exchange rates as the U.S. Holdco Notes receivable by Finance Trust are denominated in U.S. dollars while the financial statements of Finance Trust are expressed in Canadian dollars. The notes are eliminated upon combination however, the foreign exchange difference is not eliminated on combination as U.S. Holdco has a different functional currency than that of the REIT.
- (ii) For the acquisition of Hess Tower in Houston, TX in December 2011, the REIT loaned U.S. Holdco \$250.0 million on December 22, 2011 which was repaid on January 23, 2012. The loss represents a change in the foreign exchange rates between these dates. For accounting purposes this resulted in a foreign exchange loss of \$2.5 million for the year ended December 31, 2012. The REIT had entered into a foreign exchange forward contract which, on a cash basis, resulted in no gain or loss.

Income Tax Expense (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Current income taxes	\$94	\$73	\$21	\$518	\$285	\$233
Deferred income taxes	29,607	-	29,607	43,407	-	43,407
Total income taxes	\$29,701	\$73	\$29,628	\$43,925	\$285	\$43,640

The REIT is generally subject to tax in Canada under the Tax Act with respect to its taxable income each year, except to the extent such taxable income is paid or made payable to unitholders and deducted by the REIT for tax purposes. The REIT's current income tax expense is primarily due to U.S. state taxes.

The REIT's deferred income tax expense is recorded in respect of U.S. Holdco and arose due to taxable temporary differences between the tax and accounting bases of assets and liabilities net of the benefit of unused tax credits, deferred interest deductions and losses that are available to be carried forward to future tax years to the extent that it is probable that the unused tax credits, deferred interest deductions and losses can be realized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply when the assets are realized or the liabilities are settled, based on the tax laws that have been enacted or substantively enacted at the balance sheet date. Deferred income tax relating to items recognized in equity will also be recognized in equity.

At December 31, 2012, the REIT had net deferred tax liabilities of \$43.4 million (December 31, 2011 - nil) primarily related to taxable temporary differences between the tax and accounting bases of U.S. investment properties.

SEGMENTED INFORMATION

The REIT invests in investment properties in both Canada and the United States occupied by creditworthy tenants with long-term leases.

The REIT is not required to report in its financial statements on the performance of each class of assets separately due to management's assessment that all assets effectively adhere to the same investment policy of being leased on a long-term basis to creditworthy tenants and the fact that the REIT manages all assets on a similar basis. Segmented disclosure is provided in the REIT Financial Statements by net property operating income on a geographic basis as the property operations in the United States are considered to be a geographic segment. This segmented information on net property operating income is as follows:

Property operating income for the three months ended December 31, 2012

(in thousands of Canadian dollars)	Canada	United States	Total
Rentals from investment properties	\$180,731	\$49,765	\$230,496
Property operating costs	(67,507)	(10,164)	(77,671)
Property operating income	\$113,224	\$39,601	\$152,825

Property operating income for the three months ended December 31, 2011

(in thousands of Canadian dollars)	Canada	United States	Total
Rentals from investment properties	\$140,150	\$38,024	\$178,174
Property operating costs	(53,501)	(6,470)	(59,971)
Property operating income	\$86,649	\$31,554	\$118,203

Property operating income for the year ended December 31, 2012

(in thousands of Canadian dollars)	Canada	United States	Total
Rentals from investment properties	\$631,824	\$203,479	\$835,303
Property operating costs	(230,810)	(41,752)	(272,562)
Property operating income	\$401,014	\$161,727	\$562,741

Property operating income for the year ended December 31, 2011

(in thousands of Canadian dollars)	Canada	United States	Total
Rentals from investment properties	\$534,681	\$122,230	\$656,911
Property operating costs	(199,799)	(20,198)	(219,997)
Property operating income	\$334,882	\$102,032	\$436,914

The change in U.S. property operating income of \$8.0 million and \$59.7 million for the three months and year ended December 31, 2012, as compared to the respective 2011 periods, is primarily due to an increase in rentals from acquisitions as the REIT has acquired 17 properties in the United States between January 1, 2011 and December 31, 2012. Had the property operating income for properties located in the United States been shown in U.S. dollars and excluded: (i) the acquisitions during 2011 and 2012, (ii) the property income from those properties which have been sold or are held for sale, and (iii) the sundry income earned from a hedging instrument on foreign exchange, the adjusted property operating income would have been \$20.3 million for the three months ended December 31, 2012 as compared to \$20.7 million for the three months ended December 31, 2011, and the adjusted property operating income would have been \$82.4 million for the year ended December 31, 2012 as compared to \$83.0 million for the year ended December 31, 2011.

ASSETS

Real Estate Assets

The REIT acquired 12 properties during the year ended December 31, 2012. The cost of these acquisitions less mortgages entered into were funded from the REIT's general operating facilities, the issuance of the Bow Bonds secured by the Bow and Scotia Bonds (as described below) and cash on hand. There were 11 properties acquired during the year ended December 31, 2011.

2012 Acquisitions:

Property	Year Built	Property Type	Date Acquired	Square Feet	Cash Purchase Price (\$ Millions)	Anchor Tenant	Average Remaining Lease Term (years) ⁽¹⁾
25 Dockside Dr., Toronto, ON	2009	Office	Mar 9, 2012	485,000	\$186.0	Corus Entertainment Inc.	20
4527 Losee Rd., N. Las Vegas, NV	1997	Industrial	May 23, 2012	50,659	2.0	JCH Enterprises, Inc.	5
Scotia Plaza, Toronto, ON ⁽²⁾	1951 & 1989	Office	Jun 15, 2012	658,898	422.2	Bank of Nova Scotia	10.6
840 A1A N., Ponte Vedra Beach, FL	1998	Retail	Aug 1, 2012	52,959	9.1	The Fresh Market	3.4
11406 San Jose Blvd., Jacksonville, FL	1998	Retail	Aug 1, 2012	56,700	13.9	Publix	10.0
125 Merritt Island Cswy., Merritt Island, FL	1970	Retail	Aug 1, 2012	88,316	15.0	Publix	7.8
1850 Ridgewood Ave., Holly Hill, FL	2002	Retail	Aug 1, 2012	57,870	8.0	Publix	9.2
17445 U.S. Hwy 192, Clermont, FL	1998	Retail	Aug 1, 2012	77,770	10.1	Publix	6.7
8145 & 8195 Vineland Ave., Orlando, FL	2002	Retail	Aug 30, 2012	83,167	15.8	Publix	5.6
1020 Dawson Rd., Thunder Bay, ON ⁽²⁾	1970	Retail	Oct 15, 2012	42,050	1.4	-	-
1491-1575 Main St., Dunedin, FL	1985	Retail	Dec 10, 2012	74,200	10.7	Publix	8.3
955 State Road 16, St. Augustine, FL	2009	Retail	Dec 17, 2012	61,000	8.7	Publix	12.6
Total				1,788,589	\$702.9		

(1) Average remaining lease term is based on net rent.

(2) Square feet and cash purchase price is based on the REIT's pro-rata share of ownership.

The dollar figures shown above and below for U.S. acquisitions and dispositions are in Canadian dollars and are based on the exchange rates at the date of such purchase or sale.

The REIT closed a \$60.0 million interest only mortgage on 25 Dockside Drive, Toronto, the Corus property, for a term of 20 years at an interest rate of 4.91% and another \$37.0 million first mortgage for a term of 10 years at an interest rate of 4.14%. Both mortgages are non-recourse to the REIT. For the acquisition of Scotia Plaza of which the REIT has a one-third interest, the REIT issued \$216.7 million of first mortgage bonds at 3.21% for a 7-year term (the "Scotia Bonds"). The Scotia Bonds are secured by the REIT's interest in Scotia Plaza.

For seven of the retail properties purchased in Florida, the REIT obtained a U.S. \$52.3 million mortgage for a term of 7 years at an interest rate of 3.35%.

The REIT sold three industrial properties, four retail properties, a portion of an office property (sold as separate condominium units) and a parcel of land held for development during the year ended December 31, 2012. The REIT sold four properties sold during the year ended December 31, 2011.

2012 Dispositions:

Property	Property Type	Date Sold	Square Feet	Gross Proceeds (\$ Millions)	Ownership Interest Disposed
2780-2800 Skymark Ave., Mississauga, ON	Office	Apr - Dec 2012	21,509	\$3.0	100%
901 Guelph Line, Burlington, ON	Industrial	Jul 31, 2012	227,444	10.0	100%
1 Academy Dr., Jeffersonville, GA	Industrial	Sep 28, 2012	1,038,183	54.4	100%
10580 Duke Dr., Alpharetta, GA	Retail	Oct 15, 2012	129,044	13.2	100%
4855 Stone Mountain Hwy., Lilburn, GA	Retail	Oct 15, 2012	128,997	13.4	100%
2650 Dallas Hwy., Marietta, GA	Retail	Oct 15, 2012	132,847	11.7	100%
575 Molly Lane, Woodstock, GA	Retail	Oct 15, 2012	132,847	12.1	100%
940 Gateway Dr., Burlington, ON	Industrial	Nov 30, 2012	70,218	4.3	100%
12094 Dixie Rd., Caledon, ON being Part of Lot 18, Concession 3	Development	Dec 5, 2012	(1)	18.4	100%
Total			1,881,089	\$140.5	

(1) Approximately 31 acres of land held for development were sold.

The portfolio continues to remain in good condition. The weighted average age of the total portfolio from the date built or renovated is 17.5 years at December 31, 2012 (December 31, 2011 - 17.2 years) and the weighted average age of properties by type of asset is as follows:

Weighted Average Age by Type of Asset	December 31, 2012 (years)	December 31, 2011 (years)
Office	16.8	18.6
Industrial	19.1	17.9
Retail	14.4	13.3
Total	17.5	17.2

Legal title to each of the United States properties is held by a separate legal entity which is 100% owned, directly or indirectly, by U.S. Holdco. The assets of each such separate entity are not available to satisfy the debts or obligations of any other person or entity; each such separate entity maintains separate books and records. The identity of the owner of a particular U.S. property is available from U.S. Holdco. This structure does not prevent distributions to U.S. Holdco provided there are no conditions of default.

The composition of the fair value of investment properties expressed by type of asset and by region is as follows:

Type of Asset (millions)	Fair Value December 31, 2012⁽¹⁾	Fair Value December 31, 2011⁽¹⁾
Office	\$6,576	\$3,963
Industrial	1,730	1,794
Retail	1,501	1,454
Total	\$9,807	\$7,211

Region (millions)	Fair Value December 31, 2012⁽¹⁾	Fair Value December 31, 2011⁽¹⁾
Ontario	\$3,867	\$3,076
Alberta	2,871	1,042
Quebec	366	376
Other	514	510
Canada	7,618	5,004
United States	2,189	2,207
Total	\$9,807	\$7,211

(1) Please refer to note 4 of the Combined Financial Statements for the assumptions and methods in measuring the fair value of the portfolio.

Significant costs associated with investment properties are either capitalized or expensed in the year incurred. The REIT currently expects to incur the following costs:

Year	Total Amount Expected to be Incurred	Amount Expected to be Capitalized	Amount Expected to be Expensed to Property Operating Costs	Total Expected Recovery	Amount Expected to be Recovered in the Year Incurred	Amount Expected to be Recovered thereafter
2013	\$33 million	\$19 million	\$14 million	\$26 million	\$14 million	\$12 million
2014	\$24 million	\$16 million	\$8 million	\$21 million	\$11 million	\$10 million

The information contained in the table above is based on current tenancies in place and management's estimates of the timing of these projects and their recovery as additional rent.

Investment Properties Transferred From Properties Under Development

The REIT has reached practical completion on the construction of a two million square foot office building in Calgary, Alberta (the "Bow"), which is fully pre-leased to Encana Corporation for a 25-year term. Floors 3 to 57 were delivered to Encana Corporation in tranches between May 2, 2012 and February 22, 2013. The 25-year lease term is expected to commence on March 15, 2013 upon the anticipated delivery of the final two floors to Encana Corporation. The REIT estimates a further \$48.2 million in costs will be incurred to complete the project including capitalized interest. As at December 31, 2012, the total cost incurred on the project amounted to \$1.67 billion (December 31, 2011 - \$1.48 billion). This amount includes the costs for construction of 1,358 parking stalls. Encana Corporation is entitled to a 60-day free rent fixturing period and a rent credit equal to the delay penalty of approximately \$32.5 million. As at December 31, 2012, the unused portion of the rent credit balance relating to the delay penalty was approximately \$15.2 million. Refer to the Outlook section of this MD&A for further information.

The following table shows the current budget, costs incurred to date and the costs to complete:

(in thousands of Canadian dollars)	North Block Budget	South Block Budget	Costs Incurred to Date	Costs to Complete ⁽¹⁾
Land	\$42,804	\$18,000	\$60,804	\$ -
Financing costs	40,210	-	38,425	1,785
Capitalized interest on the REIT's costs as incurred	225,752	-	224,541	1,211
Soft costs	179,353	-	176,015	3,338
Hard costs	1,255,391	10,087	1,233,006	32,472
Recoveries and other income	(68,358)	-	(65,489)	(2,869)
Contingency	12,299	-	-	12,299
Budget/costs incurred to date/remaining costs	1,687,451	28,087	1,667,302	48,236
Less capitalized interest on the REIT's costs incurred ⁽²⁾	(225,752)	-	(224,541)	(1,211)
Budget/total costs incurred to date/remaining costs/less capitalized interest	\$1,461,699	\$28,087	\$1,442,761	\$47,025

(1) This information is being provided so that investors are able to understand the expected budget costs of the REIT and its impact on REIT operations. This information may not be appropriate for other purposes.

(2) Following the delivery of each completed tranche of the Bow to Encana Corporation during 2012, the REIT ceased capitalizing interest relating to that portion of the property.

On March 16, 2012, the Bow was valued by a professional external independent appraiser at \$1,795,000, assuming the building was 100% complete.

Properties Under Development (in thousands of Canadian dollars)

Project	Address	December 31, 2012 ⁽¹⁾	December 31, 2011 ⁽¹⁾
The Bow ⁽²⁾	5 th Ave. at Centre Street, Calgary, AB	\$ -	\$1,583,803
Heart Lake	Mayfield West Business Park, Caledon, ON	76,650	87,954
Airport Road	7900 Airport Rd., Brampton, ON	51,570	49,986
		\$128,220	\$1,721,743

(1) The properties under development are stated at fair value.

(2) The Bow was transferred to investment properties on December 31, 2012 as it had reached practical completion.

Assets Classified as Held For Sale

The REIT currently has one office and one industrial property; 1330 Martin Grove Ave., Toronto, ON and 295 The West Mall, Etobicoke, ON, with a total square footage of approximately 253,000 square feet, held for sale as at December 31, 2012 (December 31, 2011 - nil). The total fair value of these two properties at December 31, 2012 is \$27.8 million.

Other Assets (in thousands of Canadian dollars)

	December 31, 2012	December 31, 2011
Current:		
Restricted cash	\$40,347	\$22,110
Accounts receivable	16,772	12,711
Prepaid expenses and sundry assets	8,324	12,959
Derivative instruments	1,679	1,273
Other Assets	\$67,122	\$49,053

Restricted cash increased from \$22.1 million as at December 31, 2011 to \$40.3 million as at December 31, 2012 primarily due to cash being held in escrow relating to the Bow Bonds issued in June 2012 and funds held in escrow relating to a new mortgage that closed on December 28, 2012.

Prepaid expenses and sundry assets decreased from \$13.0 million as at December 31, 2011 to \$8.3 million as at December 31, 2012 primarily due to mortgage application fees held on several properties as at December 31, 2011 being refunded in 2012.

Derivative instruments in asset and liability positions are not presented on a net basis. Refer to the “Derivative Instruments” table under “Liabilities” for a summary of all derivative instruments held by the REIT.

LIABILITIES

The REIT’s Declaration of Trust limits the indebtedness of the REIT (subject to certain exceptions) to a maximum of 65% of the GBV of the REIT.

	December 31, 2012 ⁽¹⁾	December 31, 2011 ⁽¹⁾
Total debt to GBV as per the REIT Declaration of Trust ⁽¹⁾	48.3%	47.1%
Total debt to fair market value of total assets as per the Combined Financial Statements	51.6%	53.6%
Non-recourse mortgages as a percentage of total mortgages	70.9%	59.8%
Floating rate debt as a percentage of total debt	0.1%	9.1%
Canadian properties total debt to fair market value of total Canadian assets	50.2%	54.4%
U.S. properties total debt to fair market value of total U.S. assets	56.8%	51.4%

⁽¹⁾ Total debt per the REIT Declaration of Trust excludes all convertible debentures and the U.S. Holdco Notes payable to Finance Trust. In Q4 2012, the REIT elected to fair value its real estate assets and per the REIT Declaration of Trust, this is now considered to be its GBV. The REIT’s calculation of total debt to GBV is not recognized under IFRS and therefore does not have a standardized meaning prescribed by IFRS. This, along with all of the other ratios in the table above, are considered to be non-GAAP measures.

The non-recourse mortgages as a percentage of total mortgages increased due to non-recourse mortgages acquired or assumed from the 2011 and 2012 acquisitions, mortgage refinancing, as well as the issuance of the Bow and Scotia Bonds. The floating rate debt as a percentage of total debt decreased as a result of these new mortgages and bonds as well as due to the issuance of the \$175 million Series F Senior Debentures. The U.S. properties total debt to fair market ratio increased as the REIT acquired the Hess Tower at an acquisition price of U.S. \$442.5 million in December 2011 and the mortgage on the Hess Tower of U.S. \$250.0 million was not received until January 2012.

Mortgages Payable

(in thousands of Canadian dollars)

Opening balance - January 1, 2012	\$3,163,593
Principal repayments	(119,977)
Mortgages repaid upon maturity	(268,606)
New mortgages*	1,465,206
Mortgages released upon lender taking title to properties	(20,675)
Mortgages released on the sale of investment properties	(91,167)
Foreign exchange difference	(32,459)
Closing balance – December 31, 2012	\$4,095,915

* See table below for a breakdown of new mortgages which are shown net of financing costs.

The mortgages outstanding as at December 31, 2012 bear interest at a weighted average rate of 5.1% (December 31, 2011 – 5.9%) and mature between 2013 and 2035. The weighted average term to maturity of the REIT's mortgages is 7.7 years (December 31, 2011 - 7.7 years). Of the total mortgages outstanding, 5.7% will mature in 2013 and 7.8% will mature in 2014. The mortgages maturing during 2013 and 2014 bear interest at a weighted average rate on maturity of 7.5% and 6.2%, respectively. For a further discussion of liquidity please see "Funding of Future Commitments". For a further discussion of interest rate risk, please see "Risks and Uncertainties".

The following table below provides a summary of all 2012 new mortgages:

Portfolio	Number of Properties	Amount	Interest Rate	Maturity Date(s)
Hess Tower	1	\$244,240	4.50%	February 2020
Canadian industrial portfolio, tenanted by Purolator Courier	10	62,185	3.99%	February 2022
U.S. industrial portfolio, tenanted by Nestle USA	3	59,618	4.50%	February 2022
Corus	1	59,798	4.91%	April 2032
		36,941	4.14%	May 2022
The Bow	1	247,839	3.69%	June 2021
		247,839	3.69%	June 2022
Scotia Plaza	1	215,000	3.21%	June 2019
Canadian industrial portfolio, tenanted by Nova Chemicals	2	26,879	3.79%	June 2020
160 Elgin St., Ottawa, ON	1	198,768	4.00%	August 2022
U.S. retail grocery portfolio, anchored by Publix	7	51,204	3.35%	October 2019
1701 Frederick Rd., Opelika, AL, tenanted by Lowes	1	7,722	3.35%	October 2019
1491-1575 Main St., Dunedin, FL, anchored by Publix	1	7,173	5.75%	September 2021
	29	\$1,465,206	3.90%	8.7 years

Debt related to certain Canadian properties is held by separate legal entities, where the rent received from each property is first used to satisfy the related debt obligations with any balance then available to satisfy the cash flow requirements of the REIT.

Segmented disclosure of mortgages payable by geographic location is provided as follows:

(in thousands of Canadian dollars)	December 31, 2012	December 31, 2011
Mortgages payable - Canada	\$2,826,303	\$2,015,424
Mortgages payable - United States	1,269,612	1,148,169
Total	\$4,095,915	\$3,163,593

H&R REIT & H&R FINANCE TRUST- MD&A – December 31, 2012

Debentures Payable						December 31, 2012	December 31, 2011
	Maturity	Contractual Interest Rate	Effective Interest Rate	Conversion Price	Face Value (in \$ millions)	Carrying Value (in \$ millions)	Carrying Value (in \$ millions)
Convertible Debentures							
2013 Convertible Debentures (HR.DB)	-	6.65%	6.65%	\$23.11	\$ -	\$ -	\$126.2
2014 Convertible Debentures (HR.DB.B)	-	6.75%	6.75%	\$14.00	-	-	214.4
2017 Convertible Debentures (HR.DB.C)	Jun 30, 2017	6.00%	6.00%	\$19.00	168.3	213.3	210.6
2020 Convertible Debentures (HR.DB.D)	Jun 30, 2020	5.90%	5.90%	\$23.50	99.7	109.9	113.0
2016 Convertible Debentures (HR.DB.E)	Dec 31, 2016	4.50%	4.50%	\$25.70	75.0	77.3	78.0
					343.0	400.5	742.2
Senior Debentures							
Series A Senior Debentures	Feb 3, 2015	5.20%	5.40%	n/a	115.0	114.5	114.3
Series B Senior Debentures	Feb 3, 2017	5.90%	6.06%	n/a	115.0	114.3	114.2
Series C Senior Debentures	Dec 1, 2018	5.00%	5.30%	n/a	125.0	123.1	122.9
Series D Senior Debentures	Jul 27, 2016	4.78%	4.96%	n/a	180.0	179.0	178.7
Series E Senior Debentures	Feb 2, 2018	4.90%	5.22%	n/a	100.0	98.8	98.6
Series F Senior Debentures	Mar 2, 2020	4.45%	4.63%	n/a	175.0	173.6	-
					810.0	803.3	628.7
Total					\$1,153.0	\$1,203.8	\$1,370.9

Debentures payable decreased by \$167.1 million from December 31, 2011 to December 31, 2012 mainly due to the conversion of many of the 2013 and 2014 convertible debentures into Stapled Units during the later half of 2012. In July 2012, the REIT redeemed all of the remaining outstanding 2013 convertible debentures and 2014 convertible debentures for total cash payments of \$29.8 million and \$1.3 million, respectively. This decrease in debentures payable was mainly offset by the issuance of \$175 million Series F Senior Debentures in April 2012 bearing interest at a contractual rate of 4.45%.

Deferred tax liability

The REIT has certain subsidiaries in the United States that are subject to tax on their taxable income at a rate of approximately 38%. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	2012	2011
Deferred tax assets:		
Net operating losses and deferred interest deductions	\$72.1	\$42.6
Accounts payable and accrued liabilities	1.1	4.2
Other assets	0.2	-
	73.4	46.8
Deferred liabilities:		
Investment properties	116.4	47.3
Derivative instruments	0.4	(0.5)
	116.8	46.8
Deferred tax asset (liability)	(\$43.4)	\$ -

The deferred tax liability relating to the investment properties is derived on the basis that the US. Investment properties will be sold at their current fair value. The tax liability will only be realized upon an actual disposition.

Derivative Instruments

(in thousands of Canadian dollars)

	Fair value (liability) asset*	
	December 31 2012	December 31 2011
Foreign exchange forward contracts (a)	\$1,679	(\$730)
Foreign exchange swap (a)	-	1,273
Foreign exchange swap (a)	-	(1,106)
Interest rate swap - the Bow Facility (b)	-	(3,520)
Mortgage interest rate swaps (c)	(601)	(716)
	\$1,078	(\$4,799)

(a) The REIT entered into foreign exchange forward contracts and swaps with Canadian chartered banks effectively locking the REIT's rate to exchange U.S. dollars into Canadian dollars.

(b) The REIT entered into an interest rate swap that was intended to limit its interest rate exposure during the term of the Bow Facility. The swap was settled in June 2012.

(c) The REIT entered into interest rate swaps on three Canadian mortgages and one U.S. mortgage. The three interest rate swaps on Canadian mortgages were settled during 2012.

* Derivative instruments in asset and liability positions are not presented on a net basis. When a derivative instrument is in an asset position, the amount is recorded in "Assets - Other Assets" section of this MD&A.

USE OF PROCEEDS FROM FINANCING ISSUED DURING 2012

Financing	Disclosed Use of Proceeds	Actual Use of Proceeds
Public offering of \$175 million of unsecured senior debentures on April 2, 2012.	To repay outstanding indebtedness incurred under the REIT's credit facilities and for general trust purposes.	The entire net proceeds were used to repay bank indebtedness and for general trust purposes.
Private placement of \$500 million of first mortgage bonds secured by the Bow on June 14, 2012 (the "Bow Bonds").	To repay bank indebtedness and for future acquisitions including financing a portion of Scotia Plaza.	The entire net proceeds were used to repay bank indebtedness, acquire Scotia Plaza and for general trust purposes.
Private placement of \$216.7 million of first mortgage bonds on June 15, 2012 (the "Scotia Bonds").	To pay a portion of the purchase price for the acquisition of Scotia Plaza.	The entire proceeds were used to pay a portion of the purchase price for the acquisition of Scotia Plaza.
Public offering of \$150.1 million of Stapled Units on November 29, 2012.	For future acquisitions and the repayment of bank indebtedness and mortgage debt, including mortgages totalling \$69.7 million due February 1, 2013.	A portion of the proceeds were used to repay bank indebtedness and the remaining proceeds will be used for the repayment of mortgage debt, acquisitions and general trust purposes.

EQUITY

Unitholders' Equity

Unitholders' equity increased by \$796.5 million between December 31, 2011 and December 31, 2012. The increase is primarily due to net income, the issuance of Stapled Units resulting from conversions of convertible debentures and the REIT and Finance Trust completing a public offering of 6,360,000 Stapled units in November 2012 for gross proceeds of approximately \$150 million. This increase was partially offset by distributions paid to unitholders during the same period.

Other comprehensive income (loss) consists of the unrealized gain (loss) on translation of U.S. denominated foreign operations and the transfer of realized losses on cash flow hedges to net income.

LIQUIDITY AND CAPITAL RESOURCES**FUNDS FROM OPERATIONS**

Although funds from operations (“FFO”) is widely used by the real estate industry as a measure of operating performance, the Trusts’ method of calculating FFO may differ when comparing to other issuers. The Trusts present its FFO calculations in accordance with the Real Estate Property Association of Canada (REALPAC). FFO is a non-GAAP measure which should not be used as an alternative to comprehensive income or cash flow from operations.

(in thousands of Canadian dollars except per unit amounts)	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
Net income	\$102,635	\$24,626	\$508,860	\$338,043
Add (deduct)				
Exchangeable unit distributions	1,699	1,428	6,389	5,302
(Gain) loss on change in fair value	(17,730)	69,191	7,736	108,378
Fair value adjustment on real estate assets	(30,652)	(38,324)	(253,101)	(199,870)
Amortization of leasing expenses	1,437	1,016	5,525	4,445
Net (gain) loss on foreign exchange	(1,535)	4,165	7,007	(3,738)
Fair value adjustment to unit-based compensation	(1,313)	2,809	2,994	5,566
Loss on sale of real estate assets	1,080	26	137	541
Transaction costs on issuance of convertible debentures	-	2,813	-	2,813
Deferred income taxes	\$29,607	-	\$43,407	-
FFO	\$85,228	\$67,750	\$328,954	\$261,480
Weighted average number of units (in thousands of Stapled Units adjusted for conversion of exchangeable Stapled Units)	195,469	167,691	188,847	159,607
Diluted weighted average number of Stapled Units (in thousands of Stapled Units) for the calculation of FFO ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	212,041	197,046	214,425	188,487
FFO per Stapled Unit (basic – adjusted for conversion of exchangeable Stapled Units)	\$0.44	\$0.40	\$1.74	\$1.64
FFO per Stapled Unit (diluted)	\$0.43	\$0.39	\$1.65	\$1.57
Distributions per Stapled Unit	\$0.31	\$0.26	\$1.18	\$0.98
Payout ratio	70.5%	65.0%	67.8%	59.8%

(1) For the three months ended December 31, 2012 and 2011, 552,392 Stapled Units and 530,510 Stapled Units, respectively, are included in the determination of diluted FFO with respect to the Unit Option Plan. For the year ended December 31, 2012 and 2011, 713,857 Stapled Units and 606,556 Stapled Units, respectively, are included in the determination of diluted FFO with respect to the Unit Option Plan.

(2) The 2016, 2017 and 2020 convertible debentures are dilutive for the three months ended December 31, 2012. Therefore, debenture interest of \$4.9 million is added to FFO and 16,019,549 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for this period.

(3) All of the convertible debentures are dilutive for the three months ended December 31, 2011. Therefore, debenture interest of \$8.7 million is added to FFO and 28,824,291 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for this period.

(4) All of the convertible debentures are dilutive for the years ended December 31, 2012 and December 31, 2011. Therefore, debenture interest of \$24.5 million and \$33.5 million, respectively, are added to FFO and 24,863,667 Stapled Units and 28,274,014 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for these periods.

Included in FFO are the following items which can be a source of significant variances between different periods:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Additional recoveries for capital expenditures	\$5,253	\$4,441	\$812	\$13,775	\$7,057	\$6,718
Gain (loss) on extinguishment of debt	(45)	158	(203)	10,151	9,310	841
One-time non-recurring items*	130	7	123	(1,517)	1,919	(3,436)
The Bow	(2,038)	-	(2,038)	(1,340)	-	(1,340)
	\$3,300	\$4,606	(\$1,306)	\$21,069	\$18,286	\$2,783

* One-time non-recurring items may include lease termination payments, mortgage pre-payment penalties, sundry income, one-time occupancy and realty tax adjustments and unusual trust expenses.

Excluding the above items, FFO would have been \$81.9 million for the three months ended December 31, 2012 (Q4 2011 - \$63.1 million) and \$0.42 per basic Stapled Unit (Q4 2011 - \$0.38 per basic Stapled Unit). For the year ended December 31, 2012, FFO would have been \$307.9 million (December 31, 2011 - \$243.2 million) and \$1.63 per basic Stapled Unit (December 31, 2011 - \$1.52 per basic Stapled Unit).

ADJUSTED FUNDS FROM OPERATIONS

Although adjusted funds from operations (“AFFO”) is a common measure in the real estate industry, the Trusts’ method of calculating AFFO may differ to that of other issuers. AFFO is calculated by adjusting FFO for non-cash items such as: straight-lining of contractual rent, rent amortization of tenant inducements, effective interest rate accretion, unit-based compensation, and mortgage interest accruals on non-recourse mortgage defaults which is a non-cash item that will eventually result in a (gain) loss on extinguishment of debt, once the lender of the bankrupt properties takes legal title of properties. Non-recurring costs that impact operating cash flow may be adjusted, and capital and tenant expenditures incurred and capitalized in the period by the Trusts are deducted. AFFO is a non-GAAP measure which should not be used as an alternative to comprehensive income or cash flow from operations.

(in thousands of Canadian dollars except per unit amounts)	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
FFO	\$85,228	\$67,750	\$328,954	\$261,480
Add (deduct):				
Straight-lining of contractual rent	(16,156)	544	(32,464)	288
Rent amortization of tenant inducements	371	278	1,467	1,028
Effective interest rate accretion	626	121	1,557	908
Mortgage interest accruals on non-recourse mortgage defaults	-	311	296	2,199
(Gain) loss on extinguishment of debt	45	(158)	(10,151)	(9,310)
Unit-based compensation	804	537	3,128	2,034
Capital expenditures	(8,139)	(6,759)	(19,963)	(11,259)
Tenant expenditures	(6,599)	(2,432)	(14,231)	(9,890)
AFFO	\$56,180	\$60,192	\$258,593	\$237,478
Weighted average number of Stapled Units (in thousands of Stapled Units adjusted for conversion of exchangeable units)	195,469	167,691	188,847	159,607
Diluted weighted average number of Stapled Units (in thousands of Stapled Units) for the calculation of AFFO ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	204,881	192,072	210,176	183,511
AFFO per Stapled Unit (basic - adjusted for conversion of exchangeable units)	\$0.29	\$0.36	\$1.37	\$1.49
AFFO per Stapled Unit (diluted)	\$0.29	\$0.35	\$1.32	\$1.44

(1) For the three months ended December 31, 2012 and 2011, 552,392 Stapled Units and 530,510 Stapled Units, respectively, are included in the determination of diluted AFFO with respect to the Unit Option Plan. For the year ended December 31, 2012 and 2011, 713,857 Stapled Units and 606,556 Stapled Units, respectively, are included in the determination of diluted AFFO with respect to the Unit Option Plan.

(2) The 2017 convertible debentures are dilutive for the three months ended December 31, 2012. Therefore, debenture interest of \$2.5 million is added to AFFO and 8,859,365 Stapled Units are included in the dilutive weighted average number of Stapled Units outstanding for this period.

(3) The 2013, 2014, 2016 and 2017 convertible debentures are dilutive for the year ended December 31, 2012. Therefore, debenture interest of \$18.6 million is added to AFFO and 20,615,059 Stapled Units are included in the dilutive weighted average number of Stapled Units outstanding for this period.

(4) The 2014, 2016, 2017 and 2020 convertible debentures are dilutive for the three months and year ended December 31, 2011. Therefore, debenture interest of \$6.8 million and \$25.8 million, respectively, are added back to AFFO and 23,849,783 Stapled Units and 23,298,240 Stapled Units are included in the dilutive weighted average number of Stapled Units outstanding for these periods.

Included in AFFO are the following items which can be a source of significant variances between different periods:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2012	2011	Change	2012	2011	Change
Additional recoveries for capital expenditures	\$5,253	\$4,441	\$812	\$13,775	\$7,057	\$6,718
Capital and tenant expenditures	(14,738)	(9,191)	(5,547)	(34,194)	(21,149)	(13,045)
One-time non-recurring items*	130	7	123	(1,517)	1,919	(3,436)
The Bow	(17,426)	-	(17,426)	(31,013)	-	(31,013)
	(\$26,781)	(\$4,743)	(\$22,038)	(\$52,949)	(\$12,173)	(\$40,576)

* One-time non-recurring items may include lease termination payments, mortgage pre-payment penalties, sundry income, one-time occupancy and realty tax adjustments and unusual trust expenses.

Excluding the above items, AFFO would have been \$83.0 million for the three months ended December 31, 2012 (Q4 2011 - \$64.9 million) and \$0.42 per basic Stapled Unit (Q4 2011 - \$0.39 per basic Stapled Unit). For the year ended December 31, 2012, AFFO would have been \$311.5 million (December 31, 2011 - \$249.7 million) and \$1.65 per basic Stapled Unit (December 31, 2011 - \$1.56 per basic Stapled Unit).

The following is a reconciliation of the Trusts' AFFO to cash provided by operations.

(in thousands of Canadian dollars)	Three months ended December 31		Year ended December 31	
	2012	2011	2012	2011
AFFO	\$56,180	\$60,192	\$258,593	\$237,478
Straight-lining of contractual rent	16,156	(544)	32,464	(288)
Mortgage interest accruals on non-recourse mortgage defaults	-	(311)	(296)	(2,199)
Exchangeable unit distributions	(1,699)	(1,428)	(6,389)	(5,302)
Additions to capital expenditures and tenant expenditures	14,738	9,191	34,194	21,149
Finance cost - operations	66,593	49,551	239,455	181,012
Effective interest rate accretion	(626)	(121)	(1,557)	(908)
Realized loss on derivative instruments	-	-	(13,941)	-
Loss on foreign exchange	-	(9)	-	(8)
Transaction costs on issuance of convertible debentures	-	(2,813)	-	(2,813)
Change in other non-cash operating items	2,427	(9,684)	8,831	(23,553)
Cash provided by operations	\$153,769	\$104,024	\$551,354	\$404,568

LIQUIDITY AND CAPITAL RESOURCES**Cash Distributions**

In accordance with National Policy 41-201 - *Income Trusts and Other Indirect Offerings*, the Trusts are required to provide the following additional disclosure relating to cash distributions.

(in thousands of Canadian dollars)	Three months ended December 31, 2012	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010 ⁽¹⁾
Cash provided by operating activities	\$153,769	\$551,354	\$404,568	\$399,781
Net income	102,635	508,860	338,043	496,600
Cash distributions paid or payable relating to the period ⁽²⁾	44,475	158,423	114,112	99,426
Excess of cash provided by operating activities over cash distributions paid	109,294	392,931	290,456	300,355
Excess of net income over cash distributions paid	58,160	350,437	223,931	397,174

(1) The 2010 figures have not been adjusted for the 2012 changes in accounting policies.

(2) Cash distributions paid excludes distributions reinvested in units pursuant to the Trust's unitholder distribution reinvestment plan.

For all the periods noted above, cash provided by operating activities exceeded cash distributions. Management expects this trend to continue. Net income exceeded cash distributions paid for all periods noted above. Non-cash items such as fair value adjustment real estate assets, gain (loss) on change in fair value, gain (loss) on extinguishment of debt, deferred income tax recoveries and amortization are deducted from or added to net income (loss) and have no impact on cash available to pay current distributions.

Capital Resources

Subject to market conditions, management expects to be able to meet all of the Trusts' ongoing obligations and to finance short-term development commitments through the general operating facilities discussed below and the Trusts' cash flow from operations. As at December 31, 2012, the REIT is not in default or arrears on any of its obligations including interest or principal payments on debt and any debt covenant.

The REIT's general operating facility has been provided by the same chartered bank since the REIT's inception. This general operating facility expires on December 31, 2013 and is secured by certain investment properties. At December 31, 2012, approximately \$252.5 million was available under this facility. The REIT also has a second general operating facility with two Canadian chartered banks. This facility expires November 21, 2013 and is secured by the Bow. At December 31, 2012, approximately \$300.0 million was available under this facility.

Other than the Bow development which is described in greater detail under “Properties under Development”, the following is a summary of material contractual obligations of the REIT including payments due as at December 31, 2012 for the next 5 years and thereafter:

Contractual Obligations ⁽¹⁾ (in thousands of Canadian dollars)	Payments Due by Period				Total
	2013	2014- 2015	2016- 2017	2018 and thereafter	
Mortgages payable	\$233,717	\$670,270	\$892,252	\$2,307,039	\$4,103,278
2016 Convertible Debentures	-	-	75,000	-	75,000
2017 Convertible Debentures	-	-	168,287	-	168,287
2020 Convertible Debentures	-	-	-	99,679	99,679
Series A Senior Debentures	-	115,000	-	-	115,000
Series B Senior Debentures	-	-	115,000	-	115,000
Series C Senior Debentures	-	-	-	125,000	125,000
Series D Senior Debentures	-	-	180,000	-	180,000
Series E Senior Debentures	-	-	-	100,000	100,000
Series F Senior Debentures	-	-	-	175,000	175,000
Bank indebtedness	2,905	-	-	-	2,905
Property acquisitions	100,000	-	-	-	100,000
Total Contractual Obligations	\$336,622	\$785,270	\$1,430,539	\$2,806,718	\$5,359,149

⁽¹⁾ The amounts in the above table are the principal amounts due under the contractual agreements.

DBRS Limited (“DBRS”) provides credit ratings of debt securities for commercial entities. A credit rating generally provides an indication of the risk that the borrower will not fulfill its obligations in a timely manner with respect to both interest and principal commitments. Rating categories range from highest credit quality (generally AAA) to default payment (generally D). A credit rating is not a recommendation to buy, sell or hold securities.

DBRS has confirmed that the REIT has a credit rating of BBB with a Stable trend as at December 31, 2012. DBRS completed its review of the anticipated acquisition of Primaris by the REIT and confirmed on February 6, 2013 that the REIT’s senior debentures remain rated at BBB with a stable trend. A credit rating of BBB by DBRS is generally an indication of adequate credit quality, where protection of interest and principal is considered acceptable. A credit rating of BBB or higher is an investment grade rating. There can be no assurance that any rating will remain in effect for any given period of time or that any rating will not be withdrawn or revised by DBRS at any time. The credit rating is reviewed periodically by DBRS.

The REIT has no material capital or operating lease obligations.

Funding of Future Commitments

The REIT believes that as at December 31, 2012, through the combined amount available under its general operating facilities of \$552.5 million, it has sufficient funds for the property acquisition commitments and to complete the development of the Bow. Please refer to “Properties under Development” for further details on the costs to complete.

The following summarizes the estimated loan to value ratios that will be outstanding on properties whose mortgages mature over the next five years:

Year	Number of Properties	Mortgage Debt due on Maturity (\$000's) ⁽¹⁾	Weighted Average Interest Rate on Maturity	Fair Value of Investment Properties (\$000's) ⁽¹⁾	Loan to Value
2013	10	107,821	7.5%	347,650	31%
2014	8	182,632	6.2%	391,600	47%
2015	22	215,776	5.4%	425,428	51%
2016	37	288,147	5.3%	563,771	51%
2017	19	336,595	5.5%	609,139	55%
	96	\$1,130,971		\$2,337,588	48%

⁽¹⁾ Converting U.S. dollars to Canadian dollars at an exchange rate of \$0.99 as at December 31, 2012.

Based on the low percentage of the projected loan to values of the maturing mortgages, the REIT is confident it will be able to refinance these mortgages upon maturity should it choose to do so. In 2012, the REIT refinanced 17 mortgages totalling \$250.4 million, which had an average interest rate of 6.4% per annum, with 17 new mortgages totalling \$358.7 million bearing at an average interest rate of 4.1% per annum for an average term of 9.8 years.

OFF-BALANCE SHEET ITEMS

The REIT has co-owners and partners in various projects. As a rule the REIT does not provide guarantees or indemnities for these co-owners pursuant to property acquisitions because should such guarantees be provided, recourse would be available against the REIT in the event of a default of the co-owners. In such case, the REIT would have a claim against the underlying real estate investment. However, in certain circumstances, subject to compliance with the REIT Declaration of Trust and the determination by management that the fair value of the co-owners' investment is greater than the mortgages payable for which the REIT has provided guarantees, such guarantees will be provided.

At December 31, 2012, such guarantees amounted to \$72.1 million expiring in 2016 (December 31, 2011 - \$74.3 million, expiring in 2016), and no amount has been provided for in the Combined Financial Statements of the Trusts for these items. These amounts arise where the REIT has guaranteed a co-owner's share of the mortgage liability. The REIT, however, customarily guarantees or indemnifies the obligations of its nominee companies which hold separate title to each of its properties owned.

In addition in 2012, the REIT continued to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable thereunder until such debts are extinguished or the lenders agree to release the REIT's covenants. At December 31, 2012, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$110.3 million, expiring between 2013 and 2018 (December 31, 2011 - \$113.4 million, expiring between 2013 and 2018). There have been no defaults by the primary obligor for debts, on which the REIT has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in the Combined Financial Statements.

Related Party Transactions

H&R Property Management Ltd. (the "Property Manager"), a company partially owned by family members of the REIT's Chief Executive Officer, provides property management services for substantially all properties owned by the REIT, including leasing services, for a fee of 2% of gross revenue. The Property Manager also provides support services in connection with the acquisition, disposition and development activities of the REIT and is also entitled to an incentive fee. Acquisitions and development support services are provided for a fee of 2/3 of 1% of total acquisition and development costs. The support services relating to dispositions of investment properties are provided for a fee of 10% of the net gain on sale of investment properties adjusted for the add back of accumulated depreciation and amortization. Services are provided by the Property Manager pursuant to a property management agreement which expires on January 1, 2015 with one automatic five-year extension.

During the three months ended December 31, 2012, the REIT recorded fees pursuant to this agreement of \$3.8 million (December 31, 2011 - \$9.6 million), of which \$0.1 million (December 31, 2011 - \$5.9 million) was capitalized to the cost of investment properties acquired, \$0.1 million (December 31, 2010 - \$0.4 million) was capitalized to properties under development and \$1.5 million (December 31, 2011 - \$0.6 million) was capitalized to leasing expenses. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the three months ended December 31, 2012, a further amount of \$1.1 million (December 31, 2010 - \$0.9 million) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager.

During the year ended December 31, 2012, the REIT recorded fees pursuant to this agreement of \$19.9 million (December 31, 2011 - \$24.0 million), of which \$4.8 million (December 31, 2011 - \$9.5 million) was capitalized to the cost of investment properties acquired, \$1.1 million (December 31, 2011 - \$2.1 million) was capitalized to properties under development and \$5.5 million (December 31, 2011 - \$3.6 million) was capitalized to leasing expenses. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the year ended December 31, 2012, a further amount of \$4.5 million (December 31, 2011 - \$3.5 million) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager.

Pursuant to the above agreement, as at December 31, 2012, \$1.8 million (December 31, 2011 - \$3.5 million) was payable to the Property Manager.

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the three months ended December 31, 2012 is \$0.4 million (December 31, 2011 - \$0.3 million) and for the year ended December 31, 2012 is \$1.4 million (December 31, 2011 - \$1.4 million).

These transactions are measured at the amount of consideration established and agreed to by the related parties.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Where appropriate, the REIT uses forward contracts to lock-in lending rates on certain anticipated mortgages. This strategy provides certainty to the rate of interest on borrowings when the REIT is involved in transactions that may close further into the future than usual for typical transactions. The REIT has entered into an interest rate swap on one U.S. mortgage which effectively locked the interest rate at 5.25%. At the end of each reporting period, this interest rate swap is marked-to-market, resulting in an unrealized gain or loss recorded in comprehensive income. The REIT had also entered into interest rate swaps on three Canadian mortgages which were all settled during 2012. The REIT entered into an interest rate swap on the Bow credit facility which effectively locked the interest rate at 4.65%. The interest rate swap on the Bow was settled in June 2012.

Where appropriate, the REIT uses forward exchange contracts to lock-in foreign exchange rates. This strategy provides certainty in the foreign exchange rates on transactions that will occur in the future. The REIT has entered into forward exchange contracts with a Canadian chartered bank, which effectively locks in the REIT's rate of exchange for U.S. dollars into Canadian dollars.

SECTION III

SUMMARY OF QUARTERLY RESULTS

(in thousands of Canadian dollars)	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
Rentals from investment properties	\$230,496	\$213,861	\$204,660	\$186,286
Finance income	409	500	339	624
Net income	102,635	100,691	106,208	199,326
Total comprehensive income	109,488	72,061	116,218	196,094
	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Rentals from investment properties	\$178,174	\$169,582	\$155,861	\$153,294
Finance income	239	215	231	366
Net income	24,626	124,455	56,870	132,092
Total comprehensive income	13,708	149,382	54,073	126,903

Changes to the quarterly financial information are not reflective of seasonality or cyclicalities but generally from new property acquisitions, dispositions and changes in the fair value of real estate assets and liabilities. Revenues may also have significant

fluctuations due to recoveries from tenants for changes to property operating costs depending on when major maintenance projects are incurred.

SECTION IV

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Preparation of the Combined Financial Statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period.

Management believes the policies which are subject to greater estimation and judgement are outlined below. For a detailed description of these and other accounting policies refer to notes 1 and 2 of the Combined Financial Statements.

Use of Estimates

Information about assumption and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are:

- Fair value of real estate assets;
- Fair value of financial instruments; and
- Fair value of cash-settled unit-based compensation.

Use of Judgements

- Valuations of real estate assets

Investment properties and properties under development, which are carried on the combined statements of financial position at fair value, are valued by either qualified external valuation professionals or by management. The valuations are based on a number of assumptions, such as appropriate discount rates and capitalization rates and estimates of future rental income, operating expenses and capital expenditures. Valuation of real estate assets is one of the principal estimates and uncertainties of the REIT. Refer to note 4 of the Combined Financial Statements for further information on estimates and assumptions made in the determination of the fair value of real estate assets.

- Leases

The REIT's policy for property rental revenue recognition is described in note 2(g) of the Combined Financial Statements. The REIT makes judgements in determining whether certain leases, in particular those tenant leases with long contractual terms where the lessee is the sole tenant in a property and long-term ground leases where the REIT is the lessor, are operating or finance leases. The REIT has determined that all of its leases are operating leases.

- Tenant improvements

The REIT makes judgments with respect to whether tenant improvements provided in connection with a lease enhance the value of the leased property, which determines whether such amounts are capitalized to investment properties.

- Income Tax

The REIT currently qualifies as a real estate investment trust and a mutual fund trust for Canadian income tax purposes. A real estate investment trust will not be subject to the tax levied on "specified investment flow-through" ("SIFT") trusts provided it continues to meet prescribed conditions under the Tax Act relating to the nature of its assets and revenue (the "REIT Conditions") at all times throughout a taxation year. Accordingly, no provision for current or deferred income taxes has been recorded by the REIT at December 31, 2012 in respect of its Canadian entities

The REIT will not be subject to income tax in a year to the extent that it continues to qualify as a real estate investment trust and distributes all of its taxable income to its unitholders. Income allocated to unitholders will be taxed at the unitholder level. The

REIT currently distributes, and is required to distribute, all of its income to its unitholders. Accordingly, for financial statement reporting purposes, the tax deductibility of the REIT's distributions is treated as an exemption from taxation.

Deferred income taxes are recognized in respect of U.S. Holdco for the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that are expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. The effect on deferred income tax assets and liabilities of a change in tax rate is recognized in income or unitholders' equity, as appropriate, in the period that includes the date of enactment or substantive enactment. Deferred tax assets are recognized for all deductible temporary differences, unused tax credits and unused tax losses to the extent that it is probable that taxable profit will be available against which these tax benefits can be utilized.

DISCLOSURE CONTROLS AND PROCEDURES ("DC&P")

Each Trust's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") has designed, or caused to be designed under their direct supervision, the applicable Trusts' DC&P (as defined in National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings* ("NI 52-109"), adopted by the Canadian Securities Administrators) to provide reasonable assurance that: (i) material information relating to the applicable Trust, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the interim filings are being prepared; and (ii) material information required to be disclosed in the interim filings is recorded, processed, summarized and reported on a timely basis. The Combined Financial Statements and this MD&A were reviewed and approved by the REIT's Audit Committee and the Board of Trustees prior to this publication.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of each Trust has reviewed its internal control over financial reporting on an annual basis. No changes were made to the design of either Trust's internal control over financial reporting during the three months and year ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Trusts' internal control over financial reporting. Management has concluded that its internal controls over financial reporting are operating effectively for the year ended December 31, 2012.

Each Trust's management, including the CEO and CFO, does not expect that the applicable Trust's controls and procedures will prevent or detect all misstatements due to error or fraud. Due to the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute assurance, that all control issues and instances of fraud or error, if any, within the Trusts have been detected. The Trusts are continually evolving and enhancing its systems of controls and procedures.

SECTION V

RISKS AND UNCERTAINTIES

All real estate assets are subject to a degree of risk and uncertainty. They are affected by various factors including general market conditions and local market circumstances. An example of general market conditions would be the availability of long-term mortgage financing whereas local conditions would relate to factors affecting specific properties such as an oversupply of space or a reduction in demand for real estate in a particular area. Management attempts to manage these risks through geographic, type of asset and tenant diversification in the REIT's portfolio. The major risk factors are outlined below and in the REIT's Annual Information Form.

Credit Risk and Tenant Concentration

The REIT is exposed to credit risk as an owner of real estate in that tenants may become unable to pay the contracted rents. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on the significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties (office, industrial and retail) and acquires properties throughout Canada and the United States. In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, account for a significant portion of the cash flow. The only tenants which individually account for more than 5% of the rentals from investment properties of the REIT are Encana Corporation and Bell Canada. Both of these companies have a public debt rating that is rated with at least a BBB stable rating by a recognized rating agency.

Interest and Other Debt-Related Risk

The REIT has been able to leverage off the low interest rate environment that the Canadian economy has experienced in recent years which has enhanced its return to unitholders. A reversal of this trend, however, can significantly affect the business's ability to meet its financial obligations. In order to minimize this risk, the REIT negotiates fixed rate term debt with staggered maturities on the portfolio and attempts to match average lease maturity to average debt maturity. Derivative financial instruments may be utilized by the REIT in the management of its interest rate exposure. In addition, the REIT Declaration of Trust restricts total indebtedness permitted on the portfolio.

Construction Risks

It is likely that, subject to compliance with the REIT Declaration of Trust, the REIT will be involved in various development projects. The REIT's obligations in respect of properties under construction, or which are to be constructed, are subject to risks which include (i) the potential insolvency of a third party developer (where the REIT is not the developer); (ii) a third party developer's failure to use advanced funds in payment of construction costs; (iii) construction or other unforeseeable delays; (iv) cost overruns; (v) the failure of tenants to occupy and pay rent in accordance with existing lease agreements, some of which are conditional; (vi) the incurring of construction costs before ensuring rental revenues will be earned from the project; and (vii) increases in interest rates during the period of the development. See also "Development and Financing Risk relating to the Bow Development" below. Management strives to mitigate these risks where possible by entering into fixed price construction contracts with general contractors (and to the extent possible, on a bonded basis) and by attempting to obtain long-term financing as early as possible during construction.

Lease Rollover Risk

Lease rollover risk arises from the possibility that the REIT may experience difficulty renewing leases as they expire. Management attempts to enter into long-term leases to mitigate this risk. The leases for 19.5% of the REIT's total leasable area will expire in the next 5 years.

Currency Risk

The REIT is exposed to foreign exchange fluctuations as a result of ownership of assets in the United States and the rental income earned from these properties. In order to mitigate the risk, the REIT's debt on these properties is also held in U.S. dollars to act as a natural hedge.

The REIT is exposed to foreign exchange fluctuations as a result of the U.S. Holdco Notes being denominated in U.S. dollars.

Environmental Risk

As an owner and manager of real estate assets in Canada and the United States, the REIT is subject to various laws relating to environmental matters. These laws impose a liability for the cost of removal and remediation of certain hazardous materials released or deposited on properties owned by the REIT on or adjacent properties.

As required by the REIT Declaration of Trust and in accordance with best management practices, Phase 1 environmental audits are completed on all properties prior to acquisition. Further investigation is conducted if Phase 1 tests indicate a potential problem. The REIT has operating policies to monitor and manage risk. In addition, the standard lease utilized requires tenants to comply with environmental laws and regulations, and restricts tenants from carrying on environmentally hazardous activities or having environmentally hazardous substances on site.

Unit Prices

Publicly traded trust units will not necessarily trade at values determined solely by reference to the underlying value of trust assets. Accordingly, the Stapled Units may trade at a premium or a discount to the underlying value of the assets of the REIT and Finance Trust. Investors in Stapled Units will be subject to all of the risks of an investment in units of Finance Trust and of an investment in units of the REIT. Holders of Stapled Units should consult the December 31, 2012 management's discussion and analysis of Finance Trust and consider the risk factors stated therein. See also "Forward-Looking Disclaimer".

One of the factors that may influence the quoted price of the Stapled Units is the annual yield on the Stapled Units. Accordingly, an increase in market interest rates may lead investors in Stapled Units to demand a higher annual yield, which could adversely affect the quoted price of Stapled Units. In addition, the quoted price for Stapled Units may be affected by changes in general market

conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of the REIT and/or Finance Trust.

Availability of Cash for Distributions

As the monthly cash distribution paid by Finance Trust fluctuates, the monthly cash distribution paid by the REIT will also fluctuate in order to result in an aggregate monthly cash distribution as previously outlined. Although the REIT intends to make distributions of its available cash to unitholders in accordance with its distribution policy, these cash distributions may be reduced or suspended. The actual amount distributed by the REIT will depend on numerous factors including monthly cash distributions paid by Finance Trust, capital market conditions, the financial performance of the properties, the REIT's debt covenants and obligations, its working capital requirements, its future capital requirements, its development commitments and fluctuations in interest rates. Cash available to the REIT for distributions may be reduced from time to time because of items such as principal repayments on debt, tenant allowances, leasing commissions, capital expenditures or any other business needs that the trustees deem reasonable. The REIT may be required to use part of its debt capacity in order to accommodate any or all of the above items. The market value of Stapled Units may decline significantly if the REIT and/or Finance Trust suspends or reduces distributions. The REIT trustees retain the right to re-evaluate the distribution policy from time to time as they consider appropriate.

Ability to Access Capital Markets

As the REIT distributes a substantial portion of its income to unitholders, the REIT may need to obtain additional capital through capital markets and the REIT's ability to access the capital markets through equity issues and forms of secured or unsecured debt financing may affect the operations of the REIT as such financing may be available only on disadvantageous terms, if at all. If financing is not available on acceptable terms, further acquisitions or ongoing development projects may be curtailed and cash available for distributions or to fund future commitments may be adversely affected.

Tax Risk

Legislation amending the Tax Act to implement new provisions affecting the tax treatment of certain publicly traded trusts and partnerships became law on June 22, 2007 (referred to herein as the "SIFT Rules"). The SIFT Rules effectively tax certain income of a publicly traded trust or partnership that is distributed to its investors on the same basis as would have applied had the income been earned through a taxable corporation and distributed by way of dividend to its shareholders. The SIFT Rules apply only to "SIFT trusts", "SIFT partnerships" and their investors. A trust that meets the REIT Conditions throughout a taxation year will not be considered to be a SIFT trust in that year.

Management of the REIT intends to conduct the affairs of the REIT so that it satisfies the REIT Conditions at all times; however, as the REIT Conditions include complex revenue and asset tests, no assurances can be provided that the REIT will in fact so qualify at any time. The REIT expects to continue to qualify as a real estate investment trust; however, should it no longer qualify it would not be able to flow through its taxable income to unitholders and the REIT would be subject to tax.

The REIT operates in the United States through U.S. Holdco which is capitalized with equity provided by the REIT and debt in the form of U.S. Holdco Notes owed to Finance Trust and HRLP. As at December 31, 2012, U.S. Holdco owed \$161.5 million to Finance Trust and HRLP which is eliminated upon combination in Combined Financial Statements.

U.S. Holdco intends to treat the U.S. Holdco Notes as indebtedness for U.S. federal income tax purposes. If the Internal Revenue Service ("IRS") or a court were to determine that the U.S. Holdco Notes should be treated for U.S. federal income tax purposes as equity rather than debt, the interest on the notes could be treated as a dividend, and interest on the notes would not be deductible for U.S. federal income tax purposes. In addition, if the IRS were to determine that the interest rate on the U.S. Holdco Notes did not represent an arm's length rate, any excess amount over arm's length would not be deductible and could be recharacterized as a dividend payment instead of an interest payment. This would significantly increase the U.S. federal income tax liability of U.S. Holdco, potentially including the tax liability for prior years in which U.S. Holdco has claimed a deduction for interest paid on the U.S. Holdco Notes. In addition, U.S. Holdco could be subject to penalties. The increase in tax liability could materially adversely affect U.S. Holdco's ability to make interest payments on the U.S. Holdco Notes or the REIT's ability to make distribution on its units. Additionally, payments of interest on the U.S. Holdco Notes to non-U.S. holders of Stapled Units could be subject to withholding taxes.

To the extent that the REIT or a related party provided debt financing to U.S. Holdco (e.g., by acquiring U.S. Holdco Notes), in determining income for U.S. tax purposes, U.S. Holdco is subject to possible limitations on the deductibility of interest, if any, paid to the REIT. Section 163(j) of the U.S. Internal Revenue Code (the "Code") applies to defer U.S. Holdings' deduction of interest paid on

debt to the REIT in years that (i) the debt to equity ratio of U.S. Holdings exceeded 1.5:1, and (ii) the net interest expense exceeds an amount equal to 50% of its "adjusted taxable income" (generally, earnings before interest, taxes, depreciation, and amortization). The REIT intends to take the position that, due to the treatment of Finance Trust as a grantor trust that is disregarded for U.S. federal tax purposes, the interest paid to Finance Trust is treated as having been paid to the holders of the Finance Trust units and is therefore not subject to section 163(j). If section 163(j) applied to interest paid to Finance Trust, depending on the facts and circumstances and the availability of net operating losses to U.S. Holdco (which are subject to normal assessment by the IRS), the U.S. federal income tax liability of U.S. Holdings could increase. In such case, the amount of income available for distribution by the REIT to its unitholders could be reduced.

A foreign corporation will be classified as a passive foreign investment company ("PFIC") for United States federal income tax purposes if either (i) 75% or more of its gross income is passive income or (ii) on average for the taxable year, 50% or more of its assets (by value) produce or are held for the production of passive income. The properties of the REIT are managed by a third party rather than directly by its own employees. Although the REIT's officers and employees oversee the activities of the manager, it is likely that the REIT will be characterized as a PFIC for U.S. federal income tax purposes, though this conclusion is uncertain. In the absence of certain elections being made by a U.S. holder of REIT units, any distributions in respect of the REIT units which exceed 125% of the average amount of distributions in respect of such REIT units during the preceding three years, or, if shorter, during the preceding years in the U.S. holder's holding period ("excess distributions") and any gain on a sale or other disposition of the REIT units will be treated as ordinary income and will be subject to special tax rules, including an interest charge. U.S. holders should consult with their own tax advisors regarding the implications of these rules and the advisability of making one of the applicable PFIC elections, taking into account their particular circumstances.

In compliance with U.S. Treasury Department Circular 230, which provides rules governing certain conduct of U.S. tax advisors giving advice with respect to U.S. tax matters, please be aware that: (i) any U.S. federal tax advice contained herein is not intended to be used and cannot be used by the reader for the purpose of avoiding penalties that may be imposed under the Code; (ii) such advice was prepared in the expectation that it may be used in connection with the promotion or marketing (within the meaning of U.S. Treasury Department Circular 230) of Stapled Units; and (iii) prospective investors should seek advice based on their particular circumstances from an independent tax advisor.

On July 20, 2011, the Department of Finance announced proposed amendments to the provisions of the Tax Act concerning the income tax treatment of SIFTs, real estate investment trusts ("Real Estate Trusts") and publicly traded corporations, including changes impacting publicly traded stapled securities of such entities. Detailed draft legislation to enact these proposals and related explanatory notes were released by the government on July 25, 2012. In a publicly traded stapled structure involving a Real Estate Trust, the proposals would deny a deduction for payments made to the Real Estate Trust, or to a subsidiary of the Real Estate Trust. The Stapled Unit structure of the Trusts does not involve the kinds of payments that are stated to be the targets of the proposed amendments. In particular, the REIT does not receive interest or other income from Finance Trust and Finance Trust only receives income from a U.S. corporation which is a wholly-owned subsidiary of the REIT. The Trusts have reviewed the draft legislation and concluded that, while the draft legislation appears broader in scope than the proposals as originally announced, the proposals should not materially adversely affect the Trusts or the Stapled Units. The Trusts intend to continue to monitor developments relating to these proposals and their application.

Tax Consequences to U.S. Holders

Finance Trust qualifies as an investment trust that is classified as a grantor trust for U.S. federal income tax purposes under Treasury Regulation section 301.7701-4(c) (a "Fixed Investment Trust") and section 671 of the Code. In general, an investment trust will qualify as a Fixed Investment Trust if: (i) the trust has a single class of ownership interests, representing undivided beneficial interests in the assets of the trust; and (ii) there is no power under the trust agreement to vary the investment of the holders. If Finance Trust is a Fixed Investment Trust, then it will generally be disregarded for U.S. federal income tax purposes, with the result that the holders of Finance Trust units will be treated as owning directly their pro rata shares of all of the Finance Trust assets (i.e. primarily the U.S. Holdco Notes). Moreover, all payments made on the U.S. Holdco Notes will be treated as payments made directly to the holders of the Finance Trust units in proportion to their interest in Finance Trust.

Provided that Finance Trust qualifies as a Fixed Investment Trust and the U.S. Holdco Notes are respected as debt for U.S. federal income tax purposes, payments of principal and interest on the U.S. Holdco Notes that are attributable to U.S. holders will be treated as payments directly to the U.S. holders. Interest on the U.S. Holdco Notes will generally be taxable to U.S. holders as ordinary income at the time it is paid or accrued and will be subject to U.S. federal taxation at a maximum marginal rate of 35%. If the U.S. Holdco Notes were treated as equity rather than debt for U.S. federal income tax purposes, then the stated interest on the U.S. Holdco Notes would be treated as a distribution with respect to units.

Dilution

The number of units each of the Trusts is authorized to issue is unlimited. The trustees have the discretion to issue additional Stapled Units in certain circumstances, including under the REIT's Unit Option Plan. Any issuance of Stapled Units may have a dilutive effect on the investors of Stapled Units.

Unitholder Liability

Both the REIT and Finance Trust provide that unitholders will have no personal liability for actions of the Trusts and no recourse will be available to the private property of any unitholder for satisfaction of any obligation or claims arising out of a contract or obligation of a Trust. Each of the REIT and Finance Trust Declaration of Trust further provides that this lack of unitholder liability, where possible, must be provided for in certain written instruments signed by the applicable Trust. In addition, legislation has been enacted in the Provinces of Ontario and certain other provinces that is intended to provide unitholders in those provinces with limited liability. However, there remains a risk, which the Trusts consider to be remote in the circumstances, that a unitholder could be held personally liable for a Trust's obligations to the extent that claims are not satisfied out of the Trusts' assets. It is intended that the Trusts' affairs will be conducted to seek to minimize such risk wherever possible.

Redemption Right

Unitholders are entitled to have their units redeemed at any time on demand. It is anticipated that this redemption right will not be the primary mechanism for unitholders to liquidate their investments. The aggregate redemption price payable by the Trusts is subject to limitations. In certain circumstances, the REIT's Declaration of Trust provides for the *in specie* distributions of notes of H&R Portfolio LP Trust in the event of redemption of units of the REIT that are part of the Stapled Units. The notes which may be distributed *in specie* to unitholders in connection with a redemption will not be listed on any stock exchange, no established market is expected to develop for such notes and they may be subject to resale restrictions under applicable securities laws.

Debentures

The likelihood that purchasers of the 2016, 2017 and 2020 convertible debentures and the Series A, B, C, D, E and F Senior Debentures will receive payments owing to them under the terms of such debentures will depend on the financial health of the REIT and its creditworthiness. In addition, such debentures are unsecured obligations of the REIT and are subordinate in right of payment to all the REIT's existing and future senior indebtedness as defined in each such respective trust indenture. Therefore, if the REIT becomes bankrupt, liquidates its assets, reorganizes or enters into certain other transactions, the REIT's assets will be available to pay its obligations with respect to such debentures only after it has paid all of its senior indebtedness in full. There may be insufficient assets remaining following such payments to pay amounts due on any or all of the debentures then outstanding.

The debentures are also effectively subordinate to claims of creditors (including trade creditors) of the REIT's subsidiaries except to the extent the REIT is a creditor of such subsidiaries ranking at least *pari passu* with such other creditors. Finance Trust is a creditor of U.S. Holdco, a subsidiary of the REIT. A parent entity is entitled only to the residual equity of its subsidiaries after all debt obligations of its subsidiaries are discharged. In the event of bankruptcy, liquidation or reorganization of the REIT, holders of indebtedness of the REIT (including holders of the convertible debentures, may become subordinate to lenders to the subsidiaries of the REIT. The indentures governing such debentures do not prohibit or limit the ability of the REIT or its subsidiaries to incur additional debt or liabilities (including senior indebtedness), to amend and modify the ranking of any indebtedness or to make distributions, except, in respect of distributions, where an event of default has occurred and such default has not been cured or waived. The indentures do not contain any provision specifically intended to protect holders of debentures in the event of a future leveraged transaction involving the REIT.

OUTSTANDING UNIT DATA

The beneficial interests in each of the Trusts are represented by a single class of units of each Trust, respectively, which are unlimited in number. Each such unit carries a single vote at any meeting of unitholders of the respective Trust. As at March 4, 2013, there were 195,228,652 Stapled Units issued and outstanding (each comprised of a REIT unit and a Finance Trust unit).

As at December 31, 2012, the maximum number of units authorized to be granted under the REIT's Unit Option Plan was 18,000,000. Of this amount, 9,924,320 had been granted and 6,916,299 had been exercised and expired. As at March 4, 2013, there were 3,008,021 options to purchase Stapled Units outstanding of which 1,641,806 are fully vested.

The following table lists the principal outstanding balance of the REIT's convertible debentures as at March 4, 2013 and the number of Stapled Units required to convert the convertible debentures to equity:

Convertible Debentures	Principal outstanding as at March 4, 2013	Maximum number of Stapled Units issuable
2016 4.50% Debentures	\$75.0 million	2,918,287
2017 6.00% Debentures	168.1 million	8,845,000
2020 5.90% Debentures	99.7 million	4,240,595

SUBSEQUENT EVENTS

- (a) In January 2013, the REIT sold 1330 Martin Grove Ave., an industrial property in Toronto, ON for gross proceeds of approximately \$12.2 million.
- (b) In January 2013, the REIT sold 351 Passmore Ave., an industrial property in Scarborough, ON for gross proceeds of approximately \$8.3 million.
- (c) In February 2013, the REIT repaid a Canadian mortgage of approximately \$69.5 million bearing interest at a rate of 8.16%.
- (d) The REIT has entered into an amended and restated arrangement agreement with Finance Trust, Primaris Retail Real Estate Investment Trust ("Primaris") and PRR Investments Inc. to acquire all the property of Primaris remaining following the sale by Primaris of 18 properties to a consortium led by KingSett Capital and to become the sole unitholder of Primaris. In connection with the transaction, H&R expects to issue approximately 65.2 million stapled units for delivery to certain existing Primaris unitholders and the REIT expects to assume certain outstanding convertible debentures of Primaris. It is expected that the REIT will acquire 26 properties from Primaris with a fair value of \$3.1 billion along with assumed indebtedness of approximately \$1.4 billion. The transaction is subject to approval by the unitholders of the REIT, Finance Trust and Primaris at meetings to be held on March 22, 2013 as well as other customary closing conditions. Assuming all conditions to closing are satisfied or waived, closing is expected to occur in early April 2013.

ADDITIONAL INFORMATION

Additional information relating to the REIT and Finance Trust, including the REIT's Annual Information Form, is available on SEDAR at www.sedar.com.

Combined Financial Statements of

H&R REAL ESTATE INVESTMENT TRUST
and
H&R FINANCE TRUST

Years ended December 31, 2012 and 2011



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INDEPENDENT AUDITORS' REPORT

To the Trustees of H&R Real Estate Investment Trust

We have audited the accompanying combined financial statements of H&R Real Estate Investment Trust and H&R Finance Trust ("the Trusts"), which comprise the combined statements of financial position as at December 31, 2012 and 2011, the combined statements of comprehensive income (loss), 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 Combined Financial Statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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.



Page 2

Opinion

In our opinion, the combined financial statements present fairly, in all material respects, the combined financial position of the Trusts as at December 31, 2012 and 2011, and its combined financial performance and its combined cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw attention to note 3(b) in the combined financial statements which indicates that the Trusts have changed their accounting policy for recording real estate assets and now records them at fair value, including the reasons for, and effects of, the change on the combined financial statements.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a single horizontal line that starts under the 'K' and ends under the 'P'.

Chartered Accountants, Licensed Public Accountants

March 8, 2013
Toronto, Canada

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

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

	December 31 2012	December 31 2011 (note 3)	January 1 2011 (note 3)
Assets			
Real estate assets			
Investment properties (note 4)	\$ 9,807,062	\$ 7,210,997	\$ 5,502,809
Properties under development (notes 4 and 5)	128,220	1,721,743	1,445,352
	9,935,282	8,932,740	6,948,161
Mortgages and amount receivable	6,960	7,080	3,000
Assets classified as held for sale (note 6)	27,973	-	-
Other assets (note 7)	67,122	49,053	38,379
Cash and cash equivalents (note 8)	134,470	13,609	7,034
	\$ 10,171,807	\$ 9,002,482	\$ 6,996,574
Liabilities and Unitholders' Equity			
Liabilities			
Mortgages payable (note 9)	\$ 4,095,915	\$ 3,163,593	\$ 2,706,707
Debentures payable (note 10)	1,203,791	1,370,917	965,828
Exchangeable units (note 11)	131,045	126,695	105,652
Deferred tax liability (note 26)	43,407	-	-
Unit options payable (note 12(a))	10,585	8,640	3,409
Derivative instruments (note 13)	601	6,072	3,317
Bank indebtedness (notes 14)	2,905	440,173	89,045
Accounts payable and accrued liabilities (note 15)	176,546	175,849	170,544
	5,664,795	5,291,939	4,044,502
Unitholders' equity	4,507,012	3,710,543	2,952,072
Commitments and contingencies (note 27)			
Subsequent events (note 28)			
	\$ 10,171,807	\$ 9,002,482	\$ 6,996,574

See accompanying notes to the combined financial statements.

Approved by the Trustees:

“Robert Dickson” _____ Trustee

“Thomas J. Hofstedter” _____ Trustee

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Combined Statements of Comprehensive Income
(In thousands of Canadian dollars)

Years ended December 31, 2012 and 2011

	2012	2011 (note 3)
Property operating income:		
Rentals from investment properties (notes 17 and 25)	\$ 835,303	\$ 656,911
Property operating costs	(272,562)	(219,997)
	562,741	436,914
Finance costs:		
Finance income	1,872	1,051
Finance cost - operations (note 18)	(239,455)	(181,012)
Gain on extinguishment of debt (note 4)	10,151	9,310
Loss on change in fair value (note 19)	(7,736)	(108,378)
	(235,168)	(279,029)
Amortization of leasing expenses	(5,525)	(4,445)
Trust expenses	(15,220)	(15,366)
Fair value adjustment on real estate assets (note 4)	253,101	199,870
Loss on sale of real estate assets	(137)	(541)
Net gain (loss) on foreign exchange	(7,007)	3,738
Transaction costs on issuance of convertible debentures	-	(2,813)
Net income before income taxes	552,785	338,328
Income tax expense (note 26)	(43,925)	(285)
Net income	508,860	338,043
Other comprehensive income (loss) (note 16):		
Unrealized gain (loss) on translation of U.S. denominated foreign operations	(15,399)	5,638
Transfer of realized loss on cash flow hedges to net income	400	385
	(14,999)	6,023
Total comprehensive income all attributable to unitholders	\$ 493,861	\$ 344,066

See accompanying notes to the combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Combined Statements of Change in Unitholders' Equity
(In thousands of Canadian dollars)

Years ended December 31, 2012 and 2011

UNITHOLDERS' EQUITY	Value of Units	Accumulated net income	Accumulated distributions	Accumulated other comprehensive income (loss) (note 16)	Total
Unitholders' equity, December 31, 2010	\$ 2,224,803	\$ 1,223,775	\$ (1,485,024)	\$ (9,416)	\$ 1,954,138
Adjustment relating to changes in accounting policy (note 3)	-	1,004,413	-	(6,479)	997,934
Unitholders' equity, January 1, 2011	2,224,803	2,228,188	(1,485,024)	(15,895)	2,952,072
Proceeds from issuance of units	554,703	-	-	-	554,703
Issue cost	(22,465)	-	-	-	(22,465)
Net income	-	338,043	-	-	338,043
Distributions to unitholders (note 12(b))	-	-	(150,251)	-	(150,251)
Conversion of convertible debentures (note 10), net	32,418	-	-	-	32,418
Other comprehensive income	-	-	-	6,023	6,023
Unitholders' equity, December 31, 2011	2,789,459	2,566,231	(1,635,275)	(9,872)	3,710,543
Proceeds from issuance of units	218,687	-	-	-	218,687
Issue cost	(6,606)	-	-	-	(6,606)
Net income	-	508,860	-	-	508,860
Distributions to unitholders (note 12(b))	-	-	(215,479)	-	(215,479)
Conversion of convertible debentures (note 10), net	306,006	-	-	-	306,006
Other comprehensive loss	-	-	-	(14,999)	(14,999)
Unitholders' equity, December 31, 2012	\$ 3,307,546	\$ 3,075,091	\$ (1,850,754)	\$ (24,871)	\$ 4,507,012

See accompanying notes to the combined financial statements.

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

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

Years ended December 31, 2012 and 2011

	2012	2011
Cash provided by (used in):		
Operations:		
Net income	\$ 508,860	\$ 338,043
Items not affecting cash:		
Finance cost - operations (note 18)	239,455	181,012
Rent amortization of tenant inducements (note 17)	1,467	1,028
Amortization of leasing expenses	5,525	4,445
Net gain (loss) on foreign exchange	7,007	(3,746)
Fair value adjustment on real estate assets (note 4)	(253,101)	(199,870)
Loss on sale of real estate assets	137	541
(Gain) loss on change in fair value	(6,205)	108,378
(Gain) loss on extinguishment of debt (note 4)	(10,151)	(9,310)
Unit-based compensation (note 12(a))	6,122	7,600
Deferred tax liability (note 26)	43,407	-
Change in other non-cash operating items (note 20)	8,831	(23,553)
	551,354	404,568
Investing:		
Properties under development	(173,353)	(292,007)
Investment properties:		
Net proceeds on disposition of real estate assets	48,443	12,078
Acquisitions (note 4)	(730,253)	(1,123,537)
Capital expenditures (note 4)	(19,963)	(11,259)
Leasing expenses and tenant inducements	(14,231)	(9,890)
Mortgages receivable	-	(4,080)
Restricted cash (note 7)	(18,237)	692
	(907,594)	(1,428,003)
Financing:		
Bank indebtedness	(437,268)	351,128
Interest paid	(283,418)	(220,174)
Mortgages payable:		
New mortgages payable	1,458,033	347,956
Principal repayments	(388,583)	(175,201)
Proceeds from issuance of debentures payable	173,389	351,985
Redemption of debentures (note 10)	(31,088)	-
Proceeds from issuance of units, net	150,848	493,730
Finance cost - exchangeable unit distributions (note 18)	(6,389)	(5,302)
Distributions to unitholders (note 12(b))	(158,423)	(114,112)
	477,101	1,030,010
Increase in cash and cash equivalents	120,861	6,575
Cash and cash equivalents, beginning of year (note 8)	13,609	7,034
Cash and cash equivalents, end of year (note 8)	\$ 134,470	\$ 13,609

Supplemental cash flow information (note 20).

See accompanying notes to the combined financial statements.

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These combined financial statements include the accounts of H&R Real Estate Investment Trust (the "REIT") and H&R Finance Trust ("Finance Trust"). These combined financial statements are presented as supplementary information to the financial statements of the REIT and Finance Trust (collectively, the "Trusts"), all of which are filed on SEDAR.

The REIT is an unincorporated open-ended trust and Finance Trust is an unincorporated investment trust both domiciled in Canada. The REIT owns, operates and develops commercial properties across Canada and in the United States. The principal office and centre of administration of the Trusts is located at 3625 Dufferin Street, Suite 500, Toronto, Ontario M3K 1N4. Unitholders of each Trust participate pro rata in distributions of income and, in the event of termination of a Trust, participate pro rata in the net assets remaining after satisfaction of all liabilities of such Trust.

The combined financial statements are a result of the REIT's completion of an internal reorganization on October 1, 2008, pursuant to a Plan of Arrangement (the "Plan of Arrangement") as described in the REIT's information circular dated August 20, 2008, resulting in the stapling of the Trusts' units. The Plan of Arrangement resulted in, among other things, the creation on October 1, 2008 of Finance Trust. Each unitholder received, for each REIT unit held, a unit of Finance Trust. Each issued and outstanding Finance Trust unit is stapled to a unit of the REIT on a one-for-one basis so as to form stapled units ("Stapled Units"), and such Stapled Units are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol HR.UN. The units of each of the Trusts may only be transferred together as Stapled Units unless an event of "uncoupling" has occurred.

The presentation of combined financial statements of the Trusts is useful to the unitholders on the following basis:

- The units of the Trusts are stapled (as noted above), resulting in the two Trusts being under common ownership;
- A support agreement between the Trusts ensures that until such time as an event of "uncoupling" occurs, when units are issued by the REIT, units must also be issued by Finance Trust simultaneously so as to maintain the stapled unit structure;
- The sole activity of Finance Trust is to provide capital funding to H&R REIT (U.S.) Holdings Inc. ("U.S. Holdco"), a wholly owned U.S. subsidiary of the REIT; and
- The investment activities of Finance Trust are restricted in its Declaration of Trust to providing such funding to U.S. Holdco and to make temporary investments of excess funds.

1. Basis of preparation:

(a) Statement of compliance

These combined financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB") and using accounting policies described herein.

The combined financial statements were approved by the Board of Trustees on March 8, 2013.

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1. Basis of preparation (continued):

(b) Basis of measurement

The combined financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position which have been measured at fair value:

- (i) Real estate assets;
- (ii) Derivative financial instruments;
- (iii) Liabilities for cash-settled unit-based compensation; and
- (iv) Financial instruments at fair value through net income (loss).

(c) Functional currency and presentation

These combined financial statements are presented in Canadian dollars, which is the Trusts' functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand.

The Trusts present its combined statement of financial position based on the liquidity method, where all assets and liabilities are presented in ascending order of liquidity.

(d) Use of estimates and judgements

The preparation of these combined financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies, the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates.

(i) Use of estimates

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

- Fair value of real estate assets;
- Fair value of financial instruments; and
- Fair value of cash-settled unit-based compensation.

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1. Basis of preparation (continued):

(ii) Use of judgements

The critical judgements made in applying accounting policies that have the most significant effect on the amounts recognized in these combined financial statements are as follows:

- Valuations of real estate assets

Investment properties and properties under development, which are carried on the combined statements of financial position at fair value, are valued by either qualified external valuation professionals or by management. The valuations are based on a number of assumptions, such as appropriate discount rates and capitalization rates and estimates of future rental income, operating expenses and capital expenditures. Valuation of real estate assets is one of the principal estimates and uncertainties of these combined financial statements. Refer to note 4 for further information on estimates and assumptions made in the determination of the fair value of real estate assets.

- Leases

The REIT makes judgements in determining whether certain leases, in particular those tenant leases with long contractual terms and long-term ground leases where the REIT is the lessor, are operating or finance leases. The REIT has determined that all of its leases are operating leases.

- Income taxes

The REIT is a mutual fund trust and a real estate investment trust pursuant to the Income Tax Act (Canada) ("Tax Act"). Under current tax legislation, the REIT is not liable to pay Canadian income tax provided that its taxable income is fully distributed to unitholders each year. The REIT is a real estate investment trust if it meets prescribed conditions under the Tax Act relating to the nature of its assets and revenue (the "REIT Conditions"). The REIT has reviewed the REIT Conditions and has assessed its interpretation and application to the REIT's assets and revenue, and it has determined that it qualifies as a real estate investment trust pursuant to the Tax Act. The REIT expects to continue to qualify as a real estate investment trust; however, should it no longer qualify it would not be able to flow through its taxable income to unitholders and the REIT would be subject to tax.

- Tenant improvements

The REIT makes judgments with respect to whether tenant improvements provided in connection with a lease enhance the value of the leased property, which determines whether such amounts are capitalized to investment properties.

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2. Significant accounting policies:

The accounting policies set out below have been applied consistently for all periods presented in these combined financial statements.

(a) *Basis of combination*

The principles used to prepare combined financial statements are similar to those used to prepare consolidated financial statements. The combined financial statements include the assets, liabilities, unitholders' equity, comprehensive income (loss) and operating results of the Trusts, after elimination of the following:

- (i) the REIT's notes payable to Finance Trust; and
- (ii) the REIT's interest expense and Finance Trust's interest income from the notes payable to Finance Trust.

The foreign exchange gain (loss) recorded in net income as a result of exchanging Finance Trust's U.S. dollar note receivable from U.S. Holdco is not eliminated on combination as U.S. Holdco is a U.S. denominated foreign operation of the REIT, which results in the foreign exchange on the note payable being reported in accumulated other comprehensive income.

The combination of the Trusts does not result in the elimination of the equity of Finance Trust as neither of the Trusts hold any interest in the other. The equity of the Trusts is presented by way of combining the two together.

(b) *Basis of consolidation*

These combined financial statements include the accounts of all entities in which the REIT holds a controlling interest. The REIT carries out a portion of its activities through co-ownership agreements and records its proportionate share of assets, liabilities, revenues, expenses and cash flows of all co-ownerships in which it participates. All material intercompany transactions and balances have been eliminated upon consolidation.

(c) *Investment properties*

Investment properties are 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 commercial properties are investment properties which are measured at fair value.

The REIT performs an assessment of each investment property acquired to determine whether the acquisition is to be accounted for as an asset acquisition or a business combination. A transaction is considered to be a business combination if the acquired property meets the definition of a business: being an integrated set of activities and assets that are capable of being managed for the purpose of providing a return to the unitholders. The REIT expenses transaction costs on business combinations and capitalizes transaction costs on asset acquisitions.

Upon acquisition, 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 each reporting date. The related gain or loss in fair value is recognized in net income in the year in which it arises.

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2. Significant accounting policies (continued):

Subsequent capital expenditures are charged to investment properties only when it is probable that future economic benefits of the expenditure will flow to the REIT and the cost can be measured reliably.

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

(d) *Properties under development:*

Properties under development for future use as investment property are accounted for as investment property under IAS 40, *Investment Property*. Costs eligible for capitalization to properties under development are initially recorded at cost, and subsequent to initial recognition are accounted for using the fair value method. At each reporting date, the properties under development are recorded at fair value based on available market evidence. The related gain or loss in fair value is recognized in net income in the year in which it arises.

The cost of properties under development includes direct development costs, realty taxes and borrowing costs that are directly attributable to the development. Borrowing costs associated with direct expenditures on properties under development are capitalized. Borrowing costs relating to the purchase of a site or property acquired for redevelopment are also capitalized. The amount of borrowing costs capitalized is determined first by reference to borrowing specific to the project, where relevant, and otherwise by applying a weighted average cost of borrowings to eligible expenditures after adjusting for borrowings associated with other specific developments. Borrowing costs are capitalized from the commencement of the development until the date of practical completion. The capitalization of borrowing costs is suspended if there are prolonged periods when development activity is interrupted.

Upon practical completion of a development, the development property is transferred to investment properties at the fair value on the date of practical completion. The REIT considers practical completion to have occurred when the property is capable of operating in the manner intended by management. Generally this occurs upon completion of construction and receipt of all necessary occupancy and other material permits. Where the REIT has pre-leased space as of or prior to the start of the development and the lease requires the REIT to construct tenant improvements which enhance the value of the property, practical completion is considered to occur on completion of such improvements.

(e) *Assets held for sale and discontinued operations*

Non-current assets comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. For this purpose, a sale is highly probable if management is committed to a plan to achieve the sale; there is an active program to find a buyer; the non-current asset is being actively marketed at a reasonable price; the sale is anticipated to be completed within one year from the date of classification; and it is unlikely there will be changes to the plan.

In accordance with IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, investment properties that constitute a component of the REIT that has either been disposed of or are classified as held for sale are presented as discontinued operations in all periods presented if the property operations are expected to be eliminated and the REIT will not have significant continuing involvement following the disposition. A component of the REIT will generally represent a major line of business or geographical area of operation.

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2. Significant accounting policies (continued):

(f) *Amortization*

Leasing costs, such as commissions and tenant inducements, are deferred and amortized on a straight-line basis over the terms of the related leases.

(g) *Revenue recognition:*

The REIT retains substantially all of the benefits and risks of ownership of its investment properties and therefore, accounts for its leases with tenants as operating leases. Rentals from investment properties include all amounts earned from tenants, including recovery of operating costs.

Rental revenue from investment property is recognized in net income (loss) on a straight-line basis over the term of the related lease. The difference between the rental revenue recognized and the amounts contractually due under the lease agreements is recorded in accrued rent receivable. Lease incentives granted are recognized as an integral part of total rental income over the term of the lease.

(h) *Income taxes:*

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net income (loss) except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income (loss).

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

The REIT is a mutual fund trust and a real estate investment trust pursuant to the Tax Act. Under current tax legislation, a real estate investment trust is entitled to deduct distributions of taxable income such that it is not liable to pay income tax provided that its taxable income is fully distributed to unitholders. The REIT intends to continue to qualify as a real estate investment trust and to make distributions not less than the amount necessary to ensure that the REIT will not be liable to pay income taxes.

The REIT qualified as a real estate investment trust throughout 2012 and the 2011 comparative year. 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 net income (loss), and differences relating to investments in subsidiaries and jointly controlled entities 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. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, if such entities intend to settle current tax liabilities and assets on a net basis or the entities tax assets and liabilities will be realized simultaneously.

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.

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2. Significant accounting policies (continued):

Finance Trust qualifies as a mutual fund trust that is not a specified investment flow-through trust under the Tax Act. In accordance with the terms of Finance Trust's Declaration of Trust, all of the net income for tax purposes will be paid or be payable to unitholders in the taxation year so that no income tax is payable by Finance Trust. For financial statement reporting purposes, the tax deductibility of Finance Trust's distributions is treated as an exemption from taxation as Finance Trust has distributed and is committed to continue distributing all of its taxable income to its unitholders.

(i) *Unit option plan:*

The REIT has a unit option plan available for REIT trustees, officers, employees or consultants as disclosed in note 12(a). The unit option plan is considered to be a cash-settled liability under IFRS 2, *Share-based Payment* and as a result is measured at each reporting period and at settlement date at its fair value as defined by IFRS. The fair value of the amount payable to participants in respect of the unit option plan is recognized as an expense with a corresponding increase or decrease in liabilities, over the period that the employees unconditionally become entitled to payment. Any change in the fair value of the liability is recognized as a component of trust expenses.

(j) *Cash and cash equivalents:*

Cash and cash equivalents include deposits in banks, certificates of deposit and short-term investments with original maturities of less than 90 days.

(k) *Restricted cash:*

Restricted cash includes amounts held in reserve by lenders to fund mortgage payments, repairs and capital expenditures or property tax payments.

(l) *Foreign currency translation:*

The REIT accounts for its investments in U.S. Holdco, a wholly owned subsidiary of the REIT, in the United States ("foreign operations") as a U.S. denominated foreign operation. Assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rates in effect at the balance sheet dates and revenue and expenses are translated at the average exchange rates for the reporting periods.

The foreign currency translation adjustment is recorded as a separate component of accumulated other comprehensive income (loss) until there is a reduction in the REIT's net investment in the foreign operations. The U.S. dollar denominated bank indebtedness is designated as a hedge of the REIT's investment in self-sustaining operations. Accordingly, the accumulated unrealized gains or losses arising from the translation of this obligation are recorded as a foreign currency translation adjustment in accumulated other comprehensive income (loss).

Finance Trust's U.S. dollar denominated assets and liabilities are translated into Canadian dollars at the exchange rates in effect on the balance sheet date and revenue and expenses are translated at the actual exchange rate on the date incurred, resulting in any gain (loss) recorded in comprehensive income.

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2. Significant accounting policies (continued):

(m) *Financial instruments:*

(i) Non-derivative financial assets

Cash and cash equivalents, restricted cash, accounts receivable and mortgages and amounts receivable are non-derivative financial assets classified as loans and receivables with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

The Trusts derecognize a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Trusts have a current legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

(ii) Non-derivative financial liabilities

Non-derivative financial liabilities consist of mortgages payable, senior debentures, bank indebtedness and accounts payable and accrued liabilities. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method.

The Trusts derecognize a financial liability when its contractual obligations are discharged or cancelled or expire.

(iii) Derivative financial instruments

The REIT holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Derivatives are recognized initially at fair value; attributable transaction costs are recognized in net income (loss) as incurred. Subsequent to initial recognition, derivatives are measured at fair value at the end of each reporting period. Any resulting gain or loss is recognized in net income (loss) immediately unless the derivative is designated and effective as a hedging instrument. None of the REIT's derivative instruments are accounted for as hedges.

(iv) Financial liabilities measured at fair value through net income (loss)

A financial liability is classified at fair value through net income (loss) if it is classified as held for trading or is designated as such upon initial recognition.

The convertible debentures, Class B LP units of H&R Portfolio Limited Partnership ("HRLP"), a subsidiary partnership of the REIT and unit options payable, were designated at fair value through net income (loss) upon initial recognition. Any gains or losses arising on remeasurement are recognized in net income (loss).

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2. Significant accounting policies (continued):

(n) *Stapled Units:*

Under IAS 32, *Financial Instruments: Presentation* ("IAS 32"), puttable instruments, such as the Stapled Units are generally classified as financial liabilities unless the exemption criteria are met for equity classification. As a result of the REIT receiving consent of its unitholders to modify the REIT's Declaration of Trust to eliminate the mandatory distribution and leave distributions to the discretion of the trustees and the ability of the trustees to fund distributions by way of issuing additional units prior to the amendment, the REIT met the exemption criteria under IAS 32 for equity classification. Finance Trust also met the exemption criteria under IAS 32 for equity classification. Nevertheless, the Stapled Units are not considered ordinary units under IAS 33, *Earnings Per Share*, and therefore an income (loss) per unit calculation is not presented.

(o) *Finance costs:*

Finance costs are comprised of interest expense on borrowings, distributions on Class B LP units of HRLP classified as liabilities, gain (loss) on change in fair value of convertible debentures, gain (loss) on change in fair value of Class B LP units of HRLP, gain (loss) on derivative instruments and gain (loss) on extinguishment of debt.

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

(p) *New standards and interpretations not yet adopted:*

Standards issued but not yet effective up to the date of issuance of these financial statements are described below. The Trusts intend to adopt these standards when they become effective.

Financial Instruments: Classification and Measurement ("IFRS 9")

IFRS 9 as issued reflects the IASB's work to date on the replacement of IAS 39, *Financial Instruments - Recognition and Measurement* ("IAS 39"), and applies to classification and measurement of financial assets as defined in IAS 39. The approach to classifying an asset as either amortized cost or fair value in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of its financial assets. The standard is effective for annual periods beginning on or after January 1, 2015. In subsequent phases, the IASB will address hedge accounting and impairment. The Trusts have not yet determined the impact of IFRS 9 on its combined financial statements.

Consolidated Financial Statements ("IFRS 10")

The IASB recently issued its new suite of consolidation standards, including IFRS 10, which replaces IAS 27, *Consolidated and Separate Financial Statements*. IFRS 10 defines the principle of control over an investee when: (i) it is exposed or has rights to variable returns from its involvement with that investee; (ii) it has the ability to affect those returns through its power over that investee; and (iii) there is a link between such power and returns. This standard is effective for annual periods beginning on or after January 1, 2013. The Trusts have not yet determined the impact of IFRS 10 on its combined financial statements.

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2. Significant accounting policies (continued):

Joint Arrangements ("IFRS 11")

On May 12, 2011, the IASB issued IFRS 11. This new standard replaces IAS 31, *Interests in Joint Ventures*. The new standard eliminates the option to proportionately consolidate interests in certain types of joint ventures. This may impact the jointly controlled entities which the Trusts currently proportionately consolidate under IFRS. The new standard is not expected to have an impact on unitholders' equity or net income going forward but is expected to have a presentation impact on the financial statements. This new standard is effective for the Trusts' year end beginning January 1, 2013.

Disclosures of Interests in Other Entities ("IFRS 12")

The IASB issued IFRS 12 to replace the existing disclosure requirements for entities that have interests in subsidiaries, joint arrangements and associates. This standard also contains disclosure requirements for entities that have interests in unconsolidated structured entities. The disclosures aim to provide information in order to enable users to evaluate the nature of, and the risks associated with, an entity's interest in other entities, and the effects of those interests on the entity's financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013. The Trusts have not yet determined the impact of IFRS 12 on its combined financial statements.

3. Change in accounting policies:

- (a) In May 2011, the IASB issued IFRS 13, *Fair Value Measurement*. This new standard replaces the fair value measurement contained in individual IFRS with a single source of fair value measurement guidance. The standard defines fair value as 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 standard also establishes a framework for measuring fair value and requires a fair value hierarchy to be applied to all fair value measurements and expands disclosure requirements for fair value measurements to provide information which allows users to assess the methods and inputs used to develop fair value measurements. The Trusts have early adopted this standard beginning January 1, 2012 on a prospective basis. The significant impact of this change will be to use, at the time of measurement, the quoted prices of financial instruments, if readily available, as compared to using the bid or ask prices which were used in the comparative period.
- (b) The REIT has elected to record investment properties at fair value. This change in accounting policy has been applied on a retrospective basis.

The REIT no longer depreciates investment properties but continues to amortize deferred leasing expenses and tenant inducements. Additionally, accrued rent receivable is no longer recorded as a separate asset as it is considered to be implicit in the fair value of real estate assets.

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3. Change in accounting policies (continued):

The impact of the REIT retrospectively applying these accounting policies are as follows:

Statement of Financial Position:

	December 31, 2011	January 1, 2011
Impact of adjustment (increase/(decrease))		
Investment properties	\$ 1,416,498	\$ 977,851
Properties under development	104,686	177,021
Accrued rent receivable	(156,503)	(156,938)
Assets	\$ 1,364,681	\$ 997,934
Opening accumulated net earnings as at January 1, 2011	\$ 1,004,413	\$ 1,004,413
Opening accumulated other comprehensive loss as at January 1, 2011	(6,479)	(6,479)
Net earnings for the year ended December 31, 2011	363,320	-
Other comprehensive income for the year ended December 31, 2011	3,427	-
Liabilities and Unitholders' equity	\$ 1,364,681	\$ 997,934

Statement of Comprehensive Income:

	Year ended December 31, 2011
Impact of adjustment on net income	
Gain on extinguishment of debt	(10,416)
Fair value adjustment on real estate assets	199,870
Loss on foreign exchange	355
Depreciation and amortization	177,312
Gain on sale of investment properties	(3,801)
Net income	\$ 363,320

Statement of Cash Flows:

The adjustments noted above have also been made to the combined statement of cash flows for the same period. This change in accounting policy did not result in other significant changes to the combined statement of cash flows.

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4. Real estate assets:

	Properties Under Development 2012	Investment Properties 2012	Properties Under Development 2011	Investment Properties 2011
Opening balance, beginning of year	\$ 1,721,743	\$ 7,210,997	\$ 1,445,352	\$ 5,502,809
Acquisitions of investment properties, including transaction costs	-	737,426	-	1,443,290
Additions to existing investment properties:				
Capital expenditures	-	19,963	-	11,259
Direct leasing costs	-	14,231	-	9,383
Capital lease	-	-	-	2,785
Additions to properties under development	196,288	-	348,726	-
Dispositions	(17,824)	(133,153)	-	(72,934)
Transfer of investment properties held for sale (note 6)	-	(27,800)	-	-
Amortization of leasing costs, straight-line rents and blend and extend rents included in revenue	29,673	(4,719)	-	(6,196)
Transfer of property under development that has reached practical completion	(1,747,966)	1,747,966	-	-
Change in foreign exchange	-	(64,644)	-	48,396
Fair value adjustment on real estate assets	(53,694)	306,795	(72,335)	272,205
Closing balance, end of year	\$ 128,220	\$ 9,807,062	\$ 1,721,743	\$ 7,210,997

Legal title to each of the properties in the United States is held by a separate legal entity which is 100% owned, directly or indirectly, by U.S. Holdco, a wholly owned subsidiary of the REIT. The assets of each such separate legal entity are not available to satisfy the debts or obligations of any other person or entity. Each such separate legal entity maintains separate books and records. The identity of the owner of a particular United States property is available from U.S. Holdco. This structure does not prevent distributions to the entity owners provided there are no conditions of default.

During the year ended December 31, 2012, the lenders to two U.S. investment properties (December 31, 2011 - five properties) previously occupied by the bankrupt tenant Great Atlantic & Pacific Tea Company (December 31, 2011 - Bruno's Supermarkets LLC and Boscov's Department Store) accepted title to such respective investment properties, thereby releasing the REIT from any further obligation with respect to the mortgages on such properties. The REIT recorded a gain on the extinguishment of this debt of \$10,151 for the year ended December 31, 2012 (December 31, 2011 - \$9,310).

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4. Real estate assets (continued):

Acquisitions:

During the year ended December 31, 2012, the REIT acquired 12 investment properties (December 31, 2011 - 11 investment properties). The results of operations for these acquisitions are included in these combined financial statements from the date of acquisition.

The following table summarizes the cost plus transaction costs of the assets and liabilities as at the respective dates of acquisition:

	2012	2011
Assets		
Investment properties	\$ 735,745	\$ 1,442,914
Liabilities		
Mortgages payable, net of mark to market adjustments	7,173	319,753
Total identifiable net assets settled by cash	\$ 728,572	\$ 1,123,161

During the year ended December 31, 2012, the REIT incurred additional costs of \$1,681 (December 31, 2011 - \$376) in respect to prior year acquisitions which are not included in the above table.

Fair value disclosure:

The estimated fair values of the REIT's investment properties and properties under development are based on the following methods and key assumptions:

- (i) Consideration of recent sales of similar properties within similar market areas;
- (ii) The discounted cash flow analysis which is based upon, among other things, rental income from current leases and assumptions about rental income from future leases reflecting market conditions at each reporting period, less future cash outflows in respect of such leases discounted generally over a term of ten years;
- (iii) The direct capitalization method which is based on the conversion of current earnings directly into an expression of fair value. The normalized net income for the year is divided by an overall capitalization rate; and
- (iv) The use of external independent appraisers. During the year ended December 31, 2012, certain properties were valued by professional external independent appraisers. These properties make up 42.6% of the portfolio as at December 31, 2012 (December 31, 2011 – 38.9%). The remainder of the portfolio is valued by the REIT's internal valuation team.

The REIT utilizes external industry sources to determine a range of capitalization and discount rates. To the extent that the externally provided capitalization and discount rates ranges change from one reporting period to the next, the fair value of the investment properties would increase or decrease accordingly.

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4. Real estate assets (continued):

The REIT has utilized the following weighted average capitalization and discount rates in estimating the fair value of the investment properties (excluding properties under development):

	Overall Capitalization Rate				Discount Rate			Terminal Capitalization Rate		
	Range	Canada	United		Canada	United		Canada	United	
			States	Total		States	Total		States	Total
December 31, 2012	5.00%-9.25%	5.85%	6.73%	6.05%	6.67%	7.59%	6.88%	6.18%	7.22%	6.41%
December 31, 2011	5.75% -9.50%	6.55%	6.99%	6.68%	7.42%	7.72%	7.51%	6.90%	7.33%	7.03%
January 1, 2011	6.25% -10.00%	6.98%	7.89%	7.17%	7.85%	8.45%	7.97%	7.36%	8.22%	7.54%

5. Properties under development:

Project	Address	December 31	December 31
		2012	2011
The Bow *	5th Ave. at Centre Street, Calgary, AB (a)	\$ -	\$ 1,583,803
Heart Lake	Mayfield West Business Park, Caledon, ON	76,650	87,954
Airport Road	7900 Airport Road, Brampton, ON	51,570	49,986
		\$ 128,220	\$ 1,721,743

* See note 27(a).

(a) The Bow was transferred to investment properties on December 31, 2012 as it had reached practical completion.

6. Assets classified as held for sale:

As at December 31, 2012, there were two properties held for sale; 1330 Martin Grove Ave., Toronto, ON and 295 The West Mall, Etobicoke, ON (December 31, 2011 - nil).

The following table sets forth the balance sheet items associated with investment properties classified as held for sale:

	2012	2011
Assets		
Investment properties	\$ 27,800	\$ -
Other assets:		
Accounts receivable	106	-
Prepaid expenses and sundry assets	67	-
	\$ 27,973	\$ -

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7. Other assets:

	December 31 2012	December 31 2011
Current:		
Restricted cash*	\$ 40,347	\$ 22,110
Accounts receivable	16,772	12,711
Prepaid expenses and sundry assets	8,324	12,959
Derivative instruments (note 13)	1,679	1,273
	\$ 67,122	\$ 49,053

* Included in restricted cash are bank term deposits of \$4,000 (December 31, 2011 - \$8,395) at a rate of interest of 1.00% (December 31, 2011 - 0.90% to 1.03%).

8. Cash and cash equivalents:

Cash and cash equivalents at December 31, 2012 includes cash on hand of \$84,152 (December 31, 2011 - \$13,358) and bank term deposits of \$50,318 (December 31, 2011 - \$251) at a rate of interest of 0.91% (December 31, 2011 - 0.75%).

9. Mortgages payable:

The mortgages payable are secured by real estate assets and letters of credit in certain cases, bearing fixed interest with a contractual weighted average rate of 5.13% (December 31, 2011 - 5.89%) per annum and maturing between 2013 and 2035. Included in mortgages payable at December 31, 2012 are U.S. dollar denominated mortgages of U.S. \$1,282,436 (December 31, 2011 - U.S. \$1,125,656). The Canadian equivalents of these amounts are \$1,269,612 (December 31, 2011 - \$1,148,169).

Debt related to certain Canadian properties is held by separate legal entities, where the rent received from each property is first used to satisfy the related debt obligations with any balance then available to satisfy the cash flow requirements of the REIT.

Future principal mortgage payments are as follows:

Years ending December 31:	
2013	\$ 233,717
2014	317,904
2015	352,366
2016	422,911
2017	469,341
Thereafter	2,307,039
	4,103,278
Financing costs and mark-to-market adjustment arising on acquisitions	(7,363)
	\$ 4,095,915

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10. Debentures payable:

The full terms of the debentures are contained in the public offering documents; the following table summarizes the key terms:

					December 31	December 31	
					2012	2011	
	Maturity	Contractual interest rate	Effective interest rate	Conversion price	Face value	Carrying value	Carrying value
Convertible Debentures (a)							
2013 Convertible Debentures (HR.DB)	*	6.65%	6.65%	\$ 23.11	\$ -	\$ -	\$ 126,218
2014 Convertible Debentures (HR.DB.B)	**	6.75%	6.75%	\$ 14.00	-	-	214,393
2017 Convertible Debentures (HR.DB.C)	June 30, 2017	6.00%	6.00%	\$ 19.00	168,287	213,304	210,640
2020 Convertible Debentures (HR.DB.D)	June 30, 2020	5.90%	5.90%	\$ 23.50	99,679	109,896	112,989
2016 Convertible Debentures (HR.DB.E)	December 31, 2016	4.50%	4.50%	\$ 25.70	75,000	77,250	78,000
					342,966	400,450	742,240
Senior Debentures (b)							
Series A Senior Debentures	February 3, 2015	5.20%	5.40%	-	115,000	114,548	114,346
Series B Senior Debentures	February 3, 2017	5.90%	6.06%	-	115,000	114,343	114,204
Series C Senior Debentures	December 1, 2018	5.00%	5.30%	-	125,000	123,138	122,860
Series D Senior Debentures	July 27, 2016	4.78%	4.96%	-	180,000	178,984	178,718
Series E Senior Debentures	February 2, 2018	4.90%	5.22%	-	100,000	98,757	98,549
Series F Senior Debentures	March 2, 2020	4.45%	4.63%	-	175,000	173,571	-
					810,000	803,341	628,677
					\$1,152,966	\$1,203,791	\$1,370,917

The carrying value of the Convertible Debentures (as defined below) is determined using the quoted price on December 31, 2012 and December 31, 2011.

* In July 2012, the REIT redeemed all of the remaining outstanding 2013 Convertible Debentures for a total cash payment of \$29,791.

** In July 2012, the REIT redeemed all of the remaining outstanding 2014 Convertible Debentures for a total cash payment of \$1,297.

(a) *2017 Convertible Debentures, 2020 Convertible Debentures and 2016 Convertible Debentures (collectively, the "Convertible Debentures"):*

In December 2009, the REIT completed a public offering of \$175,000 Series C convertible unsecured subordinated debentures (the "2017 Convertible Debentures"). The 2017 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2013. Thereafter, but prior to June 30, 2015, the 2017 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2015 and prior to the maturity date, the 2017 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest.

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10. Debentures payable (continued):

In July 2010, the REIT completed a public offering of \$100,000 Series D convertible unsecured subordinated debentures (the "2020 Convertible Debentures"). The 2020 Convertible Debentures may not be redeemed by the REIT on or before June 30, 2014. Thereafter, but prior to June 30, 2016, the 2020 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after June 30, 2016 and prior to the maturity date, the 2020 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest.

In November 2011, the REIT completed a public offering of \$75,000 Series E convertible unsecured subordinated debentures (the "2016 Convertible Debentures"). The 2016 Convertible Debentures may not be redeemed by the REIT on or before November 30, 2014. Thereafter, but prior to November 30, 2015, the 2016 Convertible Debentures may be redeemed, in whole or in part, only if the current market price of a Stapled Unit is at least 125% of the conversion price. On or after November 30, 2015 and prior to the maturity date, the 2016 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest.

Each Convertible Debenture is convertible into freely tradeable Stapled Units at the holder's option at (i) any time prior to the maturity date and (ii) the business day immediately preceding the date specified by the REIT for redemption of the Convertible Debentures, at a specified conversion price, subject to adjustment upon the occurrence of certain events in accordance with the indenture governing the Convertible Debentures.

On redemption or maturity of the Convertible Debentures, the REIT may, at its option and subject to certain conditions, elect to satisfy its obligation to repay all or any portion of the principal amount of the Convertible Debentures that are to be redeemed or that are to mature through the issuance of Stapled Units by way of issuing (or causing it to be issued) a variable number of Stapled Units equal to the principal amount of the Convertible Debentures that are to be redeemed or that are to mature divided by 95% of the then fair market value of the Stapled Units.

Interest on the Convertible Debentures is payable semi-annually on June 30 and December 31.

(b) *Series A Senior Debentures, Series B Senior Debentures, Series C Senior Debentures, Series D Senior Debentures, Series E Senior Debentures and Series F Senior Debentures (collectively, the "Senior Debentures"):*

In February 2010, the REIT issued \$115,000 Series A unsecured senior debentures (the "Series A Senior Debentures"). The interest on the Series A Senior Debentures is payable semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$113,981, net of issue costs of \$1,019.

In February 2010, the REIT issued \$115,000 Series B unsecured senior debentures (the "Series B Senior Debentures"). The interest on the Series B Senior Debentures is payable semi-annually on February 3 and August 3. On issuance, the REIT recorded a liability of \$113,953, net of issue costs of \$1,047.

In September 2010, the REIT issued \$125,000 Series C unsecured senior debentures (the "Series C Senior Debentures"). The interest on the Series C Senior Debentures is payable semi-annually on June 1 and December 1. On issuance, the REIT recorded a liability of \$122,525, net of issue costs of \$2,475.

In January 2011, the REIT issued \$180,000 Series D unsecured senior debentures (the "Series D Senior Debentures"). The interest on the Series D Senior Debentures is payable semi-annually on January 27 and July 27. On issuance, the REIT recorded a liability of \$178,475, net of issue costs of \$1,525.

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10. Debentures payable (continued):

In October 2011, the REIT issued \$100,000 Series E unsecured senior debentures (the "Series E Senior Debentures"). The interest on the Series E Senior Debentures is payable semi-annually on February 2 and August 2. On issuance, the REIT recorded a liability of \$98,510, net of issue costs of \$1,490.

In April 2012, the REIT issued \$175,000 Series F unsecured senior debentures (the "Series F Senior Debentures"). The interest on the Series F Debentures is payable semi-annually on March 2 and September 2. On issuance, the REIT recorded a liability of \$173,389, net of issue costs of \$1,611.

Interest expense is recorded as a charge to net income and is calculated at an effective interest rate with the difference between the coupon rate and the effective rate being credited to the carrying value such that, at maturity, the carrying value is equal to the face value of the then outstanding Senior Debentures.

At its option, the REIT may redeem any of the Senior Debentures, in whole at any time, or in part from time to time, prior to maturity on payment of a redemption price equal to the greater of (i) the Canada Yield Price as defined in the relevant supplemental trust indenture and (ii) par, together in each case with accrued and unpaid interest to the date fixed for redemption. The REIT will give notice of any redemption at least 30 days but not more than 60 days before the date fixed for redemption. Where less than all of any Senior Debentures are to be redeemed pursuant to their terms, the Senior Debentures to be so redeemed will be redeemed on a pro rata basis according to the principal amount of Senior Debentures registered in the respective name of each holder of Senior Debentures or in such other manner as the indenture trustee may consider equitable.

The Senior Debentures are rated BBB (with a Stable trend) by DBRS Limited.

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10. Debentures payable (continued):

A summary of the carrying value of debentures payable is as follows:

	December 31 2012	December 31 2011
Convertible Debentures (note 10(a))		
Carrying value, beginning of year	\$ 742,240	\$ 614,988
Issued - 2016 Convertible Debentures	-	75,000
Conversion - 2013 Convertible Debentures*	(87,274)	(103)
Conversion - 2014 Convertible Debentures*	(216,360)	(26,436)
Conversion - 2017 Convertible Debentures*	(2,020)	(5,869)
Conversion - 2020 Convertible Debentures*	(352)	(10)
Redemption - 2013 Convertible Debentures	(29,791)	-
Redemption - 2014 Convertible Debentures	(1,297)	-
(Gain) loss on fair value (note 19)	(4,696)	84,670
Carrying value, end of year	400,450	742,240
Senior Debentures (note 10(b))		
Carrying value, beginning of year	628,677	350,840
Issued - Series D and E Senior Debentures	-	276,985
Issued - Series F Senior Debentures	173,389	-
Accretion adjustment	1,275	852
Carrying value, end of year	803,341	628,677
	\$ 1,203,791	\$ 1,370,917

* The conversion amounts above equal \$306,006 (December 31, 2011 - \$32,418).

11. Exchangeable units:

Exchangeable units represents the Class B LP units of HRLP issued to participating vendors in exchange for properties acquired by HRLP. The accounts of HRLP are consolidated into the REIT, and thus included in the combined financial statements. The Class B LP units are puttable instruments where the REIT has a contractual obligation to issue Stapled Units to participating vendors upon redemption. These puttable instruments are classified as a liability under IFRS and are measured at fair value through net income (loss) (note 19). Fair value is determined by using the quoted prices for the listed Stapled Units as all of the 5,437,565 Class B LP units of HRLP are exchangeable on a one-for-one basis, at the option of the holder, into Stapled Units. The quoted price as at December 31, 2012 was \$24.10 (December 31, 2011 - \$23.30).

Holders of the Class B LP units of HRLP are entitled to receive distributions on a per unit amount equal to a per Stapled Unit amount provided to holders of Stapled Units.

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11. Exchangeable units (continued):

As a result of a reorganization in 2009, HRLP, the REIT, Finance Trust and H&R Portfolio LP Trust (a subsidiary of the REIT) entered into an exchange and support agreement that provides, among other things, for (i) certain capital contributions to be made by the REIT in case HRLP has insufficient (a) funds to pay the required distributions on the Class B LP units of HRLP, or (b) U.S. Holdco Notes to pay the fair quoted value of the Finance Trust units required to be delivered upon exchange of any Class B LP unit; and (ii) the mechanics whereby Class B LP units may be exchanged for Stapled Units.

12. Unitholders' equity:

The REIT is an unincorporated open-ended trust. The beneficial interests in the REIT are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions.

Finance Trust is an unincorporated investment trust. The beneficial interests in Finance Trust are represented by a single class of units which are unlimited in number. Each unit carries a single vote at any meeting of unitholders and carries the right to participate pro rata in any distributions.

The units of the REIT are stapled with the units of Finance Trust effective October 1, 2008. These Stapled Units are listed and posted for trading on the TSX. The REIT has entered into a support agreement ("Support Agreement") with Finance Trust to coordinate the issuance of Stapled Units under various arrangements (note 12(c)).

The units of the Trusts are freely transferable and, other than as disclosed herein, the trustees shall not impose any restriction on the transfer of units. Provided that an event of uncoupling ("Event of Uncoupling") has not occurred: (a) each unit may be transferred only together with a unit of Finance Trust; (b) no unit may be issued by the REIT to any person unless: (i) a unit of Finance Trust is simultaneously issued to such person, or (ii) the REIT has arranged that units will be consolidated (subject to any applicable regulatory approval) immediately after such issuance, such that each holder of a REIT unit will hold an equal number of Finance Trust units and units of the REIT immediately following such consolidation; and (c) a unitholder may require the REIT to redeem any particular number of units only if it also requires, at the same time, and in accordance with the provisions of the Finance Trust Declaration of Trust, Finance Trust to redeem that same number of units of Finance Trust.

An Event of Uncoupling shall occur only: (a) in the event that unitholders of the REIT vote in favour of the uncoupling of units of Finance Trust and units of the REIT such that the two securities will trade separately; or (b) at the sole discretion of the trustees of Finance Trust, but only in the event of the bankruptcy, insolvency, winding-up or reorganization (under an applicable law relating to insolvency) of the REIT or U.S. Holdco or the taking of corporate action by the REIT or U.S. Holdco in furtherance of any such action or the admitting in writing by the REIT or U.S. Holdco of its inability to pay its debts generally as they become due. The trustees of the Trusts shall use all reasonable efforts to obtain and maintain a listing for the units of the REIT and, unless an Event of Uncoupling has occurred, the Stapled Units, on one or more stock exchanges in Canada.

The unitholders have the right to require the Trusts to redeem their units on demand. Provided that no Event of Uncoupling has occurred, unitholders who tender their units of one of the Trusts for redemption will also be required to tender for redemption corresponding units of the other Trust in accordance with the provisions of the respective Declarations of Trust. Upon the tender of their units for redemption, all of the unitholder's rights to and under such units are surrendered and the unitholder is entitled to receive a price per unit as determined by the applicable Declaration of Trust.

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12. Unitholders' equity (continued):

Upon valid tender for redemption of each unit of the REIT, the unitholder is entitled to receive a price per unit of the REIT as determined by a formula based on the market price of Stapled Units less an amount based on the principal amount of U.S. Holdco Notes owing per outstanding unit of Finance Trust. The redemption price payable by the REIT will be satisfied by way of a cash payment to the unitholder or, in certain circumstances, including where such payment would cause the REIT's monthly cash redemption obligations to exceed \$50 (subject to adjustment in certain circumstances or waiver by the trustees) an *in specie* distribution of notes of H&R Portfolio LP Trust (a subsidiary of the REIT).

Upon valid tender for redemption of each unit of Finance Trust, the unitholder is entitled to receive, except as provided below, a price per unit payable in cash equal to the Canadian dollar equivalent of the outstanding principal amount of the U.S. Holdco Notes as of the redemption date, divided by the total number of Finance Trust units issued and outstanding immediately prior to the redemption date. In certain circumstances, including where such payment would cause Finance Trust's monthly cash redemption obligations to exceed \$50 (subject to adjustment in certain circumstances or waiver by the trustees) the redemption price per Finance Trust unit being redeemed, to which a redeeming unitholder is entitled shall be the fair market value of the Finance Trust units being redeemed, as determined by the trustees, which shall be payable by way of delivery of U.S. Holdco Notes.

The following number of Stapled Units are issued and outstanding:

As at January 1, 2011	146,120,642
Issued under the Distribution Reinvestment Plan and Unit Purchase Plan (the "DRIP")	1,726,620
Issued on May 31, 2011 (at a price of \$22.15 per unit)	9,030,000
Issued on November 22, 2011 (at a price of \$22.00 per unit)	8,500,000
Issued on December 22, 2011 (at a price of \$23.30 per unit)	5,370,000
2013 Convertible Debentures converted into units	4,327
2014 Convertible Debentures converted into units	1,220,874
2017 Convertible Debentures converted into units	269,940
2020 Convertible Debentures converted into units	425
Options exercised	311,168
As at December 31, 2011	172,553,996
Issued on November 29, 2012 (at a price of \$23.60 per unit)	6,360,000
Issued under the DRIP	2,438,868
2013 Convertible Debentures converted into units	3,682,768
2014 Convertible Debentures converted into units	9,045,549
2017 Convertible Debentures converted into units	83,350
2020 Convertible Debentures converted into units	13,232
Options exercised	498,799
As at December 31, 2012	194,676,562

The weighted average number of basic Stapled Units for the year ended December 31, 2012 is 183,409,596 (December 31, 2011 - 154,168,966).

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12. Unitholders' equity (continued):

(a) Unit option plan:

As at December 31, 2012, a maximum of 18,000,000 (December 31, 2011 - 18,000,000) Stapled Units were authorized to be issued to the REIT's officers, employees, consultants and certain trustees, of which 9,924,320 options (December 31, 2011 - 8,700,000 options) have been granted. The exercise price of each option approximated the quoted price of the Stapled Units on the date of grant and shall be increased by the amount, if any, by which the fair quoted value of one Finance Trust unit at the time of exercise of such option exceeds the fair quoted value of one Finance Trust unit at the time of grant of such option. The options vest at 33.3% per year from the grant date, will be fully vested after three years, and expire ten years after the date of the grant.

During the year ended December 31, 2012, 1,224,320 options were granted (December 31, 2011 - 1,100,000).

As described in note 2(i), the unit option plan is considered a cash-settled plan with the value of the units recorded as a liability on the combined statement of financial position. The liability is released to equity when the unit options are converted to REIT units. The liability is revalued each reporting date based on the trading value of the Stapled Units. The fair value of the unit options is measured using the Black-Scholes model. Measurement inputs include unit price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected distributions, and the risk-free interest rate (based on government bonds). Service and non-market performance conditions attached to the transactions are not taken into account in measuring fair value. The fair value of the vested unit options as at December 31, 2012 is \$10,585 (December 31, 2011 - \$8,640).

Unit-based compensation expense of \$6,122 for the year ended December 31, 2012 (December 31, 2011 - \$7,600) was included in trust expenses in the statement of comprehensive income.

A summary of the status of the unit option plan and the changes during the respective periods are as follows:

	2012		2011	
	Units	Weighted average exercise price	Units	Weighted average exercise price
Outstanding, beginning of year	2,282,500	\$ 17.12	1,560,333	\$ 13.95
Granted	1,224,320	23.18	1,100,000	20.20
Exercised	(498,799)	14.57	(311,168)	12.74
Expired	-	-	(66,665)	14.18
Outstanding, end of year	3,008,021	\$ 20.01	2,282,500	\$ 17.12
Options exercisable, end of year	875,367	\$ 16.33	657,501	\$ 14.95

The options outstanding at December 31, 2012 are exercisable at varying prices ranging from \$9.30 to \$23.18 (December 31, 2011 - \$9.30 to \$20.83) with a weighted average remaining life of 8.2 years (December 31, 2011 - 8.3 years). The vested options are exercisable at varying prices ranging from \$9.30 to \$20.83 (December 31, 2011 - \$9.30 to \$16.56) with a weighted average remaining life of 7.1 years (December 31, 2011 - 7.1 years).

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12. Unitholders' equity (continued):

(b) Distributions:

Under the REIT's Declaration of Trust, the total amount of income of the REIT to be distributed to unitholders for each calendar month shall be subject to the discretion of the trustees, however, the total income distributed shall not be less than the amount necessary to ensure that the REIT will not be liable to pay income tax under Part I of the Tax Act for any year. The trustees have the discretion to pay the distributions in cash or Stapled Units. For the year ended December 31, 2012 the REIT declared per unit distributions of \$1.10 (December 31, 2011 - \$0.88).

Pursuant to Finance Trust's Declaration of Trust, unitholders of Finance Trust are entitled to receive all of the Distributable Cash of Finance Trust, as defined in the Declaration of Trust. Distributable Cash means, subject to certain exceptions, all amounts received by Finance Trust less certain costs, expenses or other amounts payable by Finance Trust, and less any amounts which, in the opinion of the trustees, may reasonably be considered to be necessary to provide for the payment of any costs or expenditures that have been or will be incurred in the activities and operations of Finance Trust and to provide for payment of any tax liability of Finance Trust. Finance Trust paid per unit distributions of \$0.08 for the year ended December 31, 2012 (December 31, 2011 - \$0.10).

The details of the distributions are as follows:

	2012	2011
Cash distributions to unitholders	\$ 158,423	\$ 114,112
Unit distributions (issued under the DRIP)	57,056	36,139
	\$ 215,479	\$ 150,251

(c) Support agreement:

Pursuant to provisions of the Declarations of Trust for Finance Trust and the REIT, at all times, each REIT unit must be stapled to a Finance Trust unit (and each Finance Trust unit must be stapled to a REIT unit) unless there is an Event of Uncoupling. As part of the Plan of Arrangement, the REIT and Finance Trust entered into the Support Agreement which provided, among other things, for the co-ordination of the declaration and payment of all distributions so as to provide for simultaneous record dates and payment dates; for co-ordination so as to permit the REIT to perform its obligations pursuant to the REIT's Declaration of Trust, Unit Option Plan, DRIP and Unitholder Rights Plan; for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable and permit the REIT to perform its obligations arising under any security issued by the REIT (including securities convertible, exercisable or exchangeable into Stapled Units); for Finance Trust to take all such actions and do all such things as are necessary or desirable to enable the REIT to perform its obligations or exercise its rights under its convertible debentures; and for Finance Trust to take all such actions and do all such things as are necessary or desirable to issue Finance Trust units simultaneously (or as close to simultaneously as possible) with the issue of REIT units and to otherwise ensure at all times that each holder of a particular number of REIT units holds an equal number of Finance Trust units, including participating in and cooperating with any public or private distribution of Stapled Units by, among other things, signing prospectuses or other offering documents.

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12. Unitholders' equity (continued):

In the event that the REIT issues additional REIT units, pursuant to the Support Agreement, the REIT and Finance Trust will coordinate so as to ensure that each subscriber receives both REIT units and Finance Trust units, which shall trade together as Stapled Units. Prior to such event, the REIT shall provide notice to Finance Trust to cause Finance Trust to issue and deliver the requisite number of Finance Trust units to be received by and issued to, or to the order of, each subscriber as the REIT directs. In consideration of the issuance and delivery of each such Finance Trust unit, the REIT (on behalf of the purchaser) or the purchaser, as the case may be, shall pay (or arrange for the payment of) a purchase price equal to the fair market value (as determined by Finance Trust in consultation with the REIT) of each such Finance Trust unit at the time of such issuance. The remainder of the subscription price for Stapled Units shall be allocated to the issuance of REIT units by the REIT.

(d) Short form base shelf prospectus:

On March 31, 2011, the Trusts issued a short form base shelf prospectus allowing the Trusts to offer and issue Stapled Units and the REIT to offer and issue the following securities: (i) preferred units; (ii) unsecured debt securities; (iii) subscription receipts exchangeable for Stapled Units and/or other securities of the REIT; (iv) warrants exercisable to acquire Stapled Units and/or other securities of the REIT; and (v) securities comprised of more than one of Stapled Units, preferred units, debt securities, subscription receipts and/or warrants offered together as a unit, or any combination thereof having an offer price of up to \$2,000,000 in aggregate (or the equivalent thereof, at the date of issue, in any other currency or currencies, as the case may be) at any time during the 25-month period that the short form base shelf prospectus (including any amendments) remains valid. As at December 31, 2012, \$662,232 Stapled Units, \$275,000 Senior Debentures and \$75,000 Convertible Debentures have been issued under the short form base shelf prospectus.

13. Derivative instruments:

		Fair value (liability) asset **		Net gain (loss) on derivative contracts*	
		December 31	December 31	December 31	December 31
		2012	2011	2012	2011
Foreign exchange forward contracts	(a)	\$ 1,679	\$ (730)	\$ 2,411	\$ (1,933)
Foreign exchange swap	(a)	-	1,273	(1,273)	1,273
Foreign exchange swap	(a)	-	(1,106)	1,106	(1,106)
Interest rate swap - the Bow Facility	(b)	-	(3,520)	3,520	(623)
Mortgage interest rate swaps	(c)	(601)	(716)	(13,846)	(276)
		\$ 1,078	\$ (4,799)	\$ (8,082)	\$ (2,665)

(a) The REIT entered into foreign exchange forward contracts and swaps with Canadian chartered banks effectively locking the REIT's rate to exchange U.S. dollars into Canadian dollars.

(b) The REIT entered into an interest rate swap that was intended to limit its interest rate exposure during the term of the Bow Facility (note 14(b)). The swap was settled in June 2012.

(c) The REIT entered into interest rate swaps on three Canadian mortgages and one U.S. mortgage. The three interest rate swaps on the Canadian mortgages were settled during 2012.

* Excludes amounts relating to foreign exchange which have been recorded in accumulated other comprehensive income (loss) (note 16).

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13. Derivative instruments (continued):

** Derivative instruments in asset and liability positions are not presented on a net basis. When a derivative instrument is in an asset position, the amount is recorded in other assets (note 7).

14. Bank indebtedness:

The REIT has the following facilities:

- (a) A general operating facility which is secured by fixed charges over certain investment properties due on December 31, 2013. The total facility as at December 31, 2012 is \$300,000 (December 31, 2011 - \$300,000) and can be drawn in either Canadian or U.S. dollars (to a maximum of \$150,000 U.S. dollars for U.S. borrowings). The amount available at December 31, 2012, after taking into account the bank indebtedness drawn of \$2,905 (December 31, 2011 - \$207,173) and the outstanding letters of credit and other items, is \$252,523 (December 31, 2011 - \$63,027). The Canadian dollar bank indebtedness bears interest at rates approximating the prime rate of a Canadian chartered bank. At December 31, 2012, the Canadian prime interest rate was 3.00% (December 31, 2011 - 3.00%) per annum.

Included in bank indebtedness at December 31, 2012 are U.S. dollar denominated amounts of \$298 (December 31, 2011 - U.S. \$144,825). The Canadian equivalents of these amounts are \$295 (December 31, 2011 - \$147,722).

- (b) A general operating facility which is secured by The Bow (the "Bow Facility") due on November 21, 2013. The total facility as at December 31, 2012 is \$300,000 (December 31, 2011 - \$400,000) and can be drawn in either Canadian or U.S. dollars (to a maximum of \$150,000 U.S. dollars). As at December 31, 2012, the REIT has drawn \$nil (December 31, 2011 - \$233,000) under the Bow Facility and the undrawn amount available at December 31, 2012 is \$300,000 (December 31, 2011 - \$167,000).

Included in bank indebtedness at December 31, 2012 are U.S. dollar denominated amounts of nil (December 31, 2011 - U.S. \$150,000). The Canadian equivalents of these amounts are nil (December 31, 2011 - \$153,000).

15. Accounts payable and accrued liabilities:

	December 31 2012	December 31 2011
Current:		
Other accounts payable and accrued liabilities	\$ 85,787	\$ 53,441
Accounts payable relating to the Bow	30,974	54,332
Debenture interest payable	14,139	27,164
Prepaid rent	29,018	24,356
Mortgage interest payable	12,831	13,188
Non-current:		
Security deposits	3,797	3,368
	\$ 176,546	\$ 175,849

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16. Accumulated other comprehensive income (loss):

	Cash flow hedges	Foreign operations	Total
Balance as at December 31, 2010	\$ (1,967)	\$ (7,449)	\$ (9,416)
Change in unrealized loss on translation of U.S. denominated foreign operations as a result of changes in accounting policy (note 3)	-	(6,479)	(6,479)
Balance as at January 1, 2011	(1,967)	(13,928)	(15,895)
Transfer of realized loss on cash flow hedges to net income	385	-	385
Unrealized gain on translation of U.S. denominated foreign operation	-	5,638	5,638
Balance as at December 31, 2011	(1,582)	(8,290)	(9,872)
Transfer of realized loss on cash flow hedges to net income	400	-	400
Unrealized loss on translation of U.S. denominated foreign operation	-	(15,399)	(15,399)
Balance as at December 31, 2012	\$ (1,182)	\$ (23,689)	\$ (24,871)

17. Rentals from investment properties:

	2012	2011
Rentals from investment properties	\$ 804,306	\$ 658,227
Straight-lining of contractual rent	32,464	(288)
Rent amortization of tenant inducements	(1,467)	(1,028)
	\$ 835,303	\$ 656,911

Operating Leases:

The REIT leases its investment properties under operating leases (note 4). The future minimum lease payments under non-cancellable leases are as follows:

	December 31 2012	December 31 2011
Less than 1 year	\$ 584,381	\$ 505,100
Between 1 and 5 years	2,258,181	2,129,411
More than 5 years	5,206,657	5,187,791
	\$ 8,049,219	\$ 7,822,302

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18. Finance cost - operations:

	2012	2011
Contractual interest on mortgages payable	\$ 200,568	\$ 171,193
Contractual interest on debentures payable	62,815	61,262
Interest on construction loans	6,766	7,235
Effective interest rate accretion	1,557	908
Bank interest and charges	5,506	4,389
Exchangeable unit distributions	6,389	5,302
	283,601	250,289
Capitalized interest*	(44,146)	(69,277)
	\$ 239,455	\$ 181,012

* The capitalized interest is determined using the REIT's weighted average rate of borrowing on all financial liabilities of 5.34% (2011 - 6.10%).

19. Gain (loss) on change in fair value:

	2012	2011
Gain (loss) on fair value of convertible debentures (note 10)	\$ 4,696	\$ (84,670)
Loss on fair value of exchangeable units (note 11)	(4,350)	(21,043)
Net loss on derivative instruments (note 13)	(8,082)	(2,665)
	\$ (7,736)	\$ (108,378)

20. Supplemental cash flow information:

The change in other non-cash operating items are as follows:

	2012	2011
Accrued rent receivable	\$ (31,378)	\$ 267
Prepaid expenses and sundry assets	4,568	(6,027)
Accounts receivable	(3,681)	(5,777)
Accounts payable and accrued liabilities	39,322	(12,016)
	\$ 8,831	\$ (23,553)

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20. Supplemental cash flow information (continued):

The following non-cash amounts have been excluded from operating, financing and investing activities in the combined statements of cash flows:

	2012	2011
Acquisition of investment properties through assumption of mortgages payable, net of mark-to-market adjustments	\$ 7,173	\$ 319,753
Non-cash write off of mortgage obligations upon lenders' consent	(20,675)	(59,056)
Non-cash write off of mortgage interest obligation included in accounts payable and accrued liabilities	679	(9,038)
Non-cash release of mortgage payable on disposition of investment property	(91,167)	(4,071)
Non-cash transfer of investment properties to lenders	10,812	58,415
Non-cash distributions to unitholders (note 12(b))	57,056	36,139
Non-cash conversion of convertible debentures (note 10)	306,006	32,418
Decrease in accounts receivable and payable for properties under development	(21,211)	(12,558)
Capitalized interest	44,146	69,277
Decrease in accounts payable for tenant inducements	-	(507)
Non-cash proceeds on options exercised	4,177	2,369

21. Capital risk management:

The REIT's primary objectives when managing capital are:

- (a) to provide unitholders with stable and growing distributions generated by revenue it derives from investments in real estate assets; and
- (b) to maximize unit value through the ongoing active management of the REIT's assets, the acquisition of additional properties and the development and construction of projects which are pre-leased to creditworthy tenants.

The REIT considers its capital to be its unitholders' equity, exchangeable units, mortgages payable, debentures payable and bank indebtedness. As long as the REIT complies with its investment and debt restrictions set out in its Declaration of Trust, it is free to determine the appropriate level of capital in context with its cash flow requirements, overall business risks and potential business opportunities. As a result of this, the REIT will make adjustments to its capital based on its investment strategies and changes in economic conditions.

The REIT's level of indebtedness is subject to the limitations set out in its Declaration of Trust. The REIT is limited to a total indebtedness to gross book value ratio of 65% (for this purpose "indebtedness" excludes Convertible Debentures, and U.S. Holdco notes payable to Finance Trust). As at December 31, 2012, this ratio was 48.2% (2011 - 47.1%). Management uses this ratio as a key indicator in managing the REIT's capital.

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21. Capital risk management (continued):

In addition to the above key ratio, the REIT's general operating facilities (note 14(a) and 14(b)) have the following covenants which are required to be calculated based on the REIT's and Finance Trust's combined financial statements:

	Covenant	2012	2011
(a) Maximum indebtedness to gross book value	65%	48.3%	47.1%
(b) Minimum interest coverage ratio	1.65 : 1	2.40 : 1	2.40 : 1
(c) Minimum equity	\$1,000,000	\$4,507,012	\$3,710,543

The REIT has various other covenants with respect to its debt. The REIT is in compliance with the covenants as at December 31, 2012.

The REIT's mortgage providers also have minimum limits on debt-to-service coverage ratios ranging from 1.10 to 1.50 as at December 31, 2012 and December 31, 2011. The REIT monitors these ratios and is in compliance with such external requirements.

22. Risk Management:

(a) Credit risk:

The REIT is exposed to credit risk as an owner of investment properties in that tenants may experience financial difficulty and be unable to fulfill their lease commitment or the failure of tenants to occupy and pay rent in accordance with existing lease agreements. Management mitigates this risk by carrying out appropriate credit checks and related due diligence on significant tenants. Management has diversified the REIT's holdings so that it owns several categories of properties and acquires investment properties throughout Canada and the United States.

In addition, management ensures that no tenant or related group of tenants, other than investment grade tenants, account for a significant portion of the REIT's cash flow. Bell Canada, rated A low by a recognized rating agency, is the only tenant which accounts for more than 5% of the rental from income properties. During the first full year of the lease agreement at the Bow, Encana Corporation is expected to also account for more than 5% of the rentals from investment properties. Encana Corporation's current public debt rating is BBB high.

The REIT's exposure to credit risk is as follows:

	December 31 2012	December 31 2011
Mortgages and amount receivable	\$ 6,960	\$ 7,080
Accounts receivable (note 7)	16,772	12,711
Derivative instruments (note 7)	1,679	1,273
	\$ 25,411	\$ 21,064

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22. Risk management (continued):

(b) *Liquidity risk:*

The REIT is subject to liquidity risk whereby it may not be able to refinance or pay its debt obligations when they become due.

The REIT's liquidity risk is as follows:

	2013	Thereafter	Total
Mortgages payable (note 9)*	\$ 233,717	\$ 3,869,561	\$ 4,103,278
Debentures payable (note 10)*	-	1,203,791	1,203,791
Derivative instruments (note 13)*	601	-	601
Bank indebtedness (note 14)*	2,905	-	2,905
Accounts payable and accrued liabilities (note 15)	172,749	3,797	176,546
	\$ 409,972	\$ 5,077,149	\$ 5,487,121

* Amounts in the above table only include the principal amount for each debt obligation.

Management's strategy for managing liquidity risk is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when they come due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the REIT's reputation. In order to meet this strategy, the REIT strives to enter into long-term leases with creditworthy tenants which assists in the REIT's primary strategy of maintaining predictable cash flows. The REIT attempts to appropriately structure the term of mortgages to closely match the term of leases for each property. This strategy enables the REIT to meet its contractual monthly mortgage obligations. Due to the long-term length of most of the REIT's mortgages, a significant amount of principal is usually paid by the time the mortgages mature.

The agreements and indentures governing indebtedness of the REIT contain covenants that, among other things, require the REIT to maintain financial ratios and thresholds and impose on the REIT restrictions (subject in each case to exceptions) regarding: the disposition of the Bow, lands related to the Bow; the creation of liens or granting of negative pledges; the purchase or redemption of securities; the entering into any merger or similar transaction with any person; changes of a fundamental nature (including senior management, business objectives, purposes or operations, capital structure, constating documents, and subordinated debt); the cancellation or waiver of material contracts and changes to the Bow budget. As a result, the REIT is limited by such covenants and restrictions.

Management monitors its liquidity risk through review of financial covenants contained in debt agreements and in accordance with the REIT's Declaration of Trust. In order to maintain liquidity, the REIT has two general operating facilities, as described in note 14(a) and 14(b), available to draw on to fund its obligations.

(c) *Market risk:*

The REIT is subject to currency risk and interest rate risk. The REIT's objective is to manage and control market risk exposure within acceptable parameters, while optimizing the return on risk.

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22. Risk management (continued):

(i) *Currency risk:*

A portion of the REIT's properties are located in the United States, resulting in the REIT being subject to foreign currency fluctuations which may impact its financial position and results. In order to mitigate the risk, the REIT's debt on these properties is also held in U.S. dollars to act as a natural hedge.

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.00 for the year ended December 31, 2012 (2011 - \$0.99) would have decreased other comprehensive income (loss) by approximately \$53,100 (2011 - \$46,000) and increased (decreased) net income (loss) by approximately \$6,400 (2011 - (\$2,700)). This analysis assumes that all other variables, in particular interest rates, remain constant (a \$0.10 weakening of the Canadian dollar against the U.S. dollar at December 31, 2012 would have had the equal but opposite effect).

(ii) *Interest rate risk:*

The REIT is exposed to interest rate risk on its borrowings. It minimizes this risk by obtaining long-term fixed interest rate debt. At December 31, 2012, the percentage of fixed rate debt to total debt was 99.9% (2011 - 90.9%). Therefore, a change in interest rates at the reporting date would not affect net income with respect to these fixed rate instruments.

The bank indebtedness is subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2012 would have decreased net earnings by approximately \$1,800 (2011 - \$1,700). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

(d) *Fair values:*

(i) *Financial assets and liabilities carried at amortized cost:*

The fair values of the REIT's mortgages and amount receivable, accounts receivable, cash and cash equivalents, bank indebtedness and accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short periods to maturity of these financial instruments.

The fair value of the mortgages payable has been determined by discounting the cash flows of these financial obligations using year-end market rates for debt of similar terms and credit risks. Based on these assumptions, the fair value of mortgages payable at December 31, 2012 has been estimated at \$4,221,565 (2011 - \$3,244,658) compared with the carrying value of \$4,095,915 (2011 - \$3,163,593).

The fair value of the Senior Debentures payable has been measured based on the ask price of each series of Senior Debenture similar terms and credit risks. Based on these assumptions, the fair value of the Senior Debentures payable at December 31, 2012 has been estimated at \$860,810 (2011 - \$659,448) compared with the carrying value of \$803,341 (2011 - \$628,677).

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22. Risk management (continued):

(ii) *Assets and Liabilities carried at fair value:*

Financial instruments measured at fair value in the statement of financial position are categorized using a fair value hierarchy that reflects the significance of the inputs used in determining the fair values.

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

December 31, 2012	Level 1	Level 2	Level 3	Total
Assets				
Investment properties	\$ -	\$ 9,807,062	\$ -	\$ 9,807,062
Properties under development	-	128,220	-	128,220
Investment properties held for sale (note 6)	-	27,800	-	27,800
Derivative instrument asset (note 7)	-	1,679	-	1,679
	-	9,964,761	-	9,964,761
Liabilities				
Convertible debentures (note 10)	(400,450)	-	-	(400,450)
Exchangeable units	(131,045)	-	-	(131,045)
Derivative instruments liabilities	-	(601)	-	(601)
	(531,495)	(601)	-	(532,096)
	\$ (531,495)	\$ 9,964,160	\$ -	\$ 9,432,665

December 31, 2011	Level 1	Level 2	Level 3	Total
Assets				
Investment properties	\$ -	\$ 7,210,997	\$ -	\$ 7,210,997
Properties under development	-	1,721,743	-	1,721,743
Derivative instrument asset (note 7)	-	1,273	-	1,273
	-	8,934,013	-	8,934,013
Liabilities				
Convertible debentures (note 10)	(742,240)	-	-	(742,240)
Exchangeable units	(126,695)	-	-	(126,695)
Derivative instruments liabilities	-	(6,072)	-	(6,072)
	(868,935)	(6,072)	-	(875,007)
	\$ (868,935)	\$ 8,927,941	\$ -	\$ 8,059,006

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23. Joint venture and co-ownership activities:

These combined financial statements include the REIT's proportionate share of assets, liabilities, revenue, expenses and cash flows of the joint ventures and co-ownerships. The REIT's proportionate share of these joint ventures and co-ownerships range between 20.0% and 98.5%, summarized as follows:

	2012	2011
Assets	\$699,746	\$235,444
Liabilities	305,109	80,694
Revenue	70,616	41,307
Expenses	30,557	14,393
Operating income from properties	40,059	26,914
Cash flows provided by operations	31,843	9,377
Cash flows provided by financing	409,291	16,508
Cash flows used in investments	(440,509)	(25,043)

The above amounts include Scotia Plaza at 33 $\frac{1}{3}$ % ownership and Telus Tower at 50% ownership, as well as the REIT's other joint venture and co-owned real estate assets.

24. Related party transactions:

H&R Property Management Ltd. (the "Property Manager"), a company partially owned by family members of the Chief Executive Officer, provides property management services for substantially all properties owned by the REIT, including leasing services, for a fee of 2% of gross revenue. The Property Manager also provides support services in connection with the acquisition, disposition and development activities of the REIT and is also entitled to an incentive fee. Acquisitions and development support services are provided for a fee of 2/3 of 1% of total acquisition and development costs. The support services relating to dispositions of investment properties are provided for a fee of 10% of the net gain on sale of investment properties adjusted for the add back of accumulated depreciation and amortization. Services are provided by the Property Manager pursuant to a property management agreement which expires on January 1, 2015 with one automatic five-year extension.

During the year ended December 31, 2012, the REIT recorded fees pursuant to this agreement of \$19,912 (December 31, 2011 - \$23,978), of which \$4,777 (December 31, 2011 - \$9,481) was capitalized to the cost of the investment properties acquired, \$1,128 (December 31, 2011 - \$2,128) was capitalized to properties under development and \$5,478 (December 31, 2011 - \$3,615) was capitalized to leasing expenses. The REIT has also reimbursed the Property Manager for certain direct property operating costs and tenant construction costs.

For the year ended December 31, 2012, a further amount of \$4,500 (December 31, 2011 - \$3,500) has been earned by the Property Manager pursuant to the above agreement, in accordance with the annual incentive fee payable to the Property Manager.

Pursuant to the above agreement, as at December 31, 2012, \$1,837 (December 31, 2011 - \$3,477) was payable to the Property Manager.

The REIT leases space to companies affiliated with the Property Manager. The rental income earned for the year ended December 31, 2012 is \$1,432 (December 31, 2011 - \$1,382).

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24. Related party transactions (continued):

These transactions are measured at the amount of consideration established and agreed to by the related parties.

Key management personnel compensation:

	2012	2011
Short-term employee salaries and benefits	\$ 3,224	\$ 3,258
Employee unit-based compensation	5,522	7,033
	\$ 8,746	\$ 10,291

25. Segmented disclosures:

Segmented information on identifiable non-current assets by geographic region and rentals from investment properties is outlined below.

Investment properties and properties under development (including amounts in note 6) are attributed to countries based on the location of the properties.

	December 31 2012	December 31 2011	January 1 2011
Canada	\$ 7,774,143	\$ 6,725,971	\$ 5,780,684
United States	2,188,939	2,206,769	1,167,477
	\$ 9,963,082	\$ 8,932,740	\$ 6,948,161

	2012	2011
Rentals from investment properties:		
Canada	\$ 631,824	\$ 534,681
United States	203,479	122,230
	\$ 835,303	\$ 656,911

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26. Income tax expense:

	2012	2011
Income tax expense included in the determination of net income:		
Current	\$ 518	\$ 285
Deferred	43,407	-
	\$ 43,925	\$ 285

A reconciliation of expected income taxes based upon the 2012 and 2011 statutory rates to the recorded income tax expense is as follows:

	2012	2011
Income tax computed at the Canadian statutory rate of nil applicable to the REIT for 2012 and 2011	\$ -	\$ -
U.S. income taxes	518	285
Deferred income taxes applicable to U.S. Holdco	43,407	-
	\$ 43,925	\$ 285

The Tax Act contains legislation (the "SIFT Rules") affecting the tax treatment of "specified investment flow-through" ("SIFT") trusts. A SIFT includes a publicly-traded trust. Under the SIFT Rules, distributions of certain income by a SIFT are not deductible in computing the SIFT's taxable income, and a SIFT is subject to tax on such income at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. The SIFT Rules do not apply to a publicly-traded trust that qualifies as a real estate investment trust under the Tax Act. The REIT completed the necessary tax restructuring to qualify as a real estate investment trust effective June 30, 2010.

The REIT has certain subsidiaries in the United States that are subject to tax on their taxable income at a rate of approximately 38%. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	2012	2011
Deferred tax assets:		
Net operating losses and deferred interest deductions	\$ 72,090	\$ 42,530
Accounts payable and accrued liabilities	1,129	4,230
Other assets	148	-
	73,367	46,760
Deferred tax liabilities:		
Investment properties	116,360	47,309
Derivative instruments	414	(549)
	116,774	46,760
Deferred tax asset (liability)	\$ (43,407)	\$ -

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Notes to Combined Financial Statements

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26. Income tax expense (continued):

As at December 31, 2011, deferred tax assets related to net operating losses and deferred interest deductions in the amount of \$13,355 have not been recognized.

At December 31, 2012, U.S. Holdco had accumulated net operating losses and deferred interest deductions available for carryforward for U.S. income tax purposes of \$187,733 (2011 - \$125,229). The net operating losses will expire between 2018 and 2032. The deferred interest deductions and the deductible temporary differences do not generally expire under current tax legislation.

27. Commitments and contingencies:

- (a) The REIT has reached practical completion on the construction of a two million square foot office building in Calgary, Alberta (the "Bow"), which is fully pre-leased to Encana Corporation for a 25-year term. Floors 3 to 57 were delivered to Encana Corporation in tranches between May 2, 2012 and February 22, 2013. The 25-year lease term is expected to commence on March 15, 2013 upon the anticipated delivery of the final two floors to Encana Corporation. The REIT estimates a further \$48,200 in costs will be incurred to complete the project, including capitalized interest. As at December 31, 2012, the total cost incurred on the project amounted to \$1,667,302 (December 31, 2011 - \$1,479,117). This amount includes the costs for the construction of 1,358 parking stalls. Encana Corporation is entitled to a 60-day free rent fixturing period and a rent credit equal to the delay penalty of approximately \$32,500. As at December 31, 2012, the unused portion of the rent credit balance relating to the delay was approximately \$15,200.
- (b) In the normal course of operations, the REIT has issued letters of credit in connection with developments, financings, operations and acquisitions. As at December 31, 2012, the REIT has outstanding letters of credit totalling \$50,198 (December 31, 2011 - \$29,775), including \$17,343 (December 31, 2011 - \$17,431) which has been pledged as security for certain mortgages payable. Of these letters of credit, \$44,547 (December 31, 2011 - \$29,775), are secured in the same manner as the bank indebtedness (note 14(a)) and \$5,651 (December 31, 2011 - nil) by a specific investment property.
- (c) The REIT provides guarantees on behalf of third parties, including co-owners. As at December 31, 2012, the REIT issued guarantees amounting to \$72,091 (December 31, 2011 - \$74,303), which expire in 2016 (December 31, 2011 - expire in 2016), relating to the co-owner's share of mortgage liability. In addition, the REIT continues to guarantee certain debt assumed by purchasers in connection with past dispositions of properties, and will remain liable until such debts are extinguished or the lenders agree to release the REIT's covenants. At December 31, 2012, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$110,292 (December 31, 2011 - \$113,407) which expires between 2013 and 2018 (December 31, 2011 - expires between 2013 and 2018). There have been no defaults by the primary obligor for debts on which the REIT has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in these combined financial statements.

Credit risks arise in the event that these parties default on repayment of their debt since they are guaranteed by the REIT. These credit risks are mitigated as the REIT has recourse under these guarantees in the event of a default by the borrowers, in which case the REIT's claim would be against the underlying real estate investments.

- (d) 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, any liability that may arise from such contingencies would not have a significant adverse effect on the combined financial statements.

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28. Subsequent events:

- (a) In January 2013, the REIT sold 1330 Martin Grove Ave., an industrial property in Toronto, ON for gross proceeds of approximately \$12,235.
- (b) In January 2013, the REIT sold 351 Passmore Ave., an industrial property in Scarborough, ON for gross proceeds of approximately \$8,330.
- (c) In February 2013, the REIT repaid a Canadian mortgage totaling \$69,525 bearing interest at a rate of 8.16%.
- (d) The REIT has entered into an amended and restated arrangement agreement with Finance Trust, Primaris Retail Real Estate Investment Trust ("Primaris") and PRR Investments Inc. to acquire all the property of Primaris remaining following the sale by Primaris of 18 properties to a consortium led by KingSett Capital and to become the sole unitholder of Primaris. In connection with the transaction, H&R expects to issue approximately 65,200 stapled units for delivery to certain existing Primaris unitholders and the REIT expects to assume certain outstanding convertible debentures of Primaris. It is expected that the REIT will acquire 26 properties from Primaris with a fair value of \$3.1 billion along with assumed indebtedness of approximately \$1.4 billion. The transaction is subject to approval by the unitholders of the REIT, Finance Trust and Primaris at meetings to be held on March 22, 2013 as well as other customary closing conditions. Assuming all conditions to closing are satisfied or waived, closing is expected to occur in early April 2013.

Corporate Information

H&R REIT Board of Trustees

Thomas J. Hofstedter ⁽¹⁾, President and Chief Executive Officer, H&R Real Estate Investment Trust
Robert Dickson ^(2,4), Strategic financial consultant, marketing communications industry
Edward Gilbert ^(1,2,3,4), Chief Operating Officer, Firm Capital Mortgage Investment Trust
Laurence A. Lebovic ^(1,3,4), Chief Executive Officer, Runnymede Development Corporation Ltd.
Ronald C. Rutman ^(2,3,4), Partner, Zeifman & Company, Chartered Accountants

H&R Finance Trust Board of Trustees

Thomas J. Hofstedter, President and Chief Executive Officer, H&R Real Estate Investment Trust
Shimshon (Stephen) Gross ⁽²⁾, President, LRG Holdings Inc.
Marvin Rubner ⁽²⁾, Manager and Founder, YAD Investments Limited.
Neil Sigler ⁽²⁾, Vice President, Gold Seal Management Inc.

(1) Investment Committee

(2) Audit Committee

(3) Compensation and Governance Committee

(4) Nominating Committee

Officers

Thomas J. Hofstedter, President and Chief Executive Officer
Larry Froom, Chief Financial Officer
Nathan Uhr, Chief Operating Officer (H&R REIT)
Cheryl Fried, Vice-President, Accounting

Auditors: KPMG LLP

Legal Counsel: Blake, Cassels & Graydon LLP

Taxability of Distributions: 61% of the distributions made by H&R REIT and 6% of the distributions made by H&R Finance Trust to unitholders during 2012 were tax deferred.

Plan Eligibility: RRSP, RRIF, DPSP, RESP, RDSP, TFSA

Stock Exchange Listing: Stapled Units and debentures of H&R are listed on the Toronto Stock Exchange under the trading symbols HR.UN; HR.DB.C, HR.DB.D, HR.DB.E.

Unitholder Distribution Reinvestment Plan and Direct Unit Purchase Plan: Since January 2000, H&R REIT has offered registered holders of its units resident in Canada the opportunity to participate in its Unitholder Distribution Reinvestment Plan (the "DRIP") and Direct Unit Purchase Plan. The DRIP allows participants to have their monthly cash distributions of H&R REIT reinvested in additional Stapled Units of H&R at a 3% discount to the weighted average price of the Stapled Units on the TSX for the five trading days (the "Average Market Price") immediately preceding the cash distribution date. The Direct Unit Purchase Plan allows participants to purchase additional Stapled Units on a monthly basis at the Average Market Price subject to a minimum purchase of \$250 per month (up to a maximum of \$13,500 per year) for each participant. For more information on the DRIP and/or the Direct Unit Purchase Plan, please contact us by email through the "Contact Us" webpage of our website, or contact our Registrar and Transfer Agent.

Registrar and Transfer Agent: CIBC Mellon Trust Company, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario, Canada M5C 2W9 Telephone: 416-643-5500 within the Toronto area or 1-800-387-0825, Fax: 416-643-5501, E-mail: inquiries@cibcmellon.com, Website: www.cibcmellon.com

Contact Information: Investors, investment analysts and others seeking financial information should go to our website at www.hr-reit.com, or e-mail info@hr-reit.com, or call 416-635-7520 and ask for Larry Froom, Chief Financial Officer, or fax 416-398-0040, or write to H&R Real Estate Investment Trust, 3625 Dufferin Street, Suite 500, Downsview, Ontario, Canada, M3K 1N4



H&R Real Estate Investment Trust and H&R Finance Trust



The Bow, Calgary



Scotia Plaza, Toronto



Corus Quay, Toronto