



**H&R Real Estate Investment Trust and H&R Finance Trust  
2016 Annual Report  
Including Combined MD&A and Financial Statements**



**The Bow, Calgary**



**Dufferin Mall, Toronto**



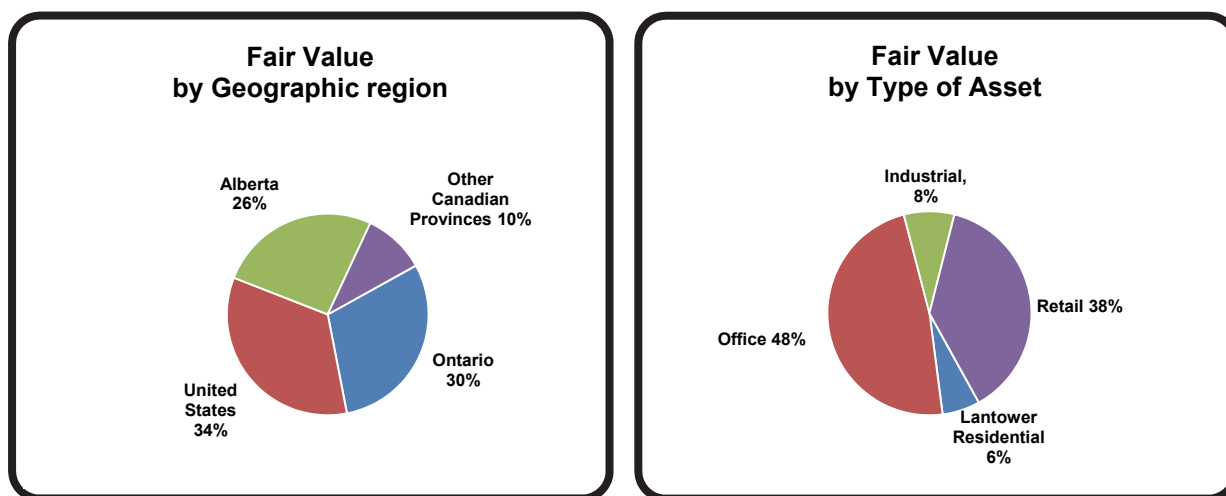
**Airport Road, Brampton – Unilever Distribution Warehouse**

## H&R Profile

H&R REIT is Canada's largest diversified real estate investment trust with total assets of approximately \$14.7 billion at December 31, 2016. H&R REIT is a fully internalized real estate investment trust and has ownership interests in a North American portfolio of high quality office, retail, industrial and residential properties comprising over 46 million square feet.

H&R Finance Trust is an unincorporated investment trust, which primarily invests in notes issued by a U.S. corporation which is a subsidiary of H&R REIT. The current note receivable balance is U.S. \$220.5 million. In 2008, H&R REIT completed an internal reorganization which resulted in each issued and outstanding H&R REIT unit trading together with a unit of H&R Finance Trust as a "Stapled Unit" on the Toronto Stock Exchange.

Additional information regarding H&R REIT and H&R Finance Trust is available at [www.hr-reit.com](http://www.hr-reit.com) and on [www.sedar.com](http://www.sedar.com).



## Primary Objectives

H&R strives to achieve two primary objectives: to maximize the value of units through active management of H&R's assets and to provide unitholders with stable and growing cash distributions generated by revenues derived from a diversified portfolio of investment properties. 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.



## 2016 Annual Report

### Financial Highlights

H&R undertook a strategic review of its assets and decided to sell certain investment properties to take advantage of the high demand for good quality assets. During 2015 and 2016, H&R sold \$1.3 billion of real estate assets and acquired \$757.5 million of real estate assets for a net decrease of \$542.5 million, at H&R's ownership share.

	3 months ended December 31		Year ended December 31	
	2016	2015	2016	2015
Rentals from investment properties (millions)	\$305.5	\$296.2	\$1,196.0	\$1,188.3
Property operating income (millions)	\$202.4	\$202.1	\$764.7	\$773.5
Net income (loss) before income taxes (millions)	\$182.6	(\$35.9)	\$590.3	\$375.1
Funds from Operations ("FFO") (millions) <sup>(1)</sup>	\$142.9	\$142.9	\$584.3	\$569.9
FFO per Stapled Unit (basic)	\$0.48	\$0.48	\$1.96	\$1.95
FFO per Stapled Unit (diluted)	\$0.47	\$0.48	\$1.93	\$1.92
Distributions per Stapled Unit	\$0.34	\$0.34	\$1.35	\$1.35
Payout ratio per Stapled Unit (as a % of FFO)	70.8%	70.8%	68.9%	69.2%

<sup>(1)</sup> FFO is a non-GAAP measure. See "Non-GAAP Financial Measures" in this press release. The Trusts' combined MD&A includes a reconciliation of FFO to net income. Readers are encouraged to review the reconciliation in the combined MD&A.

### Operating Highlights

Occupancy as at December 31, 2016 was 95.7% compared to 95.9% as at December 31, 2015. Leases representing 3.7% of total rentable area will expire during 2017 and H&R's average remaining lease term to maturity as at December 31, 2016 was 9.5 years.

### Development Highlights

Construction is progressing on the development of 1,871 luxury residential rental units for the LIC Project in which H&R has a 50% interest. The total budget at the 100% ownership level is expected to be approximately U.S. \$1.2 billion with occupancy in the first tower scheduled to begin in early 2018. As at December 31, 2016, total costs incurred amounted to \$655.3 million. The remaining costs are expected to be funded through the construction financing facility. Approximately 99.3% of total hard costs and 89.9% of total project costs have been fixed. Upon completion and stabilized occupancy, the contribution to FFO from the LIC Project at H&R's interest is projected to be U.S. \$23.0 million, which equates to an approximate 8.8% year one yield on H&R's cash investment. During the year, the fair value of the LIC Project increased by U.S. \$54.9 million, at H&R's interest. An independent third party appraisal was obtained for this property in 2016.

In Q1 2016, H&R entered into two separate 15-year build-to-suit leases for industrial properties to be developed in the Airport Road Business Park in Brampton, ON for Sleep Country Canada and Solutions 2 Go Inc. The total net leasable area for these properties will be approximately 341,775 square feet with occupancy of both projects expected to occur in Q3 2017. Upon completion, the contribution to FFO generated from these two projects is expected to be \$1.7 million.

In August 2016, H&R acquired a 31.7% non-managing interest in 38.4 acres of land located in Hercules, California, adjacent to the San Pablo Bay, northeast of San Francisco, ("Hercules Project") for the future development of multi-family residential units. The initial investment to purchase the land was approximately U.S. \$10.0 million (at H&R's interest).



## **Office Segment Highlights**

On June 30, 2016, H&R sold its 33.3% freehold and leasehold interests in Scotia Plaza and 100 Yonge Street (collectively, "Scotia Plaza") for approximately \$438.3 million. The purchaser assumed H&R's share of the existing financing on the properties. H&R recorded a gain on sale, net of related costs, of \$15.0 million. Proceeds to H&R amounted to \$227.0 million, which were primarily used to repay debt including the \$180.0 million Series D Senior Debentures that matured in July 2016.

On November 17, 2016, H&R sold a non-managing 50% interest in the TransCanada Tower in Calgary, AB for gross proceeds of approximately \$257.4 million. H&R built this property in 2001 for a total cost of \$265.8 million, at the 100% level. H&R prepaid the entire mortgage on the property of \$93.5 million upon closing. H&R recorded a loss on sale, net of related costs, of \$7.4 million. Proceeds to H&R amounted to \$163.9 million, which were primarily used to repay debt and acquire a multi-family residential property.

### **Alberta Office Exposure:**

The weighted average lease term remaining in H&R's Alberta office portfolio is 17.2 years. The leases expiring between January 1, 2017 and December 31, 2018 in H&R's Alberta office portfolio total 18,507 square feet. As at December 31, 2016, H&R's Alberta office portfolio had approximately 184,000 square feet of vacant space, at H&R's ownership share, all of which is in F1RST Tower (formerly Telus Tower). Of this vacant space, 12,667 square feet has been leased for a six-year term commencing January 1, 2017.

## **Lantower Residential Highlights**

H&R is continuing its expansion into the multi-family rental market in the United States. During 2016, Lantower Residential acquired four multi-family properties in the United States, all of which were built between 2012 and 2015. These properties comprise 1,246 units and were purchased for a total price of U.S. \$232.2 million.

As at December 31, 2016, Lantower Residential has a portfolio of 12 properties, comprised of an aggregate of 3,832 units, an average age of 13 years and an average monthly rent of U.S. \$1,081 per unit.

## **Industrial Segment Highlights**

In February 2016, H&R acquired a 50% managing interest in a 264,802 square foot newly constructed industrial property in Calgary, AB for \$15.5 million (at H&R's interest).

During 2016, H&R sold its 50% ownership interest in a 139,734 square foot industrial property in Montreal, QC for \$4.2 million and its 50% ownership interest in a 52,792 square foot industrial property in Vaughan, ON for \$3.0 million.

## **Retail Highlights**

During 2016, H&R sold its 100% interest in five retail properties, totaling 490,839 square feet, all of which were located in the U.S. for U.S. \$61.8 million.



## Primaris Highlights and Target Update

In November 2016, H&R entered into a conditional agreement to sell a 50% non-managing interest in two enclosed shopping centres for \$211.6 million which closed in January 2017. The purchaser assumed 50% of the existing financing on the properties of approximately \$126.6 million. The net proceeds of approximately \$81.0 million have been used to repay debt.

Redevelopment of the former Target stores has commenced, however, the space has not been transferred to properties under development because the space is part of an existing, already developed property. For the year ended December 31, 2016, H&R spent approximately \$31.0 million in redevelopment and, in addition, capitalized \$2.4 million of the property operating and finance costs attributable to this space. The following table is a summary of H&R's leasing progress on the former Target space:

	Square Feet at 100%	Square Feet at H&R's Interest	Annual Base Rent at H&R's interest (\$ Millions)
Former Target Canada space <sup>(1)</sup>	1,062,676	774,035	\$4.0
Backfill progress:			
Committed space	583,989	404,270	6.4
Conditional agreements	191,364	176,364	1.5
Advanced discussions	44,215	25,645	0.8
<b>Total backfill progress</b>	<b>819,568</b>	<b>606,279</b>	<b>8.7</b>
Space currently being marketed	49,759	32,593	0.6
<b>Total gross leasable area ("GLA") upon completion of redevelopment</b>	<b>869,327</b>	<b>638,872</b>	<b>\$9.3</b>
Potential GLA converted for landlord uses (common area etc.)	135,508	106,242	N/A
Space for demolition/potential redevelopment	57,841	28,921	N/A
<b>Total<sup>(2)</sup></b>	<b>1,062,676</b>	<b>774,035</b>	

<sup>(1)</sup> The above table is disclosed as of February 6, 2017 and H&R's interest has been updated to reflect the 50% sale of two enclosed shopping centres which closed in January 2017.

<sup>(2)</sup> Represents square footage based on current redevelopment plans and is subject to change based on tenant demand.

H&R expects that, once the above leasing is complete, the new tenants will contribute approximately \$9.3 million annually or 225% of the total base rental revenue lost through Target's departure. H&R expects most of the remaining leases will be entered into by Q2 2017, with occupancy occurring between 2017 and early 2019. Throughout 2016, committed space tenants occupied 73,736 square feet and contributed \$0.4 million in base rent at H&R's interest. The total remaining cost of subdividing and re-leasing the premises is expected to be approximately \$78.0 million at H&R's ownership interest. A partial lease settlement from Target of \$20.4 million was received and recognized in the Trusts' Financial Statements as Other Income for the year ended December 31, 2016.

## Debt and Liquidity Highlights

H&R repaid all of the outstanding Series D Senior Debentures upon maturity for a cash payment of \$180.0 million in July 2016 and all of the outstanding 2016 Convertible Debentures upon maturity for a cash payment of \$75.0 million in December 2016. In November 2016, H&R issued \$200.0 million principal amount of 2.923% Series L Senior Debentures maturing May 6, 2022.

During 2016, H&R (excluding ECHO) secured 12 new mortgages and secured an increase to an existing mortgage adding a total of \$191.1 million of debt at a weighted average interest rate of 2.9% for an average term of 5.1 years and repaid 48 mortgages, which had a weighted average interest rate of 4.9%, upon maturity totalling \$629.2 million. The current weighted average interest rate on outstanding debt is 4.3% with an average term to maturity of 4.8 years.



As at December 31, 2016, the debt to total asset ratio per the Trusts' Financial Statements was 44.3% compared to 46.2% at December 31, 2015 and cash on hand plus undrawn credit facilities amounted to \$400.3 million.

As at December 31, 2016, unencumbered assets were approximately \$3.0 billion and unsecured debt was approximately \$1.7 billion, resulting in a coverage ratio of 1.8x (December 31, 2015 - 1.4x).

### **Distribution Increase**

The trustees approved an increase in the current monthly distribution per Stapled Unit commencing December 2016, resulting in a \$0.03 annual increase to a total of \$1.38 per annum.

A handwritten signature in black ink, appearing to read 'Tom Hofstedter', with a stylized flourish at the end.

*Tom Hofstedter*  
*President and Chief Executive Officer*  
*March 31, 2017*

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

**For the Year ended December 31, 2016**

Dated: February 15, 2017

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## SECTION I

### BASIS OF PRESENTATION

Financial data included in this combined Management's Discussion and Analysis ("MD&A") of combined results of operations and combined financial position of H&R Real Estate Investment Trust ("H&R") and H&R Finance Trust ("Finance Trust" and together with H&R, the "Trusts") for the year ended December 31, 2016 includes material information up to February 15, 2017. 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 Trusts and appended notes for the year ended December 31, 2016 ("Trusts' 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 properties, owned by H&R through an investment in a joint venture or an associate are treated as equity accounted investments in the Trusts' Financial Statements. For the purposes of this MD&A, the Trusts have accounted for these equity accounted investments on a proportionately consolidated basis, and have included reconciliations to the Trusts' combined statements of financial position and statements of comprehensive income on pages 14, 22 and 23, respectively. The Trusts refer to these proportionately consolidated amounts as "The Trusts' interests". This non-GAAP measure is calculated as the sum of the applicable line item in the Trusts' Financial Statements in accordance with IFRS and the Trusts' proportionate share of equity accounted investments for such line item. Management views this method as relevant because it is consistent with how H&R and its co-owners manage the net assets and assess operating performance of each of its co-owned properties. See "Non-GAAP financial measures".

On October 24, 2013, the Ontario Securities Commission (on its behalf and on behalf of the other provincial securities regulators) issued a decision which permits H&R and Finance Trust to file one set of combined financial statements rather than separate financial statements. The Trusts' Financial Statements have been presented on a basis whereby the assets and liabilities of H&R and Finance Trust have been combined in accordance with the accounting principles applicable to both H&R and Finance Trust in accordance with IFRS, to reflect the financial position and results of H&R and Finance Trust on a combined basis. This same decision permits H&R and Finance Trust to file one combined MD&A which has been done for the year ended December 31, 2016.

### 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 "Results of Operations", "Liquidity and Capital Resources", "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, the amount of distributions to unitholders, H&R's expectation with respect to contributions to rental revenue by new tenants in former Target locations, the timing of completion and occupancy of any leases relating to premises vacated by Target and the cost of subdividing and re-leasing premises vacated by Target, the expected budget and occupancy of the Long Island City, NY Project ("LIC Project"), the expected cash flow to H&R from the LIC Project, the expected net leasable area, occupancy date and the expected cash flow from the industrial properties at Airport Road Business Park, the expected capital and tenant expenditures for 160 Elgin St., in Ottawa, ON and 310-320-330 Front St. in Toronto, ON, the adoption of new accounting policies and qualification of H&R for the REIT exemption. 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: real property ownership, credit risk and tenant concentration; lease rollover risk, interest and other debt-related risk; construction risks; currency risk; liquidity risk, financing credit risk, environmental risk; co-ownership interest in properties, joint arrangement risks; unit price risk; availability of cash for distributions; ability to access capital markets; dilution; unitholder liability; redemption right risk; risks relating to debentures, tax risk and tax consequences to U.S. holders. 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 other than in Alberta; local real estate conditions are stable other than in Alberta; 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 H&R 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 H&R 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 H&R's materials filed with the Canadian securities regulatory authorities or for any failure of H&R 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 H&R 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 February 15, 2017 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**

The Trusts' Financial Statements are prepared in accordance with IFRS. However, in this MD&A, a number of measures are presented that are not generally accepted accounting principles ("GAAP") measured under IFRS. These measures, as well as the reasons why management believes these measures are useful to investors, are described below.

None of these non-GAAP financial measures should be construed as an alternative to financial measures calculated in accordance with GAAP. Further, the Trusts' method of calculating these supplemental non-GAAP financial measures may differ from the methods of other real estate investment trusts or other issuers, and accordingly may not be comparable.

### **(a) The Trusts' interests**

The Trusts apply the equity method of accounting to investments in joint ventures and associates in the Trusts' Financial Statements as prescribed under IFRS. Throughout this MD&A, any references to the "Trusts' Financial Statements" refer to amounts as reported under IFRS and any references to "The Trusts' interests" are non-GAAP measures which include amounts per the Trusts' Financial Statements plus the Trusts' proportionate share of equity accounted investments. See "Basis of Presentation".

### **(b) Property operating income (cash basis)**

Property operating income is the rental revenue generated from H&R's investment properties, net of the property operating expenses incurred. Property operating income (cash basis) is a non-GAAP measure which adjusts property operating income to exclude two non-cash items; straight-lining of contractual rent and realty taxes accounted for under IFRS Interpretations Committee 21, *Levies* ("IFRIC 21"). Effective January 1, 2014, H&R adopted IFRIC 21 which relates to the timing of the liability recognition for U.S. realty taxes. By excluding the impact of IFRIC 21, U.S. realty tax expenses are evenly matched with realty tax recoveries received from tenants throughout the period. Management believes this non-GAAP measure is important for investors as it adjusts property operating income for non-cash items which allows investors to better understand H&R's operating performance.

### **(c) Same-Asset property operating income and Same-Asset property operating income (cash basis)**

Same-Asset property operating income and Same-Asset property operating income (cash basis) are non-GAAP financial measures used by H&R which management believes are useful for investors as they reflect period-over-period performance for properties owned by H&R throughout both periods. This typically excludes acquisitions, business combinations, dispositions and transfers of properties under development to investment properties during the last two fiscal years.

### **(d) Funds from operations ("FFO")**

FFO is a non-GAAP financial measure widely used in the real estate industry as a measure of operating performance. The Trusts present their combined FFO calculations in accordance with the Real Property Association of Canada (REALpac) guidelines however, this method of calculating FFO may differ when comparing to other issuers. Management believes this to be a useful measure for investors as it adjusts for items included in net income that are not recurring including gain (loss) on sale of real estate assets, as well as non-cash items such as the fair value adjustments on investment properties. FFO should not be construed as an alternative to net income or cash flows provided by operating activities calculated in accordance with IFRS. See "Funds From Operations" for reconciliations of property operating income and net income to FFO.

**(e) Adjusted funds from operations (“AFFO”)**

AFFO is also a widely used measure in the real estate industry to assess the sustainability of cash distributions. 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 capital and tenant expenditures. Although capital and tenant expenditures can vary from quarter to quarter due to tenant turnovers, vacancies and the age of a property, the Trusts have elected to deduct actual capital and tenant expenditures spent and capitalized in the period instead of deducting a normalized amount based on historical activity. This differs from others in the industry as many entities deduct a normalized amount of capital and tenant expenditures in their AFFO calculation. There is no standard industry definition of AFFO, and as a result, the Trusts’ calculation of combined AFFO may differ from other issuers’ calculations. AFFO should not be construed as an alternative to net income or cash provided by operations calculated in accordance with IFRS. See “Adjusted Funds from Operations” for a reconciliation of AFFO to cash provided by operations.

**(f) Interest coverage ratio**

The interest coverage ratio is reported at the Trusts’ interests and is calculated by dividing the sum of: (i) property operating income (excluding IFRIC 21), (ii) other income, (iii) finance income, (iv) trust expenses (excluding unit-based compensation) and (v) transaction costs; by finance costs from operations (excluding effective interest rate accretion and exchangeable unit distributions). Management uses this ratio to evaluate its ability to service the interest requirements of its outstanding debt.

**(g) Debt to total assets ratios**

H&R’s Declaration of Trust limits the indebtedness of H&R (subject to certain exceptions) to a maximum of 65% of the total assets of H&R, based on the Trusts’ Financial Statements. The Trusts also present this ratio at the Trusts’ interests. Debt includes mortgages payable (including mortgages classified as held for sale), the face value of debentures payable, bank indebtedness and loan payable. Management uses this ratio to determine its flexibility to incur additional debt and ensure it is in compliance with H&R’s Declaration of Trust.

**(h) Unencumbered asset to unsecured debt coverage ratio**

The unencumbered asset to unsecured debt coverage ratio is reported at the Trusts’ interests (excluding ECHO) and is calculated by dividing the sum of: (i) unencumbered assets, defined as investment properties without encumbrances for mortgages or bank indebtedness; by unsecured debt which includes the face value of senior debentures and H&R’s unsecured bank facilities. Management believes this ratio is important for unsecured debt holders, as a higher ratio indicates more properties available to be financed with mortgages to repay unsecured debt.

**OVERVIEW**

H&R is an unincorporated open-ended trust created by a declaration of trust (“H&R’s Declaration of Trust”) and governed by the laws of the Province of Ontario. Unitholders are entitled to have their H&R units comprising part of the Stapled Units (as defined below) 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 H&R’s information circular dated August 20, 2008, as an open-ended limited purpose unit trust pursuant to its declaration of Trust (“Finance Trust’s Declaration of Trust”). Each issued and outstanding Finance Trust unit is “stapled” to a unit of H&R on a one-for-one basis such that Finance Trust units and H&R 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 H&R 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” (as described below), in which case Finance Trust units will cease to be listed on the TSX).

H&R has two primary objectives:

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

H&R’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.

H&R’s strategy to mitigate risk is diversification both by asset class and geographic location. H&R invests in four real estate asset classes which management views as comprising six separate operating segments. H&R invests in office, retail, industrial and residential properties and acquires

properties both in Canada and the United States. H&R's retail asset class is further viewed by management as being comprised of three different operating segments: (i) enclosed shopping centres and multi-tenant retail plazas throughout Canada managed by Primaris Management Inc. ("Primaris"); (ii) other retail properties throughout Canada and the United States managed by H&R REIT Management Services LP ("HRRMSLP"), a wholly-owned subsidiary of H&R, ("H&R Retail"), and (iii) H&R's 33.6% interest in Echo Realty LP ("ECHO"), a privately held real estate and development company which focuses on developing and owning a core portfolio of grocery anchored shopping centres in the United States. H&R's residential segment operates as Lantower Residential, a wholly-owned subsidiary of H&R, and focuses on acquiring multi-family properties in the United States. H&R therefore has six operating segments and management assesses the results of these operations separately.

The primary purpose of Finance Trust is to be a flow-through vehicle to allow H&R to indirectly access the capital markets in a tax-efficient manner by indirectly borrowing money from H&R'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 H&R. As at December 31, 2016, Finance Trust holds U.S. \$220.5 million of aggregate principal amount of notes payable by U.S. Holdco ("U.S. Holdco Notes") (December 31, 2015 – U.S. \$220.4 million). Subject to cash flow requirements, Finance Trust intends to distribute to its unitholders, who are also unitholders of H&R, all of its cash flow, consisting primarily of interest paid by U.S. Holdco, less administrative and other expenses and amounts to satisfy liabilities. The U.S. Holdco Notes are eliminated in the Trusts' Financial Statements, however the related foreign exchange difference is not eliminated upon combination as it flows through net income (loss) on the Finance Trust financial statements and other comprehensive income (loss) on H&R financial statements.

### **Mechanics of "Stapling" the Units of Finance Trust and H&R**

Pursuant to the provisions of the Declarations of Trust for Finance Trust and H&R at all times each H&R unit must be "stapled" to a Finance Trust unit (and each Finance Trust unit must be "stapled" to a H&R unit) unless there is an event of uncoupling. Any references in this MD&A to units should be considered references to Stapled Units. As part of the Plan of Arrangement, H&R 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 H&R to perform its obligations pursuant to H&R's Declaration of Trust, Unit Option Plan, Incentive Unit 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 H&R to perform its obligations arising under any security issued by H&R (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 H&R 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 H&R units and to otherwise ensure at all times that each holder of a particular number of H&R 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 H&R issues additional H&R units, pursuant to the Support Agreement, H&R and Finance Trust will coordinate so as to ensure that each subscriber receives both H&R units and Finance Trust units, which shall trade together as Stapled Units. Prior to such event, H&R 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 H&R directs. In consideration of the issuance and delivery of each such Finance Trust unit, H&R (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 H&R) 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 H&R units by H&R. 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 H&R vote in favour of the uncoupling of units of Finance Trust and units of H&R 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 H&R or U.S. Holdco or the taking of corporate action by H&R or U.S. Holdco in furtherance of any such action or the admitting in writing by H&R 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 H&R and, unless an Event of Uncoupling has occurred, the Stapled Units, on one or more stock exchanges in Canada.

### **Investment Restrictions**

Under Finance Trust's 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.

Finance Trust's 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.

## CHANGE IN ACCOUNTING POLICY

Except as described below, the accounting policies applied by the Trusts as at and for the year ended December 31, 2016, are the same as those applied in the Trusts' Financial Statements as at and for the year ended December 31, 2015. The Trusts' Financial Statements reflect the retrospective application of a voluntary change in accounting policy adopted in 2016 to classify interest paid and finance cost-exchangeable unit distributions as an operating activity in the combined statements of cash flows, instead of within financing activities, as previously reported. The change in accounting policy was adopted in accordance with IAS 7, Statement of Cash Flows, which provides a policy choice to classify interest paid as either an operating activity or a financing activity. H&R considers the classification of these interest payments within operating activities to be the most useful to financial statement users when comparing distributions to cash provided by operations and, consequently, that this presentation results in reliable and more relevant information.

The following table outlines the effect of this accounting policy change for the year ended December 31, 2015:

	Previously reported	Restatement	Restated
Cash provided by operating activities	771,542	(304,188)	\$467,354
Cash used in financing activities	(466,202)	304,188	(\$162,014)

## SECTION II

### SUMMARY OF QUARTERLY RESULTS

The following tables summarize certain financial information of the Trusts per the Trusts' financial statements for the quarters indicated below:

(in thousands of Canadian dollars)	Q4 2016	Q3 2016	Q2 2016	Q1 2016
Rentals from investment properties	\$305,500	\$297,258	\$289,835	\$303,418
Net income (loss) from equity accounted investments	82,176	4,758	(19,722)	(18,871)
Finance income	925	854	1,694	1,242
Net income	140,616	113,865	104,079	30,185
Total comprehensive income (loss)	180,987	139,798	88,387	(58,794)

	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Rentals from investment properties	\$296,236	\$297,055	\$295,688	\$299,335
Net income (loss) from equity accounted investments	(39,017)	20,884	9,493	9,481
Finance income	1,225	986	811	748
Net income (loss)	(39,454)	165,949	119,554	94,099
Total comprehensive income	15,342	249,903	102,995	199,369

Fluctuations between quarterly results are generally from new property acquisitions, dispositions, changes in foreign exchange rates and changes in the fair value of real estate assets and the fair value of 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.

Net income (loss) from equity accounted investments increased by \$77.4 million in Q4 2016 compared to Q3 2016 primarily due to the fair value adjustment on real estate assets increasing by \$53.3 million mainly due to the value of the LIC Project increasing by U.S. \$54.9 million at H&R's interest. An independent third party appraisal was obtained for this property in Q4 2016.

Net income (loss) from equity accounted investments increased by \$121.2 million in Q4 2016 compared to Q4 2015 primarily due to the fair value adjustment on real estate assets increasing by \$100.5 million, the majority of which relates to the value of the LIC Project increasing by U.S. \$54.9 million at H&R's interest, and a fair value write-down in Q4 2015 to F1RST Tower in Calgary as a result of higher expected vacancies due to an overall weakening of the Alberta economy.

Net income increased by \$180.1 million in Q4 2016 compared to Q4 2015 primarily due to the following: (i) an increase in the fair value adjustment on real estate assets in particular relating to several investment properties in Alberta that had been written down in Q4 2015 due to the overall weakening of the Alberta economy and (ii) an increase in net income (loss) in equity accounted investments as explained above.

Total comprehensive income increased by \$165.6 million in Q4 2016 compared to Q4 2015 primarily due to the increase in net income explained above offset by a decrease in the unrealized gain on translation of U.S. denominated foreign operations.

## SELECTED ANNUAL INFORMATION

The following table summarizes certain financial information of the Trusts per the Trusts' Financial Statements for the years indicated below:

<b>(in thousands of Canadian dollars except per unit amounts)</b>	<b>Year Ended December 31, 2016</b>	Year Ended December 31, 2015	Year Ended December 31, 2014
Rentals from investment properties	<b>\$1,196,011</b>	\$1,188,314	\$1,227,803
Finance income	<b>4,715</b>	3,770	901
Net income	<b>388,745</b>	340,148	424,655
Total comprehensive income	<b>350,378</b>	567,609	515,190
Total assets	<b>14,155,012</b>	13,990,315	13,368,380
Total non-current financial liabilities <sup>(1)</sup>	<b>5,186,536</b>	5,771,833	5,226,705
Cash distributions per unit	<b>\$1.35</b>	\$1.35	\$1.35

<sup>(1)</sup> The total non-current financial liabilities includes mortgages payable, the face value of debentures payable, bank indebtedness and accounts payable and accrued liabilities.

**FINANCIAL HIGHLIGHTS**

(in thousands except per unit amounts)	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Total assets <sup>(1)</sup>	<b>\$14,736,194</b>	\$14,714,535	\$13,941,980	\$14,107,004
Ratio of debt to total assets per the Trusts' Financial Statements <sup>(2)</sup>	<b>44.3%</b>	46.2%	46.3%	49.2%
Ratio of debt to total assets based on the Trusts' interests <sup>(1)</sup>	<b>46.0%</b>	48.4%	48.1%	50.8%
Unencumbered asset to unsecured debt coverage ratio <sup>(1)</sup>	<b>1.78</b>	1.41	1.30	1.05
Stapled Units outstanding	<b>285,280</b>	279,610	274,773	269,975
Exchangeable units outstanding	<b>16,564</b>	16,664	16,664	17,403
	<b>Three months ended December 31, 2016</b>	Three months ended December 31, 2015	<b>Year ended December 31, 2016</b>	Year ended December 31, 2015
Rentals from investment properties <sup>(1)</sup>	<b>\$327,851</b>	\$331,331	<b>\$1,310,168</b>	\$1,320,287
Same-Asset property operating income (cash basis) <sup>(1)(3)</sup>	<b>196,101</b>	199,127	<b>776,314</b>	774,307
FFO <sup>(1)</sup>	<b>142,899</b>	142,879	<b>584,301</b>	569,943
Weighted average number of basic Stapled Units for FFO <sup>(1)</sup>	<b>300,482</b>	294,944	<b>298,404</b>	293,026
FFO per basic Stapled Unit <sup>(1)</sup>	<b>0.48</b>	0.48	<b>1.96</b>	1.95
Distributions paid per Stapled Unit	<b>0.34</b>	0.34	<b>1.35</b>	1.35
Payout ratio per Stapled Unit as a % of FFO <sup>(1)</sup>	<b>70.8%</b>	70.8%	<b>68.9%</b>	69.2%
Interest coverage ratio <sup>(1)</sup>	<b>3.00</b>	2.82	<b>2.91</b>	2.84

Property operating income and net income are 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 30-36.

(1) These are non-GAAP measures reported at the Trusts' interests. See "Non-GAAP Financial Measures" on pages 2 and 3.

(2) This is a non-GAAP measure. See "Non-GAAP Financial Measures" on pages 2 and 3;

(3) Same-Asset property operating income (cash basis) includes properties owned by H&R for the two-year period ended December 31, 2016 and excludes the impact of straight-lining of contractual rent as well as realty taxes accounted for under IFRIC 21.

**KEY PERFORMANCE DRIVERS**

<b>OPERATIONS<sup>(1)</sup></b>		Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total*
<i>Occupancy as at December 31</i>	<b>2016</b>	<b>96.9%</b>	<b>87.4%</b>	<b>98.6%</b>	<b>94.3%</b>	<b>99.8%</b>	<b>93.1%</b>	<b>95.7%</b>
	2015	98.0%	87.1%	98.7%	94.5%	99.0%	93.8%	95.9%
<i>Occupancy – Same-Asset as at December 31<sup>(2)</sup></i>	<b>2016</b>	<b>96.9%</b>	<b>87.4%</b>	<b>98.6%</b>	<b>93.7%</b>	<b>99.8%</b>	<b>92.7%</b>	<b>95.8%</b>
	2015	98.0%	87.1%	98.6%	94.0%	99.6%	95.5%	96.1%
<i>Average contractual rent per sq.ft. for the year ended December 31-Canadian properties<sup>(3)</sup></i>	<b>2016</b>	<b>\$26.12</b>	<b>\$23.83</b>	<b>\$11.70</b>	<b>N/A</b>	<b>\$6.52</b>	<b>N/A</b>	<b>\$18.32</b>
	2015	\$26.20	\$24.32	\$11.52	N/A	\$6.31	N/A	\$18.80
<i>Average contractual rent per sq.ft. for the year ended December 31-U.S. properties<sup>(4)</sup></i>	<b>2016</b>	<b>\$35.07</b>	<b>N/A</b>	<b>\$13.25</b>	<b>\$15.01</b>	<b>\$3.64</b>	<b>\$14.04</b>	<b>\$14.59</b>
	2015	\$34.03	N/A	\$12.87	\$14.43	\$3.49	\$12.76	\$13.96
<i>Average remaining term to maturity of leases as at December 31 (in years)</i>	<b>2016</b>	<b>12.6</b>	<b>4.6</b>	<b>7.1</b>	<b>11.3</b>	<b>7.5</b>	<b>N/A</b>	<b>9.5</b>
	2015	13.1	4.5	7.5	11.7	7.8	N/A	9.9
<i>Average remaining term to maturity of mortgages payable as at December 31 (in years)</i>	<b>2016</b>	<b>5.2</b>	<b>4.3</b>	<b>5.8</b>	<b>11.1</b>	<b>6.4</b>	<b>8.3</b>	<b>5.7</b>
	2015	5.9	5.6	5.0	11.2	6.9	9.3	6.2

\* Weighted average total.

(1) Includes properties held within equity accounted investments and investment properties classified as assets held for sale.

(2) Same-Asset refers to those properties owned by H&R for the two-year period ended December 31, 2016.

(3) All amounts are stated in Canadian dollars and exclude properties sold in their respective year.

(4) All amounts are stated in U.S. dollars and exclude properties sold in their respective year.

**PORTFOLIO OVERVIEW**

The geographic diversification of the portfolio of properties in which the Trusts have an interest and their related square footage, including those properties held in entities that the Trusts account for as equity accounted investments as at December 31, 2016, are outlined in the charts below:

Number of Properties	Canada			United States	Total
	Ontario	Alberta	Other		
Office	21	5	4	7	37
Primaris	6	18	7	-	31
H&R Retail	35	2	7	82	126
ECHO <sup>(1)</sup>	-	-	-	215	215
Industrial	38	18	30	15	101
Lantower Residential <sup>(2)</sup>	-	-	-	12	12
<b>Total</b>	<b>100</b>	<b>43</b>	<b>48</b>	<b>331</b>	<b>522</b>

Square Feet (in thousands) <sup>(3)</sup>	Canada			United States	Total
	Ontario	Alberta	Other		
Office	6,424	2,961	893	2,023	12,301
Primaris	2,394	3,939	2,416	-	8,749
H&R Retail	1,771	240	707	4,664	7,382
ECHO <sup>(1)</sup>	-	-	-	2,979	2,979
Industrial	4,683	1,895	2,053	3,152	11,783
Lantower Residential <sup>(2)</sup>	-	-	-	3,538	3,538
<b>Total</b>	<b>15,272</b>	<b>9,035</b>	<b>6,069</b>	<b>16,356</b>	<b>46,732</b>

<sup>(1)</sup> ECHO also has four development projects and five parcels of vacant land areas which are not included in the table above.

<sup>(2)</sup> Lantower Residential's properties contain 3,832 apartment units.

<sup>(3)</sup> Square feet (in thousands) is based on the Trusts' interest in the net leasable area of properties.



**LEASE MATURITY PROFILE**

The following tables disclose H&R's leases expiring in Canada and the United States including equity accounted investments but excluding Lantower Residential.

**Canadian Portfolio:**

	Office		Primaris		H&R Retail		Industrial		Total	
LEASE EXPIRIES	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry
2017	175,525	28.42	833,568	27.81	36,354	16.54	120,183	7.94	1,165,630	25.50
2018	418,075	19.55	1,172,840	23.62	163,718	11.12	960,632	4.93	2,715,265	15.63
2019	507,147	20.35	953,302	20.41	1,007,577	10.49	828,867	5.90	3,296,893	13.72
2020	174,026	24.83	999,460	20.65	96,715	15.32	693,178	8.30	1,963,379	16.40
2021	425,424	17.75	889,818	23.46	567,110	12.56	276,949	5.83	2,159,301	17.21
	1,700,197	20.79	4,848,988	23.07	1,871,474	11.54	2,879,809	6.23	11,300,468	16.53
Total % of each segment	16.5%		55.4%		68.8%		33.4%		37.2%	

**U.S. Portfolio<sup>(1)</sup>:**

	Office		H&R Retail		ECHO		Industrial		Total	
LEASE EXPIRIES	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry	Sq.ft.	Rent per sq.ft. (\$) on expiry
2017	-	-	243,707	12.98	186,479	9.47	-	-	430,186	11.46
2018	-	-	329,392	13.05	141,730	12.62	493,506	2.98	964,628	7.83
2019	-	-	417,027	11.10	98,791	13.14	242,785	3.69	758,603	8.99
2020	-	-	102,539	39.66	343,490	6.69	-	-	446,029	14.27
2021	-	-	287,094	13.02	146,219	16.88	606,143	3.13	1,039,456	7.80
	-	-	1,379,759	14.42	916,709	10.49	1,342,434	3.18	3,638,902	9.28
Total % of each segment	-		29.6%		30.8%		42.6%		28.4%	

<sup>(1)</sup> U.S. dollars.

TOP TWENTY SOURCES OF REVENUE BY TENANT<sup>(1)</sup>

Tenant	% of rentals from investment properties <sup>(2)</sup>	Number of locations	H&R owned sq.ft. (in 000's)	Average lease term to maturity (in years) <sup>(3)</sup>	Credit Ratings (S&P)
1. Encana Corporation	11.8%	2	2,059	20.9	BBB Negative
2. Bell Canada	8.0	24	2,542	8.6	BBB+ Stable
3. Hess Corporation	5.0	2	848	<sup>(8)</sup>	BBB- Stable
4. New York City Department of Health	3.6	1	660	13.9	AA Stable
5. Giant Eagle, Inc.	3.5	192	1,961	13.2	Not Rated
6. Canadian Tire Corporation <sup>(4)</sup>	2.5	19	2,666	8.7	BBB+ Stable
7. Lowe's Companies, Inc. <sup>(5)</sup>	2.5	22	2,664	3.2	A- Stable
8. TransCanada Pipelines Limited	1.9	2	499	13.8	A- Negative
9. Canadian Imperial Bank of Commerce	1.7	9	555	7.3	A+ Stable
10. Corus Entertainment Inc.	1.6	1	472	16.2	BB Stable
11. Telus Communications	1.6	17	425	6.4	BBB+ Stable
12. Nestle Canada and USA	1.5	4	1,255	7.1	AA Stable
13. Ontario Realty Corporation and other Ontario Agencies <sup>(6)</sup>	1.2	4	366	3.6	A+ Stable
14. Shell Oil Products	1.1	17	223	5.5	A Stable
15. Marsh Supermarkets	1.0	9	548	14.3	Not Rated
16. Loblaw Companies Limited <sup>(7)</sup>	0.9	21	302	9.2	BBB Stable
17. Public Works and Government Services, Canada	0.9	5	309	5.8	AAA Stable
18. Toronto-Dominion Bank	0.9	8	259	9.8	AA- Stable
19. Royal Bank of Canada	0.8	4	244	7.6	AA- Negative
20. Publix Super Markets Inc	0.8	14	531	9.5	Not Rated
<b>Total</b>	<b>52.8%</b>	<b>377</b>	<b>19,388</b>	<b>12.0</b>	

<sup>(1)</sup> Includes the Trusts' interests in equity accounted investments.

<sup>(2)</sup> The percentage of rentals from investment properties is based on estimated annualized Same-Asset gross revenue excluding straight-lining of contractual rent, rent amortization of tenant inducements and capital expenditure recoveries.

<sup>(3)</sup> Average lease term to maturity is weighted based on net rent.

<sup>(4)</sup> Canadian Tire Corporation includes Canadian Tire, Mark's, Sport Chek, Atmosphere and Sports Experts.

<sup>(5)</sup> Lowe's Companies, Inc. includes Rona.

<sup>(6)</sup> Other Ontario agencies include: Legal Aid Ontario, Ontario Lottery and Gaming Corporation, Liquor Control Board of Ontario and Hydro One Networks.

<sup>(7)</sup> Loblaw Companies Limited includes Loblaw, No Frills and Shoppers Drug Mart.

<sup>(8)</sup> Due to the confidentiality under the tenant lease, the term is not disclosed.

## FINANCIAL AND OPERATING HIGHLIGHTS 2016

### Financial Highlights

H&R undertook a strategic review of its assets and decided to sell certain investment properties to take advantage of the strong property market and high demand for good quality assets. During 2015 and 2016, H&R sold \$1.3 billion of real estate assets and acquired \$757.5 million of real estate assets for a net decrease of \$542.5 million, at H&R's ownership share. This had the following impact on H&R's financial results at the Trusts' interests:

- Rentals from investment properties decreased by \$10.1 million for the year ended December 31, 2016 compared to the respective 2015 period.
- Property Operating income decreased by \$19.6 million for the year ended December 31, 2016 compared to the respective 2015 period.
- FFO, excluding non-recurring items, decreased by \$5.9 million for the year ended December 31, 2016 compared to the respective 2015 period.
- FFO per unit, excluding non-recurring items, was \$1.88 for the year ended December 31, 2016 compared to \$1.93 per unit for the year ended December 31, 2015.

While financial results have declined over the past two years due to net property sales, H&R has used the net proceeds from those sales to significantly improve its financial position which has resulted in the following:

- As at December 31, 2016, the debt to total asset ratio per the Trusts' Financial Statements was 44.3% compared to 46.2% at December 31, 2015.
- Interest coverage ratio was 3.00 for the three months ended December 31, 2016 compared to 2.82 for the three months ended December 31, 2015.
- As at December 31, 2016, unencumbered assets were approximately \$3.0 billion and unsecured debt was approximately \$1.7 billion, resulting in a coverage ratio of 1.8x (December 31, 2015 - 1.4x).

### Operating Highlights

Occupancy as at December 31, 2016 was 95.7% compared to 95.9% as at December 31, 2015. Leases representing only 3.7% of total rentable area will expire during 2017 and H&R's average remaining lease term to maturity as at December 31, 2016 was 9.5 years (in each case, excluding leases from Lantower Residential).

## SUMMARY OF SIGNIFICANT 2016 ACTIVITY

### Development Highlights

Construction is progressing on the development of 1,871 luxury residential rental units for the LIC Project in which H&R has a 50% interest. The total budget at the 100% ownership level is expected to be approximately U.S. \$1.2 billion with occupancy in the first tower scheduled to begin in early 2018. As at December 31, 2016, total costs incurred amounted to \$655.3 million. The remaining costs are expected to be funded through the construction financing facility. Approximately 99.3% of total hard costs and 89.9% of total project costs have been fixed. Upon completion and stabilized occupancy, the contribution to FFO from the LIC Project at H&R's interest is projected to be U.S. \$23.0 million, which equates to an approximate 8.8% year one yield on H&R's cash investment. During the year, the fair value of the LIC Project increased by U.S. \$54.9 million, at H&R's interest. An independent third party appraisal was obtained for this property in 2016.

In Q1 2016, H&R entered into two separate 15-year build-to-suit leases for industrial properties to be developed in the Airport Road Business Park in Brampton, ON for Sleep Country Canada and Solutions 2 Go Inc. The total net leasable area for these properties will be approximately 341,775 square feet with occupancy of both projects expected to occur in Q3 2017. Upon completion, the contribution to FFO generated from these two projects is expected to be \$1.7 million.

In August 2016, H&R acquired a 31.7% non-managing interest in 38.4 acres of land located in Hercules, California, adjacent to the San Pablo Bay, northeast of San Francisco, ("Hercules Project") for the future development of multi-family residential units. The initial investment to purchase the land was approximately U.S. \$10.0 million (at H&R's interest).

### Office Segment Highlights

On June 30, 2016, H&R sold its 33.3% freehold and leasehold interests in Scotia Plaza and 100 Yonge Street (collectively, "Scotia Plaza") for approximately \$438.3 million. The purchaser assumed H&R's share of the existing financing on the properties. H&R recorded a gain on sale, net of related costs, of \$15.0 million. Proceeds to H&R amounted to \$227.0 million, which were primarily used to repay debt including the \$180.0 million Series D Senior Debentures that matured in July 2016.

On November 17, 2016, H&R sold a non-managing 50% interest in the TransCanada Tower in Calgary, AB for gross proceeds of approximately \$257.4 million. H&R built this property in 2001 for a total cost of \$265.8 million, at the 100% level. H&R prepaid the entire mortgage on the property of \$93.5

million upon closing, which included a prepayment penalty of \$13.6 million. H&R recorded a loss on sale, net of related costs, of \$7.4 million. Proceeds to H&R amounted to \$163.9 million, which were primarily used to repay debt and acquire a multi-family residential property.

*Alberta Office Exposure:*

The weighted average lease term remaining in H&R's Alberta office portfolio is 17.2 years. The leases expiring between January 1, 2017 and December 31, 2018 in H&R's Alberta office portfolio total 18,507 square feet. As at December 31, 2016, H&R's Alberta office portfolio had approximately 184,000 square feet of vacant space, at H&R's ownership share, all of which is in F1RST Tower (formerly Telus Tower). Of this vacant space, 12,667 square feet has been leased for a six-year term commencing January 1, 2017.

H&R Retail Highlights

During 2016, H&R sold its 100% interest in five retail properties, totaling 490,839 square feet, all of which were located in the U.S. for U.S. \$61.8 million.

Primaris Highlights and Target Update

*Primaris Highlights:*

In November 2016, H&R entered into a conditional agreement to sell a 50% non-managing interest in two enclosed shopping centres for \$211.6 million which closed in January 2017. The purchaser assumed 50% of the existing financing on the properties of approximately \$126.6 million. The net proceeds of approximately \$81.0 million have been used to repay debt.

*Target Update:*

Redevelopment of the former Target stores has commenced, however, the space has not been transferred to properties under development because the space is part of an existing, already developed property. For the year ended December 31, 2016, H&R spent approximately \$31.0 million in redevelopment and, in addition, capitalized \$2.4 million of the property operating and finance costs attributable to this space. The following table is a summary of H&R's leasing progress on the former Target space:

	Square Feet at 100%	Square Feet at H&R's Interest	Annual Base Rent at H&R's interest (\$ Millions)
Former Target Canada space <sup>(1)</sup>	1,062,676	774,035	\$4.0
Backfill progress:			
Committed space	583,989	404,270	6.4
Conditional agreements	191,364	176,364	1.5
Advanced discussions	44,215	25,645	0.8
<b>Total backfill progress</b>	<b>819,568</b>	<b>606,279</b>	<b>8.7</b>
Space currently being marketed	49,759	32,593	0.6
<b>Total gross leasable area ("GLA") upon completion of redevelopment</b>	<b>869,327</b>	<b>638,872</b>	<b>\$9.3</b>
Potential GLA converted for landlord uses (common area etc.)	135,508	106,242	N/A
Space for demolition/potential redevelopment	57,841	28,921	N/A
<b>Total<sup>(2)</sup></b>	<b>1,062,676</b>	<b>774,035</b>	

<sup>(1)</sup> The above table is disclosed as of February 6, 2017 and H&R's interest has been updated to reflect the 50% sale of two enclosed shopping centres which closed in January 2017.

<sup>(2)</sup> Represents square footage based on current redevelopment plans and is subject to change based on tenant demand.

H&R expects that, once the above leasing is complete, the new tenants will contribute approximately \$9.3 million annually or 225% of the total base rental revenue lost through Target's departure. H&R expects most of the remaining leases will be entered into by Q2 2017, with occupancy occurring between 2017 and early 2019. Throughout 2016, committed space tenants occupied 73,736 square feet and contributed \$0.4 million in base rent at H&R's interest. The total remaining cost of subdividing and re-leasing the premises is expected to be approximately \$78.0 million at H&R's ownership interest. A partial lease settlement from Target of \$20.4 million was received and recognized in the Trusts' Financial Statements as Other Income for the year ended December 31, 2016.

#### Lantower Residential Highlights

H&R is continuing its expansion into the multi-family rental market in the United States. During 2016, Lantower Residential acquired four multi-family properties in the United States, all of which were built between 2012 and 2015. These properties comprise 1,246 units and were purchased for a total price of U.S. \$232.2 million.

As at December 31, 2016, Lantower Residential has a portfolio of 12 properties, comprised of an aggregate of 3,832 units, an average age of 13 years and an average monthly rent of U.S. \$1,081 per unit.

#### Industrial Segment Highlights

In February 2016, H&R acquired a 50% managing interest in a 264,802 square foot newly constructed industrial property in Calgary, AB for \$15.5 million (at H&R's interest).

During 2016, H&R sold its 50% ownership interest in a 139,734 square foot industrial property in Montreal, QC for \$4.2 million and its 50% ownership interest in a 52,792 square foot industrial property in Vaughan, ON for \$3.0 million.

#### Debt and Liquidity Highlights

H&R repaid all of the outstanding Series D Senior Debentures upon maturity for a cash payment of \$180.0 million in July 2016 and all of the outstanding 2016 Convertible Debentures upon maturity for a cash payment of \$75.0 million in December 2016. In November 2016, H&R issued \$200.0 million principal amount of 2.923% Series L Senior Debentures maturing May 6, 2022.

During 2016, H&R (excluding ECHO) secured 12 new mortgages and secured an increase to an existing mortgage adding a total of \$191.1 million of debt at a weighted average interest rate of 2.9% for an average term of 5.1 years and repaid 48 mortgages, which had a weighted average interest rate of 4.9% upon maturity totalling \$629.2 million. The current weighted average interest rate on outstanding debt is 4.3% with an average term to maturity of 4.8 years.

As at December 31, 2016, the debt to total asset ratio per the Trusts' Financial Statements was 44.3% compared to 46.2% at December 31, 2015 and cash on hand plus undrawn credit facilities amounted to \$400.3 million.

As at December 31, 2016, unencumbered assets were approximately \$3.0 billion and unsecured debt was approximately \$1.7 billion, resulting in a coverage ratio of 1.8x (December 31, 2015 - 1.4x).

#### Distribution Increase

The trustees approved an increase in the current monthly distribution per Stapled Unit commencing December 2016, resulting in a \$0.03 annual increase to a total of \$1.38 per annum.

## SECTION III

## FINANCIAL POSITION

(in thousands of Canadian dollars)	December 31, 2016			December 31, 2015		
	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interests <sup>(1)</sup>	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interest <sup>(1)</sup>
<b>Assets</b>						
Real estate assets						
Investment properties	\$12,564,144	\$1,046,539	\$13,610,683	\$12,576,075	\$1,512,361	\$14,088,436
Properties under development	118,268	510,527	628,795	97,504	226,494	323,998
	<b>12,682,412</b>	<b>1,557,066</b>	<b>14,239,478</b>	<b>12,673,579</b>	<b>1,738,855</b>	<b>14,412,434</b>
Equity accounted investments	1,051,187	(1,051,187)	-	1,117,786	(1,117,786)	-
Assets classified as held for sale	211,550	-	211,550	3,000	-	3,000
Other assets	161,842	41,000	202,842	157,663	53,200	210,863
Cash and cash equivalents	48,021	34,303	82,324	38,287	49,951	88,238
	<b>\$14,155,012</b>	<b>\$581,182</b>	<b>\$14,736,194</b>	<b>\$13,990,315</b>	<b>\$724,220</b>	<b>\$14,714,535</b>
<b>Liabilities and Unitholders' Equity</b>						
Liabilities						
Mortgages payable	\$4,001,451	\$328,812	\$4,330,263	\$4,537,278	\$572,669	\$5,109,947
Debentures payable	1,491,591	-	1,491,591	1,550,769	-	1,550,769
Exchangeable units	370,533	-	370,533	334,110	-	334,110
Deferred tax liability	386,775	167	386,942	189,658	-	189,658
Liabilities classified as held for sale	126,815	-	126,815	-	-	-
Loan payable	-	-	-	55,717	-	55,717
Bank indebtedness	647,772	181,250	829,022	321,033	90,058	411,091
Accounts payable and accrued liabilities	217,425	51,591	269,016	176,830	40,884	217,714
Non-controlling interest	-	19,362	19,362	-	20,609	20,609
	<b>7,242,362</b>	<b>581,182</b>	<b>7,823,544</b>	<b>7,165,395</b>	<b>724,220</b>	<b>7,889,615</b>
Unitholders' equity	6,912,650	-	6,912,650	6,824,920	-	6,824,920
	<b>\$14,155,012</b>	<b>\$581,182</b>	<b>\$14,736,194</b>	<b>\$13,990,315</b>	<b>\$724,220</b>	<b>\$14,714,535</b>

(1) "The Trusts' interests" is a non-GAAP measure which includes amounts per the Trusts' Financial Statements and the Trusts' proportionate share of equity accounted investments.

Properties under development per the Trusts' Financial Statements as at December 31, 2016 increased by \$20.8 million compared to December 31, 2015, primarily due to the development of two buildings in the Airport Road Business Park. Refer to page 18 in this MD&A for further information.

Equity accounted investments per the Trusts' Financial Statements as at December 31, 2016 decreased by \$66.6 million compared to December 31, 2015, primarily due to the sale of H&R's interest in Scotia Plaza, offset by the development of the LIC Project and the acquisition of land for the Hercules Project.

Mortgages payable per the Trusts' Financial Statements as at December 31, 2016 decreased by \$535.8 million compared to December 31, 2015, primarily due to the REIT repaying mortgages upon sale and maturity of \$338.8 million, principal repayments of \$151.0 million, mortgages reclassified to liabilities held for sale of \$126.6 million partially offset by new mortgages of \$131.9 million.

Deferred tax liability per the Trusts' Financial Statements as at December 31, 2016 increased by \$197.1 million compared to December 31, 2015, primarily due to increases in the fair value of U.S. investment properties resulting in higher deferred tax.

Bank indebtedness per the Trusts' Financial Statements as at December 31, 2016 increased by \$326.7 million compared to December 31, 2015, primarily due to H&R using its banking credit facilities to repay mortgages and fund certain U.S. acquisitions.

**ASSETS**

**Real Estate Assets:**

**2016 Acquisitions:**

Property/Acquisition	Year Built	Segment	Date Acquired	Number Of Units	Purchase Price (\$ Millions)	Ownership Interest Acquired
283009 Logistics Dr., Calgary, AB <sup>(1)(2)</sup>	2014	Industrial	Feb 23, 2016	-	\$15.5	50%
3767 Southwest Durham Dr., Durham, NC	2014	Multi-family	Jun 22, 2016	322	76.8 <sup>(3)</sup>	100%
Hercules Bayfront, Hercules, CA <sup>(1)</sup>	-	Multi-family-Dev.	Aug 10, 2016	-	13.0 <sup>(3)</sup>	31.7%
4025 Huffines Blvd., Carrollton, TX	2012	Multi-family	Aug 15, 2016	312	59.9 <sup>(3)</sup>	100%
4504 W. Spruce St., Tampa, FL	2014	Multi-family	Oct 19, 2016	300	90.6 <sup>(3)</sup>	100%
327 W. Sunset Rd., San Antonio, TX	2015	Multi-family	Nov 30, 2016	312	76.2 <sup>(3)</sup>	100%
<b>Total</b>				<b>1,246</b>	<b>\$332.0</b>	

<sup>(1)</sup> Purchase price is stated at H&R's ownership interest.

<sup>(2)</sup> The square footage at H&R's interest is 132,401.

<sup>(3)</sup> Translated to Canadian dollars as at the date acquired.

During the year ended November 30, 2016, ECHO acquired four properties, four properties under development and two land parcels totaling 94,872 square feet for a purchase price of \$21.7 million, at H&R's interest.

**2015 Acquisitions:**

Property	Year Built	Segment	Date Acquired	Number Of Units	Purchase Price (\$ Millions) <sup>(1)</sup>	Ownership Interest Acquired
8401 Memorial Lane, Plano, TX	2008	Multi-family	Feb 10, 2015	398	\$65.8	100%
12932 Mallory Circle, Orlando, FL	2004	Multi-family	Apr 15, 2015	314	61.0	100%
12101 Fountainbrook Blvd., Orlando, FL	2000	Multi-family	Apr 21, 2015	400	65.5	100%
1801 Warner Ranch Rd., Round Rock, TX	2001	Multi-family	Oct 8, 2015	358	61.5	100%
325 Murray Farm Rd., Fairview, TX	2008	Multi-family	Oct 28, 2015	304	57.4	100%
125 & 175 Fountain Crt., Fairview, TX	2008	Multi-family	Oct 28, 2015	116	19.1	100%
<b>Total</b>				<b>1,890</b>	<b>\$330.3</b>	

<sup>(1)</sup> Translated to Canadian dollars as at the date acquired.

During the year ended November 30, 2015, ECHO acquired nine properties, two properties under development and four land parcels totaling 215,225 square feet for a purchase price of \$73.5 million, at H&R's interest.

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**2016 Dispositions:**

Property	Segment	Date Sold	Square Feet	Selling Price (\$ Millions)	Ownership Interest Sold
2800 Skymark Ave., Mississauga, ON <sup>(1)</sup>	Office	Q1-Q4 2016	22,940	\$3.2	100%
1929 N.E. Pine Island Rd., Cape Coral, FL	H&R Retail	Mar 28, 2016	119,598	24.1 <sup>(3)</sup>	100%
733 Pleasant Hill Rd., Lilburn, GA	H&R Retail	Mar 30, 2016	132,847	6.0 <sup>(3)</sup>	100%
1 Moyal Ct., Vaughan, ON <sup>(2)</sup>	Industrial	Apr 7, 2016	26,396	3.0	50%
150 New Jersey State Hwy Route 73, Voorhees, NJ	H&R Retail	Apr 11, 2016	115,396	24.8 <sup>(3)</sup>	100%
3712 Call Field Rd., Wichita Falls, TX	H&R Retail	May 19, 2016	108,178	14.7 <sup>(3)</sup>	100%
Scotia Plaza, Toronto, ON <sup>(2)</sup>	Office	Jun 30, 2016	743,812	438.3	33.3%
20600 Clark-Graham Ave., Montreal, QC <sup>(2)</sup>	Industrial	Aug 31, 2016	69,867	4.2	50%
110 S. Southwest Loop #323, Tyler, TX	H&R Retail	Sep 26, 2016	14,820	11.2 <sup>(3)</sup>	100%
3900 Gantz Rd., Grove City, OH <sup>(2)</sup>	Industrial	Oct 27, 2016	87,012	3.7 <sup>(3)</sup>	50.5%
450-1st St. S.W., (TransCanada Tower) Calgary, AB <sup>(2)</sup>	Office	Nov 17, 2016	465,594	257.4	50%
<b>Total</b>			<b>1,906,460</b>	<b>\$790.6</b>	

<sup>(1)</sup> Sold as separate condominium units.

<sup>(2)</sup> Square feet and selling price are based on the ownership interest disposed.

<sup>(3)</sup> Translated to Canadian dollars as at the date sold.

During the year ended November 30, 2016, ECHO sold a 34,815 square foot property for gross proceeds of \$2.2 million, at H&R's interest.

**2015 Dispositions:**

Property	Segment	Date Sold	Square Feet	Selling Price (\$ Millions)	Ownership Interest Sold
1400 Church St., Pickering, ON	Industrial	Jan 29, 2015	716,261	\$70.2	100%
2800 Skymark Ave., Mississauga, ON <sup>(1)</sup>	Office	Q1 and Q2 2015	11,098	5.3	100%
Industrial Portfolio - Tranche 2 <sup>(2)(3)</sup>	Industrial	Mar 24, 2015	3,497,440	239.6	49.5%-50%
6315 Kenway Dr., Mississauga, ON <sup>(2)</sup>	Industrial	Apr 13, 2015	34,339	3.7	50%
1 Kenview Blvd., Brampton, ON	Office	May 28, 2015	74,338	6.3	100%
44285 Ice Rink Plaza, Ashburn, VA	H&R Retail	Jun 25, 2015	13,815	10.5 <sup>(5)</sup>	100%
46651 Algonkian Pkwy., Sterling, VA	H&R Retail	Jun 25, 2015	16,838	12.3 <sup>(5)</sup>	100%
4527 Losee Rd., Las Vegas, NV	Industrial	Jun 26, 2015	50,659	5.5 <sup>(5)</sup>	100%
14111-14300 Entertainment Blvd. & 14140 Triangle Rd., Richmond, BC	H&R Retail	Sep 1, 2015	314,033	103.0	100%
360 Spinnaker Way, Vaughan, ON <sup>(2)</sup>	Industrial	Oct 9, 2015	31,429	5.3	75%
7900 Airport Rd., Brampton, ON <sup>(4)</sup>	Development	Dec 3, 2015	-	10.3	100%
11 Kenview Blvd., Brampton, ON <sup>(2)</sup>	Industrial	Dec 8, 2015	72,118	5.9	50%
<b>Total</b>			<b>4,832,368</b>	<b>\$477.9</b>	

<sup>(1)</sup> Sold as separate condominium units.

<sup>(2)</sup> Square feet and selling price are based on the ownership interest disposed.

<sup>(3)</sup> H&R retained an ownership interest of 50%-50.5% in these properties.

<sup>(4)</sup> Part of Block 2, Plan 43M-1939, designated as Parts 9-11, Plan 43R-35791 which consisted of approximately 11.8 acres of land.

<sup>(5)</sup> Translated to Canadian dollars as at the date sold.

During the year ended November 30, 2015, ECHO sold three properties totaling 74,177 square feet for gross proceeds of \$3.3 million, at H&R's interest.



**Investment Properties by Segment and Region:**

The following tables disclose the fair values of the Trusts' interests in investment properties by operating segment and geographic location, excluding assets held for sale:

<b>Segment (millions)</b>	<b>Fair Value December 31, 2016<sup>(1)</sup></b>	<b>Fair Value December 31, 2015<sup>(1)</sup></b>
Office	\$6,496	\$7,043
Primaris	2,943	3,205
H&R Retail	1,547	1,621
ECHO	768	734
Industrial	1,102	1,062
Lantower Residential	755	423
<b>Total portfolio</b>	<b>\$13,611</b>	<b>\$14,088</b>

<b>Region (millions)</b>	<b>Fair Value December 31, 2016<sup>(1)</sup></b>	<b>Fair Value December 31, 2015<sup>(1)</sup></b>
Ontario	\$4,144	\$4,649
Alberta	3,539	3,916
Other	1,323	1,432
Canada	9,006	9,997
United States	4,605	4,091
<b>Total portfolio</b>	<b>\$13,611</b>	<b>\$14,088</b>

<sup>(1)</sup> Please refer to note 4 of the Trusts' Financial Statements for the assumptions and methods used in measuring the fair value of the portfolio.

The following weighted average capitalization rates as at December 31, 2016 are calculated based on stabilized property operating income at the Trusts' interests, excluding assets held for sale, for the three months ended December 31, 2016 (December 31, 2015 - based on the three months ended December 31, 2015). The capitalization rates disclosed below are reported at the Trusts' interests and include equity accounted investments which differs from the Trusts' Financial Statements.

<b>Weighted Average Overall Capitalization Rates</b>	<b>December 31, 2016</b>						
	<b>Office</b>	<b>Primaris</b>	<b>H&amp;R Retail</b>	<b>ECHO</b>	<b>Industrial</b>	<b>Residential</b>	<b>Total</b>
<b>Canada</b>	5.92%	5.53%	6.61%	-	6.41%	-	5.88%
<b>United States</b>	5.27%	-	7.09%	6.77%	7.02%	5.39%	6.06%

<b>Weighted Average Overall Capitalization Rates</b>	<b>December 31, 2015</b>						
	<b>Office</b>	<b>Primaris</b>	<b>H&amp;R Retail</b>	<b>ECHO</b>	<b>Industrial</b>	<b>Residential</b>	<b>Total</b>
Canada	5.96%	5.56%	6.76%	-	6.79%	-	5.94%
United States	6.34%	-	7.36%	6.86%	6.84%	5.82%	6.68%

### ***Properties under Development***

#### Long Island City Project

In June 2014, H&R purchased a 50% interest in the LIC Project. Tishman Speyer, a U.S. real estate company, is the developer and manager of the LIC Project. The parcel is zoned for 1.3 million square feet of mixed-used development, potentially accommodating up to approximately 1,871 luxury residential rental units and approximately 14,000 square feet of retail space. The site is located adjacent to H&R's Two Gotham Center office property. Construction commenced in Q1 2015 with occupancy in the first tower expected to begin in early 2018. H&R's total cash investment in the LIC Project is \$260.7 million. The total project cost of all phases at the 100% level is expected to be approximately U.S. \$1.2 billion. As at December 31, 2016, total costs incurred amounted to \$655.3 million. The remaining costs are expected to be funded through the construction financing facility. Approximately 99.3% of total hard costs and 89.9% of total project costs have been fixed. Upon completion and stabilized occupancy, the contribution to FFO from the LIC Project at H&R's interest is projected to be U.S. \$23.0 million, which equates to an approximate 8.8% year one yield on H&R's cash investment. During the year, the fair value of the LIC Project increased by U.S. \$54.9 million, at H&R's interest. An independent third party appraisal was obtained for this property in 2016.

#### Development of Airport Road Project

In Q1 2016, H&R entered into two separate 15-year build-to-suit leases for industrial properties to be developed in the Airport Road Business Park in Brampton, ON for Sleep Country Canada and Solutions 2 Go Inc. The total net leasable area for these properties will be approximately 341,775 square feet with occupancy of both projects expected to occur in Q3 2017. Upon completion, the contribution to FFO from these two projects is expected to be \$1.7 million.

#### Hercules Project

In August 2016, H&R acquired a 31.7% non-managing interest in 38.4 acres of land located in Hercules, California, adjacent to the San Pablo Bay, northeast of San Francisco, for the future development of multi-family residential units. The initial investment to purchase the land was approximately U.S. \$10.0 million (at H&R's interest).

#### ECHO

During the year ended December 31, 2016, eight ECHO properties were transferred from properties under development to investment properties. H&R's share of the square footage transferred was 79,922 and the value transferred was \$60.9 million. Major tenants at these properties include Giant Eagle, Inc. and Safeway Inc.

### ***Assets and Liabilities Classified as Held for Sale***

As at December 31, 2016, H&R had a 50% ownership interest in two Primaris properties with a fair value of \$211.6 million and liabilities of \$126.8 million classified as held for sale. In January 2017, these assets were sold for \$211.6 million. As at December 31, 2015, H&R had a 50% ownership interest in one industrial property with a fair value of \$3.0 million classified as held for sale. In April 2016, this asset was sold for \$3.0 million.

## LIABILITIES AND UNITHOLDERS' EQUITY

All ratios and amounts in the table below are non-GAAP measures.

	December 31, 2016	December 31, 2015
Debt to total assets per the Trusts' Financial Statements	44.3%	46.2%
Debt to total assets based on the Trusts' interests	46.0%	48.4%
Ratio of non-recourse mortgages as a percentage of total mortgages	54.2%	55.6%
Unencumbered assets <sup>(1)</sup> (in thousands of Canadian dollars)	\$3,011,721	\$2,063,794
Unsecured debt	\$1,689,418	\$1,467,999
Unencumbered asset to unsecured debt coverage ratio	1.78:1	1.41:1
Interest coverage ratio	2.91:1	2.84:1
Weighted average interest rate of outstanding debt <sup>(2)</sup>	4.3%	4.4%
Weighted average term to maturity of outstanding debt (in years) <sup>(2)</sup>	4.8	5.3

<sup>(1)</sup> Excludes ECHO.

<sup>(2)</sup> Outstanding debt includes mortgages and the face value of debentures payable.

### ***Mortgages Payable***

The following table shows the change in the Trusts' interests in mortgages payable from January 1, 2016 to December 31, 2016:

<i>(in thousands of Canadian dollars)</i>	
Opening balance, beginning of year	\$5,109,947
Principal repayments	(175,505)
Mortgages repaid	(424,863)
New mortgages	216,289
Mortgages reclassified to liabilities held for sale	(126,567)
Mortgages released upon the sale of investment properties	(208,948)
Effective interest rate accretion on mortgages	(4,823)
Change in foreign exchange rates	(55,267)
<b>Closing balance, end of year</b>	<b>\$4,330,263</b>

The following table shows the mortgage maturity profile at the Trusts' interests as at December 31, 2016:

<b>MORTGAGES PAYABLE</b>	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2017	\$152,220	\$391,805	\$544,025	12.6	4.7%
2018	153,959	148,879	302,838	7.0	4.8%
2019	165,639	146,229	311,868	7.2	3.6%
2020	146,186	372,820	519,006	12.0	4.4%
2021	126,716	718,136	844,852	19.5	4.0%
Thereafter			1,801,192	41.7	
			4,323,781	100%	
Financing costs and mark-to-market adjustments arising on acquisitions <sup>(1)</sup>			6,482		
<b>Total</b>			<b>\$4,330,263</b>		

<sup>(1)</sup> 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 Trusts' mortgages payable balances and are recognized in finance costs over the life of the applicable mortgage.

The mortgages outstanding as at December 31, 2016 bear interest at a weighted average rate of 4.4% (December 31, 2015 - 4.6%) and mature between 2017 and 2040. The weighted average term to maturity of the Trusts' mortgages is 5.7 years (December 31, 2015 - 6.2 years). 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".

### **Debentures Payable**

Debentures payable decreased by \$59.2 million from \$1,550.8 million as at December 31, 2015 to \$1,491.6 million as at December 31, 2016 primarily due to H&R repaying; (i) all of the outstanding Series D Senior Debentures upon maturity for a cash payment of \$180.0 million in July 2016 and (ii) all of the outstanding 2016 Convertible Debentures upon maturity for a cash payment of \$75.0 million in December 2016. This was offset by the issuance of the \$200.0 million Series L Senior Debentures maturing May 6, 2022.

In Q1 2016, H&R entered into three interest rate swap agreements to effectively fix the interest rate on the following: (i) \$60.0 million floating rate Series I Senior Debentures which matured in January 2017 were fixed at 2.54% per annum; (ii) U.S \$125.0 million floating rate Series J Senior Debentures maturing in February 2018 were fixed at 2.04% per annum; and (iii) \$200.0 million floating rate Series K Senior Debentures maturing in March 2019 were fixed at 2.36% per annum. These interest rate swaps are intended to limit H&R's interest rate exposure during the respective terms and are marked-to-market through net income each reporting period.

H&R has elected to measure the outstanding convertible debentures at fair value. H&R uses the quoted prices on the TSX to determine the fair value of each series of convertible debentures as permitted under IFRS 13, *Fair Value Measurement*. The fluctuation in fair value between each period is recorded as a gain (loss) on change in fair value.

### **Exchangeable Units**

Certain of H&R's subsidiaries have exchangeable units outstanding which are puttable instruments where H&R 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.

At the end of each period the fair value is determined by using the quoted prices of Stapled Units on the TSX as the exchangeable units are exchangeable into Stapled Units at the option of the holder. Holders of all exchangeable units are entitled to receive the economic equivalent of distributions on a per unit amount equal to a per Stapled Unit amount provided to holders of Stapled Units.

During the year ended December 31, 2016, 100,000 exchangeable units were exchanged for Stapled Units.

The following number of exchangeable units are issued and outstanding:

	Number of Exchangeable Units	Quoted Price of Stapled Units	Amounts per the Trusts' Financial Statements (\$000's)
<b>As at December 31, 2016</b>	<b>16,563,816</b>	<b>\$22.37</b>	<b>\$370,533</b>
As at December 31, 2015	16,663,816	\$20.05	\$334,110

A subsidiary of H&R also holds 0.4 million Stapled Units to mirror 0.4 million exchangeable units. Therefore, when the approximately 16.6 million exchangeable units are exchanged for Stapled Units, the number of outstanding Stapled Units will only increase by 16.2 million. These 0.4 million exchangeable units have been excluded from the weighting of exchangeable units used to calculate FFO and AFFO per unit amounts as they are already included in the total Stapled Units outstanding.

### **Deferred Tax Liability**

H&R has certain subsidiaries in the United States that are subject to tax on their taxable income at a rate of approximately 37.5%. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	December 31, 2016	December 31, 2015
<b>Deferred tax assets:</b>		
Net operating losses and deferred interest deductions	\$79.2	\$84.9
Accounts payable and accrued liabilities	2.3	2.1
Other assets	1.8	0.9
	<b>83.3</b>	<b>87.9</b>
<b>Deferred liabilities:</b>		
Investment properties	405.1	254.2
Equity accounted investments	65.1	23.4
	<b>470.2</b>	<b>277.6</b>
Deferred tax liability	<b>(\$386.9)</b>	<b>(\$189.7)</b>

The deferred tax liability as at December 31, 2016 increased by \$197.2 million compared to December 31, 2015, primarily due to increases in the fair value of U.S. investment properties resulting in higher deferred tax. The deferred tax liability relating to the investment properties is derived on the basis that the U.S. investment properties will be sold at their current fair value. The tax liability will only be realized upon an actual disposition.

### **Loan Payable**

In February 2016, H&R repaid the remainder of the loan payable to ECHO for a total cash payment of U.S. \$60.8 million. The amount presented on the Trusts' combined statements of financial position as at December 31, 2015 represents the loan payable amount net of H&R's interest in the equity accounted investment in ECHO.

### **Unitholders' Equity**

Unitholders' equity increased by \$87.7 million from \$6,824.9 million as at December 31, 2015 to \$6,912.6 million as at December 31, 2016. The increase is primarily due to net income and the issuance of units under the DRIP, partially offset by distributions paid to unitholders and other comprehensive loss.

Other comprehensive income (loss) consists of the unrealized gain on translation of U.S. denominated foreign operations and the transfer of realized losses on cash flow hedges to net income. Fluctuations in other comprehensive income (loss) is primarily due to changes in foreign exchange rates.

### **Normal Course Issuer Bid**

On July 8, 2016, the Trusts received approval from the TSX for the renewal of their normal course issuer bid ("NCIB"), allowing the Trusts to purchase for cancellation up to a maximum of 5.0 million Stapled Units on the open market until the earlier of July 13, 2017 or the date on which the Trusts have purchased the maximum number of Stapled Units permitted under the NCIB. During the year ended December 31, 2016, under a previous NCIB, the

Trusts purchased and cancelled 141,800 Stapled Units at a weighted average price of \$19.28 per unit, for a total cost of approximately \$2.7 million. During the year ended December 31, 2015, under a previous NCIB, the Trusts purchased and cancelled 179,400 Stapled Units at a weighted average price of \$21.94 per unit, for a total cost of approximately \$3.9 million.

**RESULTS OF OPERATIONS**

(in thousands of Canadian dollars)	Three months ended December 31					
	2016			2015		
	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interests <sup>(1)</sup>	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interests <sup>(1)</sup>
Property operating income:						
Rentals from investment properties	\$305,500	\$22,351	\$327,851	\$296,236	\$35,095	\$331,331
Property operating costs	(103,134)	(4,008)	(107,142)	(94,134)	(9,638)	(103,772)
	<b>202,366</b>	<b>18,343</b>	<b>220,709</b>	202,102	25,457	227,559
Net income (loss) from equity accounted investments	82,176	(82,065)	111	(39,017)	39,413	396
Other income	1,454	-	1,454	-	-	-
Finance cost - operations	(69,861)	(4,511)	(74,372)	(74,202)	(6,960)	(81,162)
Finance income	925	(18)	907	1,225	162	1,387
Fair value adjustments on financial instruments	6,198	9,588	15,786	11,803	(186)	11,617
Trust expenses	(7,014)	(382)	(7,396)	(2,581)	(848)	(3,429)
Fair value adjustment on real estate assets	(32,488)	59,931	27,443	(148,086)	(57,023)	(205,109)
Gain (loss) on sale of real estate assets, net of related costs	(7,816)	(571)	(8,387)	1,665	(16)	1,649
Gain on foreign exchange	6,695	-	6,695	11,212	-	11,212
Net income before income taxes	182,635	315	182,950	(35,879)	(1)	(35,880)
Income tax expense	(42,019)	(145)	(42,164)	(3,575)	146	(3,429)
Net income attributable to the Trusts' unitholders	140,616	170	140,786	(39,454)	145	(39,309)
Non-controlling interest	-	(170)	(170)	-	(145)	(145)
Net income	140,616	-	140,616	(39,454)	-	(39,454)
Other comprehensive income:						
Unrealized gain on translation of U.S. denominated foreign operations	40,363	-	40,363	54,788	-	54,788
Transfer of realized loss on cash flow hedges to net income	8	-	8	8	-	8
	<b>40,371</b>	<b>-</b>	<b>40,371</b>	54,796	-	54,796
Total comprehensive income all attributable to unitholders	\$180,987	\$ -	\$180,987	\$15,342	\$ -	\$15,342

<sup>(1)</sup> "The Trusts' interests" is a non-GAAP measure which includes amounts per the Trusts' Financial Statements and the Trusts' proportionate share of equity accounted investments.

Net income before income taxes per the Trusts' Financial Statements increased by \$218.5 million for the three months ended December 31, 2016 compared to the three months ended December 31, 2015 primarily due to the following: (i) large write downs Q4 2015 to the fair value of certain investment properties in Alberta due to the overall weakening of the Alberta economy and (ii) an increase in net income (loss) in equity accounted investments primarily due to the value of the LIC Project increasing by U.S. \$54.9 million in Q4 2016 at H&R's interest, and a fair value write-down in Q4 2015 to F1RST Tower in Calgary as a result of higher expected vacancies due to the overall weakening of the Alberta economy.

## RESULTS OF OPERATIONS

(in thousands of Canadian dollars)	Year ended December 31					
	2016			2015		
	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interests <sup>(1)</sup>	Amounts per the Trusts' Financial Statements	Equity accounted investments	The Trusts' interests <sup>(1)</sup>
Property operating income:						
Rentals from investment properties	\$1,196,011	\$114,157	\$1,310,168	\$1,188,314	\$131,973	\$1,320,287
Property operating costs	(431,271)	(33,061)	(464,332)	(414,801)	(40,039)	(454,840)
	764,740	81,096	845,836	773,513	91,934	865,447
Net income (loss) from equity accounted investments	48,341	(47,813)	528	841	(288)	553
Other income	20,353	-	20,353	-	-	-
Finance cost - operations	(287,325)	(22,341)	(309,666)	(295,010)	(24,863)	(319,873)
Finance income	4,715	461	5,176	3,770	447	4,217
Fair value adjustments on financial instruments	(33,830)	(1,039)	(34,869)	36,240	(1,122)	35,118
Trust expenses	(29,852)	(1,611)	(31,463)	(9,327)	(1,123)	(10,450)
Fair value adjustment on real estate assets	133,738	(22,489)	111,249	(178,868)	(61,763)	(240,631)
Gain (loss) on sale of real estate assets, net of related costs	(8,167)	14,484	6,317	(5,428)	(2,832)	(8,260)
Gain (loss) on foreign exchange	(8,944)	-	(8,944)	49,375	-	49,375
Transaction costs	(13,483)	-	(13,483)	-	-	-
Net income before income taxes	590,286	748	591,034	375,106	390	375,496
Income tax expense	(201,541)	(290)	(201,831)	(34,958)	(114)	(35,072)
Net income attributable to the Trusts' unitholders	388,745	458	389,203	340,148	276	340,424
Non-controlling interest	-	(458)	(458)	-	(276)	(276)
Net income	388,745	-	388,745	340,148	-	340,148
Other comprehensive income (loss):						
Unrealized gain (loss) on translation of U.S. denominated foreign operations	(38,397)	-	(38,397)	227,430	-	227,430
Transfer of realized loss on cash flow hedges to net income	30	-	30	31	-	31
	(38,367)	-	(38,367)	227,461	-	227,461
Total comprehensive income all attributable to unitholders	\$350,378	\$ -	\$350,378	\$567,609	\$ -	\$567,609

<sup>(1)</sup> "The Trusts' interests" is a non-GAAP measure which includes amounts per the Trusts' Financial Statements and the Trusts' proportionate share of equity accounted investments.

Net income before income taxes per the Trusts' Financial Statements increased by \$215.2 million for the year ended December 31, 2016 compared to the year ended December 31, 2015 primarily due to a 2016 increase in the fair value adjustment on real estate assets for U.S. real estate assets which recorded fair value increases for Two Gotham Center in Long Island City, NY and Hess Tower in Houston, TX. This was partially offset by fair value adjustments on financial instruments, specifically the gain (loss) on fair value of exchangeable units which is determined using the quoted prices of Stapled Units on the TSX. The gain (loss) on foreign exchange also offset this increase due to the Canadian dollar weakening against the U.S. dollar.

**PROPERTY OPERATING INCOME**

Property operating income consists of rentals from investment properties (“rentals”) less property operating costs. Rentals include all amounts earned from tenants related to lease agreements, including basic rent, parking income, operating costs and realty tax recoveries. Property operating costs primarily consist of realty taxes, maintenance and utilities. Maintenance includes costs relating to items such as cleaning, interior and exterior building repairs and maintenance, elevator, HVAC, security and wages and benefits. Management believes that property operating income is a useful measure for investors as it provides a snapshot of how H&R’s properties are performing before financing costs and other sources of income and expenditures which are not directly related to the day-to-day operations of a property. Property operating income (cash basis) adjusts property operating income to exclude straight-lining of contractual rent and realty taxes accounted for under IFRIC 21. Management believes this non-GAAP measure is important for investors as it adjusts property operating income for non-cash items which allows investors to better understand H&R’s operating performance. “Same-Asset” refers to those properties owned by H&R for the entire two-year period ended December 31, 2016. “Transactions” refers to property operating income earned related to properties acquired, disposed of and transferred from properties under development to investment properties.

(in thousands of Canadian dollars)	Three months ended December 31, 2016			Three months ended December 31, 2015		
	Same-Asset	Transactions	The Trusts’ interests	Same-Asset	Transactions	The Trusts’ interests
Rentals	\$304,511	\$20,839	\$325,350	\$299,816	\$29,868	\$329,684
Percentage rent	1,380	(2)	1,378	1,325	17	1,342
Straight-lining of contractual rent	1,294	(171)	1,123	1,453	(1,148)	305
Total rentals	307,185	20,666	327,851	302,594	28,737	331,331
Property operating costs	(101,174)	(5,968)	(107,142)	(92,758)	(11,014)	(103,772)
Property operating income	206,011	14,698	220,709	209,836	17,723	227,559
Straight-lining of contractual rent	(1,294)	171	(1,123)	(1,453)	1,148	(305)
Realty taxes in accordance with IFRIC 21	(8,616)	(2,264)	(10,880)	(9,256)	(1,030)	(10,286)
Property operating income (cash basis)	\$196,101	\$12,605	\$208,706	\$199,127	\$17,841	\$216,968

Same-Asset property operating income (cash basis) decreased by \$3.0 million for the three months ended December 31, 2016 compared to the three months ended December 31, 2015 primarily due to Target vacating 831,688 square feet (at H&R’s ownership interest in Q2 2015) and Telus Corporation vacating 170,918 square feet at F1RST Tower (at H&R’s ownership interest) in April 2016. Included in Same-Asset property operating income (cash basis) for the three months ended December 31, 2016 and 2015 were lease termination payments of \$0.1 million and \$0.3 million, respectively.

Property operating income (cash basis) from Transactions decreased by \$5.2 million for the three months ended December 31, 2016 compared to the three months ended December 31, 2015, primarily due to the sale of Scotia Plaza. For a list of properties purchased and sold in 2016 & 2015, please refer to pages 15 and 16 of this MD&A.

(in thousands of Canadian dollars)	Year ended December 31, 2016			Year ended December 31, 2015		
	Same-Asset	Transactions	The Trusts’ interests	Same-Asset	Transactions	The Trusts’ interests
Rentals	\$1,193,953	\$107,188	\$1,301,141	\$1,182,249	\$117,522	\$1,299,771
Percentage rent	3,454	15	3,469	3,584	55	3,639
Straight-lining of contractual rent	6,195	(637)	5,558	16,908	(31)	16,877
Total rentals	1,203,602	106,566	1,310,168	1,202,741	117,546	1,320,287
Property operating costs	(421,093)	(43,239)	(464,332)	(411,526)	(43,314)	(454,840)
Property operating income	782,509	63,327	845,836	791,215	74,232	865,447
Straight-lining of contractual rent	(6,195)	637	(5,558)	(16,908)	31	(16,877)
Realty taxes in accordance with IFRIC 21	-	-	-	-	-	-
Property operating income (cash basis)	\$776,314	\$63,964	\$840,278	\$774,307	\$74,263	\$848,570

Same-Asset property operating (cash basis) income increased by \$2.0 million for the year ended December 31, 2016 compared to the year ended December 31, 2015 primarily due to the strengthening of the U.S. dollar compared to the Canadian dollar and contractual rental escalations. This was partially offset by Target vacating 831,688 square feet (at H&R’s ownership interest in Q2 2015) and Telus Corporation vacating 170,918 square feet at



F1RST Tower (at H&R's ownership interest) in April 2016. Included in Same-Asset property operating income (cash basis) for the year ended December 31, 2016 and 2015 were lease termination payments of \$1.8 million and \$2.3 million, respectively.

Property operating income (cash basis) from Transactions decreased by \$10.3 million for the year ended December 31, 2016 compared to the year ended December 31, 2015, primarily due to the sale of Scotia Plaza. For a list of properties purchased and sold in 2016 & 2015, please refer to pages 15 and 16 of this MD&A.

Refer to the "Segmented Information" section of this MD&A for further details on property operating income.

## SEGMENTED INFORMATION

H&R's strategy to mitigate risk is diversification both by geographic location and asset class.

### Geographic Locations:

The Trusts operate in two geographic locations: Canada and the United States. Property operations for both Canada and the United States share the same investment and operating policies as described above in the "Operating Segments" section of this MD&A. The Trusts have provided additional disclosure for Ontario and Alberta but does not view these individual provinces as separate geographic locations.

(in thousands of Canadian dollars)	Same-Asset property operating income (cash basis)				Occupancy (same asset)	
	Three months ended December 31		Year ended December 31		As at December 31	
	2016	2015	2016	2015	2016	2015
Ontario <sup>(1)</sup>	\$66,793	\$66,536	\$253,320	\$256,420	96.4%	95.6%
Alberta	51,985	54,628	207,621	214,671	91.4%	93.0%
Other Canada	22,848	22,898	86,537	86,287	95.9%	96.8%
Total – Canada	141,626	144,062	547,478	557,378	94.8%	95.1%
United States <sup>(1)</sup>	54,475	55,065	228,836	216,929	98.1%	98.3%
The Trusts' interests	\$196,101	\$199,127	\$776,314	\$774,307	95.8%	96.1%

<sup>(1)</sup> Property operating income relating to corporate entities has been included in Ontario for Canadian properties and the United States for U.S. properties.

Same-Asset property operating income (cash basis) from Canada decreased by \$2.4 million and \$9.9 million, respectively, for the three months and year ended December 31, 2016 compared to the respective 2015 periods primarily due to the Primaris segment discussed below. Included in Same-Asset property operating income (cash basis) from the Canadian region was lease termination payments of \$0.1 million and \$1.8 million, respectively, for the three months and year ended December 31, 2016, compared to \$0.3 million and \$2.3 million, respectively, for the three months and year ended December 31, 2015.

Same-Asset property operating (cash basis) income from the U.S. changed by (\$0.6 million) and \$11.9 million, respectively, for the three months and year ended December 31, 2016 compared to the respective 2015 periods. The average exchange rate for the three months ended December 31, 2016 was Canadian \$1.32 for each U.S. \$1.00 (Q4 2015 - \$1.34). The average exchange rate for the year ended December 31, 2016 was Canadian \$1.32 for each U.S. \$1.00 (December 31, 2015 - \$1.28).

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The Trusts have provided the table below to disclose the United States region in U.S. dollars to eliminate the effect of fluctuations in foreign exchange.

United States: (in thousands of U.S. dollars)	Same-Asset property operating income (cash basis)				Occupancy (same asset)	
	Three months ended December 31		Year ended December 31		As at December 31	
	2016	2015	2016	2015	2016	2015
Office <sup>(1)</sup>	\$15,303	\$14,953	\$70,168	\$66,610	100.0%	100.0%
H&R Retail	14,513	14,563	58,510	58,084	99.1%	99.0%
ECHO	7,710	7,757	30,022	30,608	93.7%	94.0%
Industrial	2,786	2,741	11,146	10,906	100.0%	100.0%
Lantower Residential	957	999	3,514	3,268	92.7%	95.5%
U.S. total in U.S. dollars	\$41,269	\$41,013	\$173,360	\$169,476	98.1%	98.3%

<sup>(1)</sup> Property operating income relating to corporate entities has been included in the Office segment with the exception of Primaris and ECHO, which have been reported in their specific segment.

Same-Asset property operating income (cash basis) from the U.S. region increased by \$0.3 million and \$3.9 million, respectively, for the three months and year ended December 31, 2016 compared to the respective 2015 periods primarily due to contractual rental escalations in certain office properties.

**Operating Segments:**

H&R invests in four real estate asset classes which management views as comprising six separate operating segments. H&R invests in office, retail, industrial and residential properties both in Canada and the United States. H&R's retail asset class is further viewed by management as being comprised of three different operating segments: (i) enclosed shopping centres and multi-tenant retail plazas throughout Canada managed by Primaris; (ii) other retail properties throughout Canada and the United States managed by HRRMSLP ("H&R Retail"), and (iii) H&R's 33.6% interest in ECHO, a privately held real estate and development company which focuses on developing and owning a core portfolio of grocery anchored shopping centres in the United States. H&R's residential segment operates as Lantower Residential, and focuses on acquiring multi-family properties in the United States. H&R therefore has six operating segments and management assesses the results of these operations separately. The Chief Executive Officer measures the performance of H&R's real estate assets on the basis of property operating income, and, additionally, Same-Asset property operating income which highlights period-over-period changes in rental rates, occupancy, percentage rent and sundry income. Further disclosure of segmented information by operating segment can be found in the Trusts' Financial Statements.

(in thousands of Canadian dollars)	Same-Asset property operating income (cash basis)				Occupancy (same asset)	
	Three months ended December 31		Year ended December 31		As at December 31	
	2016	2015	2016	2015	2016	2015
Office <sup>(1)</sup>	\$95,492	\$97,179	\$385,257	\$379,498	96.9%	98.0%
Primaris	44,761	46,332	169,694	178,676	87.4%	87.1%
H&R Retail	26,651	26,835	106,792	103,737	98.6%	98.6%
ECHO	10,177	10,386	39,629	39,178	93.7%	94.0%
Industrial	17,757	17,071	70,303	69,034	99.8%	99.6%
Lantower Residential	1,263	1,324	4,639	4,184	92.7%	95.5%
The Trusts' interests	\$196,101	\$199,127	\$776,314	\$774,307	95.8%	96.1%

<sup>(1)</sup> Property operating income relating to corporate entities has been included in the Office segment with the exception of Primaris and ECHO, which have been reported in their specific segment.

Same-Asset property operating income (cash basis) from the Office segment decreased by \$1.7 million for the three months ended December 31, 2016 compared to the respective 2015 period due to a decline in occupancy, primarily as a result of Telus Corporation vacating approximately 170,918 square feet at F1RST Tower (at H&R's ownership interest) in April 2016. Same-Asset property operating income (cash basis) from the Office segment increased by \$5.8 million for the year ended December 31, 2016 compared to the respective 2015 period primarily due to contractual rental escalations and the strengthening of the U.S. dollar compared to the Canadian dollar. This was partially offset by a decline in occupancy primarily as a result of Telus Corporation vacating approximately 170,918 square feet (at H&R's ownership interest) in April 2016.

Same-Asset property operating income (cash basis) from the Primaris segment decreased by \$1.6 million and \$9.0 million, respectively, for the three months and year ended December 31, 2016 compared to the respective 2015 periods primarily due to several tenant bankruptcies that occurred in the last 12 months. In addition, Target vacating in Q2 2015 further decreased Same-Asset property operating income (cash basis) for the year ended December 31, 2016 compared to the year ended December 31, 2015.

Same-Asset property operating income (cash basis) from the H&R Retail segment increased by \$3.1 million for the year ended December 31, 2016 compared to the respective 2015 period primarily due to the strengthening of the U.S. dollar compared to the Canadian dollar.

Same-Asset property operating income (cash basis) from the Industrial segment increased by \$1.3 million for the year ended December 31, 2016 compared to the respective 2015 period primarily due to the strengthening of the U.S. dollar compared to the Canadian dollar.

For the 16 enclosed shopping centres within the Primaris segment, sales per square foot, on a same-tenant basis, for Commercial Retail Units (“CRU”) have decreased to \$539 per square foot for the rolling twelve months ended December 31, 2016 from \$547 in the comparative period. For the same 16 properties within the Primaris segment, all store sales decreased by 2.0%. These figures only include enclosed shopping centres owned by Primaris for the entire rolling 24-month period ending December 31, 2016.

	All Store Sales (in thousands of Canadian dollars) Rolling 12 month ended December 31			Same Store Sales (per square foot) Rolling 12 month ended December 31		
	2016	2015	% Change	2016	2015	% Change
	Cataraqui Town Centre	<b>\$87,874</b>	\$88,194	(0.4%)	<b>\$536</b>	\$510
Dufferin Mall	<b>113,645</b>	107,495	5.7	<b>620</b>	608	2.0
Grant Park <sup>(1)</sup>	<b>25,269</b>	26,079	(3.1)	<b>453</b>	463	(2.2)
Kildonan Place <sup>(1)</sup>	<b>77,355</b>	75,381	2.6	<b>541</b>	529	2.3
McAllister Place <sup>(1)</sup>	<b>56,263</b>	56,498	(0.4)	<b>509</b>	509	-
Medicine Hat Mall	<b>55,125</b>	63,583	(13.3)	<b>475</b>	506	(6.1)
Orchard Park Shopping Centre	<b>166,362</b>	160,020	4.0	<b>676</b>	643	5.1
Park Place Shopping Centre	<b>87,527</b>	88,682	(1.3)	<b>592</b>	606	(2.3)
Peter Pond Mall <sup>(2)</sup>	<b>70,615</b>	88,046	(19.8)	<b>623</b>	784	(20.5)
Place d’Orleans <sup>(1)</sup>	<b>96,936</b>	96,915	-	<b>450</b>	455	(1.1)
Place du Royaume	<b>105,982</b>	104,941	1.0	<b>418</b>	407	2.7
Regent Mall <sup>(1)</sup>	<b>81,410</b>	79,338	2.6	<b>577</b>	576	0.2
Sherwood Park Mall	<b>49,122</b>	53,696	(8.5)	<b>467</b>	512	(8.8)
St. Albert Centre	<b>29,729</b>	31,445	(5.5)	<b>497</b>	530	(6.2)
Stone Road Mall	<b>109,822</b>	111,540	(1.5)	<b>607</b>	601	1.0
Sunridge Mall	<b>100,791</b>	108,450	(7.1)	<b>490</b>	524	(6.5)
<b>Total<sup>(3)</sup></b>	<b>\$1,313,827</b>	<b>\$1,340,303</b>	<b>(2.0%)</b>	<b>\$539</b>	<b>\$547</b>	<b>(1.5%)</b>

<sup>(1)</sup> All store sales and same-store sales have been reported as if Primaris owned 100% of Grant Park, Kildonan Place, McAllister Place, Place d’Orleans and Regent Mall for the entire rolling 12 months ended December 31, 2016 and 2015.

<sup>(2)</sup> All store sales and same-store sales have primarily decreased due to the recent wildfire in Fort McMurray, AB. Peter Pond Mall closed in accordance with a city-wide evacuation order on May 3, 2016. The mall re-opened on June 1, 2016 and all stores were re-opened in July 2016.

<sup>(3)</sup> The total same-store sales figures have been presented on a weighted average basis.

**OTHER INCOME AND EXPENSE ITEMS**

The other income and expense items section of this MD&A provides management's commentary on the Trusts' Results of Operations for line items below net income from equity accounted investments, where there has been a significant change between periods or where a breakdown is needed for the reader to recalculate FFO or AFFO.

<b>Other Income</b> <b>(in thousands of Canadian dollars)</b>	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Other income	\$1,454	\$ -	\$1,454	\$20,353	\$ -	\$20,353

On January 15, 2015, Target Corporation announced plans to discontinue operating stores in Canada through its subsidiary Target Canada Co. ("Target"). Primaris has an interest in nine malls where Target was a tenant: a 50% interest in four of these malls and a 100% interest in the other five malls. Three of the leases were guaranteed by Target Corporation, the U.S. parent of Target. In March 2016, Primaris entered into binding agreements with Target and Target Corporation concluding the terms of settlement relating to the leases that were disclaimed pursuant to the *Companies' Creditors Arrangement Act*. The binding agreements were approved by the courts in June 2016. An initial distribution in respect of the settlement proceeds, in the amount of \$18.9 million was received on July 4, 2016. A further distribution in respect of the settlement proceeds, in the amount of \$1.5 million, was received on October 25, 2016.

<b>Finance Costs</b> <b>(in thousands of Canadian dollars)</b>	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Finance cost – operations:						
Contractual interest on mortgages payable	(\$51,686)	(\$58,317)	\$6,631	(\$219,131)	(\$230,134)	\$11,003
Contractual interest on debentures payable	(14,543)	(15,730)	1,187	(60,019)	(64,715)	4,696
Effective interest rate accretion	663	804	(141)	3,312	5,353	(2,041)
Bank interest and charges	(4,074)	(2,295)	(1,779)	(13,457)	(7,881)	(5,576)
Exchangeable unit distributions	(5,630)	(5,624)	(6)	(22,480)	(22,496)	16
	(75,270)	(81,162)	5,892	(311,775)	(319,873)	8,098
Capitalized interest	898	-	898	2,109	-	2,109
	(74,372)	(81,162)	6,790	(309,666)	(319,873)	10,207
Finance income	907	1,387	(480)	5,176	4,217	959
Fair value adjustments on financial instruments	15,786	11,617	4,169	(34,869)	35,118	(69,987)
	(\$57,679)	(\$68,158)	\$10,479	(\$339,359)	(\$280,538)	(\$58,821)

The decrease in contractual interest on mortgages payable of \$6.6 million and \$11.0 million for the three months and year ended December 31, 2016 compared to the respective 2015 periods is primarily due to the repayment of mortgages upon sale and maturity, and contractual interest savings arising from mortgage financings completed at lower interest rates.

The decrease in contractual interest on debentures payable of \$1.2 million and \$4.7 million for the three months and year ended December 31, 2016 compared to the respective 2015 periods is primarily due to the repayment of the Series H Senior Debentures in October 2015 and Series D Senior Debentures in July 2016 offset by the issuance of the Series J Senior Debentures in February 2015, Series K Senior Debentures in July 2015 and Series L Senior Debentures in November 2016. The repayment of the Series A Senior Debentures in February 2015 further decreased the contractual interest on debentures payable for the year ended December 31, 2016 compared to the respective 2015 period.

The decrease in fair value adjustments on financial instruments of \$70.0 million for the year ended December 31, 2016 compared to the respective 2015 period is primarily due to the gain (loss) on fair value of exchangeable units whereby at the end of each period, the fair value is determined by using the quoted prices of Stapled Units on the TSX, as the exchangeable units are exchangeable into Stapled Units at the option of the holder. For the three months and year ended December 31, 2016, the change in fair value is based on the quoted price of Stapled Units which was \$22.37 as at December 31, 2016 (September 30, 2016 - \$22.43, December 31, 2015 - \$20.05). For the three months and year ended December 31, 2015, the change in fair value is based on the quoted price of Stapled Units which was \$20.05 as at December 31, 2015 (September 30, 2015 - \$20.57, December 31, 2014 - \$21.73).

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<b>Trust Expenses</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Other expenses	(\$3,631)	(\$3,560)	(\$71)	(\$13,547)	(\$11,147)	(\$2,400)
Unit-based compensation	(3,765)	131	(3,896)	(17,916)	697	(18,613)
Trust expenses	(\$7,396)	(\$3,429)	(\$3,967)	(\$31,463)	(\$10,450)	(\$21,013)

Other expenses are primarily comprised of salaries, professional fees, trustee fees and corporate overhead expenses. Other expenses increased by \$2.4 million for the year ended December 31, 2016 compared to the respective 2015 period primarily due to an increase in salaries, professional fees and corporate expenses relating to Lantower Residential and ECHO.

Unit-based compensation is comprised of the following two compensation plans: the Unit Option Plan and the Incentive Unit Plan. Both plans are considered to be cash-settled under IFRS 2, *Share-based Payments* and as a result, are measured at each reporting period and settlement date at its fair value as defined by IFRS 2 based on the quoted prices of Stapled Units on the TSX.

<b>Fair Value Adjustment on Real Estate Assets</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Fair value adjustment on real estate assets	\$27,443	(\$205,109)	\$232,552	\$111,249	(\$240,631)	\$351,880

H&R records its real estate assets at fair value. The fair value adjustment on real estate assets for the year ended December 31, 2016 of \$111.2 million is primarily due to the U.S. real estate assets having fair value increases of \$394.4 million for Two Gotham Center in Long Island City, NY, Hess Tower in Houston, TX and the LIC Project. Independent third party appraisals were obtained for these properties in 2016. This was partially offset by fair value decreases to H&R's Alberta portfolio of (\$194.0 million) as a result of higher vacancies in H&R's Office portfolio in Calgary and an overall weakening of the Alberta economy. The fair value adjustment on real estate assets for the year ended December 31, 2015 of (\$240.6 million) was primarily due to fair value decreases to H&R's Alberta portfolio of (\$229.2 million) as a result of the overall weakening of the Alberta economy.

<b>Gain (Loss) on Sale of Real Estate Assets, Net of Related Costs</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Gain (loss) on sale of real estate assets, net of related costs	(\$8,387)	\$1,649	(\$10,036)	\$6,317	(\$8,260)	\$14,577

The loss on sale of real estate assets, net of related costs of \$8.4 million for the three months ended December 31, 2016, is primarily due to a loss on sale of \$7.4 million from the sale of H&R's 50% non-managing interest in TransCanada Tower in November 2016.

The gain on sale of real estate assets, net of related costs of \$6.3 million for the year ended December 31, 2016, is primarily due to a gain on sale of \$15.0 million from the sale of H&R's 33.3% freehold and leasehold interests in Scotia Plaza in Q2 2016. This was partially offset by a loss on sale of \$7.4 million from the sale of H&R's 50% non-managing interest in TransCanada Tower in November 2016.

For a list of properties sold in 2016 & 2015, please refer to page 16 in this MD&A.

<b>Gain (Loss) on Foreign Exchange</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Gain (loss) on foreign exchange	\$6,695	\$11,212	(\$4,517)	(\$8,944)	\$49,375	(\$58,319)

The amounts in the table above were recorded by Finance Trust due to the translation of the U.S. Holdco Notes into Canadian dollars. The U.S. Holdco Notes are eliminated in the Trusts' Financial Statements however, the related foreign exchange difference is not eliminated on combination as it flows through net income of Finance Trust and other comprehensive income of H&R as U.S. Holdco is a subsidiary of H&R and forms part of its net investment in the United States. U.S. Holdco is not a subsidiary of Finance Trust. The exchange rate as at December 31, 2016 was Canadian \$1.34 for each U.S. \$1.00 (September 30, 2016 - \$1.31, December 31, 2015 - \$1.38). The exchange rate as at December 31, 2015 was \$1.38 for each U.S. \$1.00 (September 30, 2015 - \$1.33, December 31, 2014 - \$1.16).

<b>Transaction Costs</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Transaction costs	\$ -	\$ -	\$ -	<b>(\$13,483)</b>	\$ -	(\$13,483)

On February 18, 2016, the Ontario Ministry of Finance (the “Ministry”) announced retroactive amendments to the regulations under the *Land Transfer Act* (Ontario) that impact the availability of an exemption from Ontario land transfer tax for certain transactions involving trusts (including real estate investment trusts) and partnerships. On March 24, 2016, the Ministry announced relieving measures that limited the reassessment period to dispositions that occurred on or after February 18, 2012 and provided a voluntary disclosure program (including interest and penalty relief) that runs to June 30, 2017. As a consequence of the amendments in Q1 2016, H&R recorded a provision for additional land transfer tax.

<b>Income Tax Expense</b> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Current income taxes	<b>(\$989)</b>	(\$283)	(\$706)	<b>(\$2,087)</b>	(\$2,455)	\$368
Deferred income taxes	<b>(41,175)</b>	(3,146)	(38,029)	<b>(199,744)</b>	(32,617)	(167,127)
Total income taxes	<b>(\$42,164)</b>	(\$3,429)	(\$38,735)	<b>(\$201,831)</b>	(\$35,072)	(\$166,759)

Current income taxes expense of \$2.5 million for the year ended December 31, 2015, includes a minimum income tax expense of \$1.1 million relating to the sale of U.S. properties sold during 2015.

H&R 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 H&R for tax purposes. H&R’s current income tax expense is primarily due to U.S. state taxes.

H&R’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 statement of financial position date. Deferred income tax relating to items recognized in equity will also be recognized in equity.

As at December 31, 2016, H&R had net deferred tax liabilities of \$386.9 million (December 31, 2015 - \$189.7 million) primarily related to taxable temporary differences between the tax and accounting bases of U.S. investment properties.

## FUNDS FROM OPERATIONS

FFO is a non-GAAP measure that is widely used by the real estate industry, particularly by those publicly traded entities that own and operate investment properties. FFO is a financial measure which should not be considered as an alternative to net income, cash flow from operations, or any other operating or liquidity measure prescribed under IFRS. The Trusts present FFO in accordance with the REALpac White Paper on Funds from Operations. The use of FFO, combined with the required IFRS presentations, has been included for the purpose of improving the understanding of the operating results of the Trusts. FFO provides an operating performance measure that when compared period over period reflects the impact on operations of trends in occupancy levels, rental rates, property operating costs, acquisition activities and finance costs, that is not immediately apparent from net income determined in accordance with IFRS.

### Realty taxes in accordance with IFRIC 21:

As a result of the requirements of IFRIC 21 wherein the obligating event that gives rise to the property tax liability (where such property taxes meet the definition of a levy in IFRIC 21) does not occur over a period of time, an adjustment is made to FFO to reflect a pro-rata expense over the period of ownership.

### Incremental leasing costs:

Leasing costs related to full-time or salaried staff, and related internal costs, that can be directly attributed to signed leases and that would otherwise be capitalized if incurred from external sources are added back to profit or loss in determining FFO. The purpose of this adjustment is to achieve consistency between entities that use internal leasing personnel and those that use external leasing personnel.

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FFO (in thousands of Canadian dollars)	Three Months Ended December 31		Year ended December 31	
	2016	2015	2016	2015
<b>Property operating income per the Trusts' interests</b>	<b>\$220,709</b>	<b>\$227,559</b>	<b>\$845,836</b>	<b>\$865,447</b>
Add (deduct) items per the Trusts' interests:				
Realty taxes in accordance with IFRIC 21	(10,880)	(10,286)	-	-
Net income (loss) from equity accounted investments	111	396	528	553
Other income	1,454	-	20,353	-
Finance cost - operations (excluding exchangeable unit distributions)	(68,742)	(75,538)	(287,186)	(297,377)
Notional interest capitalization <sup>(1)</sup>	3,724	2,697	13,994	8,317
Finance income	907	1,387	5,176	4,217
Trust expenses (excluding the fair value adjustment to unit-based compensation)	(4,946)	(4,416)	(18,811)	(14,456)
Current income taxes expense	(989)	(283)	(2,087)	(2,455)
Non-controlling interest	(170)	(145)	(458)	(276)
Incremental leasing costs	1,721	1,508	6,956	5,973
<b>FFO</b>	<b>\$142,899</b>	<b>\$142,879</b>	<b>\$584,301</b>	<b>\$569,943</b>
Add (deduct) items per the Trusts' Financial Statements:				
Realty taxes in accordance with IFRIC 21	9,574	9,134	-	-
FFO adjustments from equity accounted investments (page 36)	66,377	(58,770)	(23,191)	(74,034)
Exchangeable unit distributions	(5,630)	(5,624)	(22,480)	(22,496)
Fair value adjustments on real estate assets and financial instruments	(26,290)	(136,283)	99,908	(142,628)
Fair value adjustment to unit-based compensation	(2,450)	987	(12,652)	4,006
Gain (loss) on sale of real estate assets, net of related costs	(7,816)	1,665	(8,167)	(5,428)
Gain (loss) on foreign exchange	6,695	11,212	(8,944)	49,375
Transaction costs	-	-	(13,483)	-
Deferred income tax expense	(41,022)	(3,146)	(199,591)	(32,617)
Incremental leasing costs	(1,721)	(1,508)	(6,956)	(5,973)
<b>Net income per the Trusts' Financial Statements</b>	<b>\$140,616</b>	<b>(\$39,454)</b>	<b>\$388,745</b>	<b>\$340,148</b>

<sup>(1)</sup> Represents an adjustment to add general or indirect interest incurred in respect of properties under development held in and through equity accounted investments.

**FFO**

<b>(per the Trusts' interests)</b> <b>(in thousands of Canadian dollars except per unit amounts)</b>	Three Months Ended December 31		Year ended December 31	
	2016	2015	2016	2015
FFO	\$142,899	\$142,879	\$584,301	\$569,943
Weighted average number of Stapled Units (in thousands of Stapled Units adjusted for conversion of exchangeable Stapled Units) <sup>(1)</sup>	300,482	294,944	298,404	293,026
Diluted weighted average number of Stapled Units (in thousands of Stapled Units) for the calculation of FFO <sup>(1)(2)(3)(4)</sup>	312,142	305,442	310,072	303,651
FFO per Stapled Unit (basic – adjusted for conversion of exchangeable units)	\$0.48	\$0.48	\$1.96	\$1.95
FFO per Stapled Unit (diluted)	\$0.47	\$0.48	\$1.93	\$1.92
Distributions per Stapled Unit	\$0.34	\$0.34	\$1.35	\$1.35
Payout ratio per Stapled Unit as a % of FFO	70.8%	70.8%	68.9%	69.2%

<sup>(1)</sup> For the three months and year ended December 31, 2016, included in the weighted average and diluted weighted average number of Stapled Units are exchangeable units of 16,130,642 and 16,188,019, respectively. For the three months and year ended December 31, 2015, included in the weighted average and diluted weighted average number of Stapled Units are exchangeable units of 16,230,642.

<sup>(2)</sup> For the three months ended December 31, 2016 and 2015, 1,493,059 Stapled Units and 330,669 Stapled Units, respectively, are included in the determination of diluted FFO with respect to H&R's Unit Option Plan and Incentive Unit Plan. For the years ended December 31, 2016 and 2015, 1,501,069 Stapled Units and 457,248 Stapled Units, respectively, are included in the determination of diluted FFO with respect to H&R's Unit Option Plan and Incentive Unit Plan.

<sup>(3)</sup> The 2016, 2018 and 2020 convertible debentures are dilutive for the three months ended December 31, 2016 and 2015. Therefore, debenture interest of \$3.3 million and \$3.3 million, respectively, is added to FFO and 10,167,061 Stapled Units and 10,167,133 Stapled Units, respectively, are included in the diluted weighted average number of Stapled Units outstanding for these periods.

<sup>(4)</sup> The 2016, 2018 and 2020 convertible debentures are dilutive for the years ended December 31, 2016 and 2015. Therefore, debenture interest of \$13.3 million and \$13.3 million, respectively, is added to FFO and 10,167,115 Stapled Units and 10,167,230 Stapled Units, respectively, are included in the diluted weighted average number of Stapled Units outstanding for these periods.

Included in FFO per the Trusts' interests are the following items which can be a source of variances between periods:

<b>(in thousands of Canadian dollars)</b>	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Lease termination payments	\$91	\$336	(\$245)	\$5,855	\$6,205	(\$350)
Adjustment to straight-lining of contractual rent	-	(3,910)	3,910	(2,535)	(1,684)	(851)
Other income	1,454	-	1,454	20,353	-	20,353
Current income taxes <sup>(1)</sup>	-	-	-	-	(1,087)	1,087
	\$1,545	(\$3,574)	\$5,119	\$23,673	\$3,434	\$20,239

<sup>(1)</sup> Includes minimum income tax payable relating to the sale of U.S. properties.

Excluding the above items, FFO would have been \$141.4 million for the three months ended December 31, 2016 (Q4 2015 - \$146.5 million) and \$0.47 per basic Stapled Unit (Q4 2015 - \$0.50 per basic Stapled Unit). For the year ended December 31, 2016, FFO would have been \$560.6 million (December 31, 2015 - \$566.5 million) and \$1.88 per basic Stapled Unit (December 31, 2015 - \$1.93 per basic Stapled Unit).



**ADJUSTED FUNDS FROM OPERATIONS**

In calculating AFFO, the Trusts adjust FFO for costs incurred relating to leasing and capital expenditures, straight-line rent in excess of contractual rent paid by tenants and non-cash expenses such as amortization. Although capital and tenant expenditures can vary from quarter to quarter due to tenant turnovers, vacancies and the age of a property, the Trusts have elected to deduct actual capital and tenant expenditures spent and capitalized in the period instead of deducting a normalized amount based on historical activity. This differs from others in the industry as many entities are deducting a normalized amount of capital and tenant expenditures in their AFFO calculation. Capital expenditures excluded and not deducted in the calculation of AFFO relate to capital expenditures which generate a new investment stream, such as the construction of a new retail pad during property expansion or intensification, development activities or acquisition activities. AFFO is a supplemental measure that is used in the real estate industry to assess the sustainability of cash distributions.

AFFO is a non-GAAP financial measure not defined under IFRS. AFFO should not be considered as an alternative to net income, cash provided by operations or any other IFRS measure. There is no common industry definition or methodology for the calculation of AFFO. Furthermore, some entities present AFFO as a modified earnings measure and not as a cash measure as presented herein.

(in thousands of Canadian dollars except per unit amounts)	Three Months Ended December 31		Year ended December 31	
	2016	2015	2016	2015
<b>FFO</b>	<b>\$142,899</b>	\$142,879	<b>\$584,301</b>	\$569,943
Add (deduct) items per the Trusts' interests:				
Straight-lining of contractual rent	(1,123)	(305)	(5,558)	(16,877)
Rent amortization of tenant inducements	876	844	3,707	3,328
Effective interest rate accretion	(663)	(804)	(3,312)	(5,353)
Unit-based compensation	1,315	856	5,264	3,309
Capital expenditures	(20,539)	(16,543)	(71,231)	(52,186)
Tenant expenditures	(7,356)	(22,666)	(41,668)	(56,789)
Incremental leasing costs	(1,721)	(1,508)	(6,956)	(5,973)
<b>AFFO</b>	<b>\$113,688</b>	\$102,753	<b>\$464,547</b>	\$439,402
Weighted average number of Stapled Units (in thousands of Stapled Units adjusted for conversion of exchangeable Stapled Units <sup>(1)</sup> )	<b>300,482</b>	294,944	<b>298,404</b>	293,026
Diluted weighted average number of Stapled Units (in thousands of Stapled Units) for the calculation of AFFO <sup>(1)(2)(3)(4)(5)</sup>	<b>312,142</b>	301,202	<b>310,072</b>	303,651
AFFO per Stapled Unit (basic - adjusted for conversion of exchangeable units)	<b>\$0.38</b>	\$0.35	<b>\$1.56</b>	\$1.50
AFFO per Stapled Unit (diluted)	<b>\$0.37</b>	\$0.35	<b>\$1.54</b>	\$1.49

<sup>(1)</sup> For the three months and year ended December 31, 2016, included in the weighted average and diluted weighted average number of Stapled Units are exchangeable units of 16,130,642 and 16,188,019, respectively. For the three months and year ended December 31, 2015, included in the weighted average and diluted weighted average number of Stapled Units are exchangeable units of 16,230,642.

<sup>(2)</sup> For the three months ended December 31, 2016 and 2015, 1,493,059 Stapled Units and 330,669 Stapled Units, respectively, are included in the determination of diluted AFFO with respect to H&R's Unit Option Plan and Incentive Unit Plan. For the years ended December 31, 2016 and 2015, 1,501,069 Stapled Units and 457,248 Stapled Units, respectively are included in the determination of diluted AFFO with respect to H&R's Unit Option Plan and Incentive Unit Plan.

<sup>(3)</sup> The 2016, 2018 and 2020 convertible debentures are dilutive for the three months ended December 31, 2016. Therefore, debenture interest of \$3.3 million is added to AFFO and 10,167,061 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for this period.

<sup>(4)</sup> The 2016 and 2018 convertible debentures are dilutive for the three months ended December 31, 2015. Therefore, debenture interest of \$1.9 million is added to AFFO and 5,926,537 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for this period.

<sup>(5)</sup> The 2016, 2018 and 2020 convertible debentures are dilutive for the years ended December 31, 2016 and 2015. Therefore, debenture interest of \$13.3 million and \$13.3 million, respectively, is added to AFFO and 10,167,115 Stapled Units and 10,167,230 Stapled Units, respectively, are included in the diluted weighted average number of Stapled Units outstanding for these periods.

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Included in AFFO per the Trusts' interests are the following items which can be a source of variances between periods:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Additional current year capital expenditure recoveries net of capital expenditures	\$341	\$2,663	(\$2,322)	\$1,962	\$4,488	(\$2,526)
Lease termination payments	91	336	(245)	5,855	6,205	(350)
Other income	1,454	-	1,454	20,353	-	20,353
Current income taxes <sup>(1)</sup>	-	-	-	-	(1,087)	1,087
Capital expenditures	(20,539)	(16,543)	(3,996)	(71,231)	(52,186)	(19,045)
Tenant expenditures	(7,356)	(22,666)	15,310	(41,668)	(56,789)	15,121
	<b>(\$26,009)</b>	<b>(\$36,210)</b>	<b>\$10,201</b>	<b>(\$84,729)</b>	<b>(\$99,369)</b>	<b>\$14,640</b>

(1) Includes minimum income tax payable relating to the sale of U.S. properties.

Excluding the above items, AFFO would have been \$139.7 million for the three months ended December 31, 2016 (Q4 2015 - \$139.0 million) and \$0.46 per basic Stapled Unit (Q4 2015 - \$0.47 per basic Stapled Unit). For the year ended December 31, 2016, AFFO would have been \$549.3 million (December 31, 2015 - \$538.8 million) and \$1.84 per basic Stapled Unit (December 31, 2015 - \$1.84 per basic Stapled Unit).

H&R's capital and tenant expenditures have been at an elevated level the last two years. The following is a breakdown of H&R's capital and tenant expenditures by operating segment:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
Office:						
Capital expenditures	\$11,595	\$11,373	\$222	\$48,517	\$37,269	\$11,248
Tenant expenditures	5,326	18,795	(13,469)	29,220	39,497	(10,277)
Primaris:						
Capital expenditures	3,737	2,866	871	11,756	8,694	3,062
Tenant expenditures	1,858	3,254	(1,396)	8,221	10,882	(2,661)
H&R Retail:						
Capital expenditures	-	74	(74)	182	797	(615)
Tenant expenditures	152	232	(80)	1,182	1,981	(799)
ECHO:						
Capital expenditures	1,126	796	330	2,616	1,813	803
Tenant expenditures	11	86	(75)	560	538	22
Industrial:						
Capital expenditures	2,219	231	1,988	2,941	848	2,093
Tenant expenditures	9	299	(290)	2,485	3,891	(1,406)
Lantower Residential:						
Capital expenditures	1,862	1,203	659	5,219	2,765	2,454
Tenant expenditures	-	-	-	-	-	-
	<b>\$27,895</b>	<b>\$39,209</b>	<b>(\$11,314)</b>	<b>\$112,899</b>	<b>\$108,975</b>	<b>\$3,924</b>

H&R's Office segment had elevated capital and tenant expenditures for the last two years due to the following:

160 Elgin St., in Ottawa, ON is currently undergoing a complete renovation of the lobby and all of the retail space. Total capital and tenant expenditures spent during the three months and year ended December 31, 2016 were \$8.8 million and \$29.1 million, respectively, compared to the three months and year ended December 31, 2015 of \$7.0 million and \$11.2 million, respectively. H&R expects to spend an additional \$13.6 million in capital and tenant expenditures in order to complete these projects.

310-320-330 Front St., in Toronto, ON experienced significant tenant turnover when Royal Bank of Canada vacated 274,100 square feet on December 31, 2014. TD Bank moved into 231,170 square feet throughout 2015 & 2016 and Penguin Random House Canada moving into 53,500 square feet in November 2015 resulting in higher than normal tenant expenditures. Total capital and tenant expenditures spent during the three months and year ended December 31, 2016 were \$0.8 million and \$13.7 million, respectively, compared to the three months and year ended December 31, 2015 of \$11.3 million and \$32.1 million, respectively. H&R expects to spend an additional \$1.3 million in tenant expenditures in order to complete these projects.

Included in capital and tenant expenditures for the year ended December 31, 2016 and 2015 was \$11.5 million and \$9.8 million, respectively, relating to Scotia Plaza. H&R will not incur any further capital or tenant expenditures for Scotia Plaza which was sold on June 30, 2016.

The following is a reconciliation of the Trusts' AFFO to cash provided by operations per the Trusts' Financial Statements:

(in thousands of Canadian dollars except per unit amounts)	Three Months Ended December 31		Year ended December 31	
	2016	2015	2016	2015
<b>AFFO</b>	<b>\$113,688</b>	\$102,753	<b>\$464,547</b>	\$439,402
Straight-lining of contractual rent	816	116	4,781	15,823
Net (income) loss from equity accounted investments	(82,176)	39,017	(48,341)	(841)
Finance cost - operations (excluding exchange-unit distributions)	64,231	68,578	264,845	272,514
Effective interest rate accretion	401	594	2,595	4,337
Interest paid	(90,478)	(86,690)	(299,533)	(304,188)
Transaction costs	-	-	(13,483)	-
Additions to capital expenditures and tenant expenditures	24,833	37,248	93,606	96,344
Adjustments for the Trusts' interests in equity accounted investments	69,707	(56,743)	(3,870)	(60,561)
Change in other non-cash operating items	(3,002)	42,615	(40,951)	4,524
<b>Cash provided by operations</b>	<b>\$98,020</b>	\$147,488	<b>\$424,196</b>	\$467,354

<b>FFO and AFFO from Equity Accounted Investments<sup>(1)</sup></b> <b>(in thousands of Canadian dollars)</b>	Three Months Ended December 31			Year ended December 31		
	2016	2015	Change	2016	2015	Change
<b>Net income (loss) from equity accounted investments per the Trusts' Financial Statements (pages 21 &amp; 22)</b>	<b>\$82,176</b>	<b>(\$39,017)</b>	<b>\$121,193</b>	<b>\$48,341</b>	<b>\$841</b>	<b>\$47,500</b>
Realty taxes in accordance with IFRIC 21	(1,306)	(1,152)	(154)	-	-	-
Fair value adjustments on financial instruments	(9,588)	186	(9,774)	1,039	1,122	(83)
Fair value adjustment on real estate assets	(59,931)	57,023	(116,954)	22,489	61,763	(39,274)
(Gain) loss on sale of real estate assets, net of related costs	571	16	555	(14,484)	2,832	(17,316)
Deferred income taxes expense	153	-	153	153	-	153
Notional interest capitalization <sup>(2)</sup>	3,724	2,697	1,027	13,994	8,317	5,677
<b>FFO from equity accounted investments</b>	<b>15,799</b>	<b>19,753</b>	<b>(3,954)</b>	<b>71,532</b>	<b>74,875</b>	<b>(3,343)</b>
Straight-lining of contractual rent	(307)	(189)	(118)	(777)	(1,054)	277
Rent amortization of tenant inducements	301	333	(32)	1,466	1,228	238
Effective interest rate accretion	(262)	(210)	(52)	(717)	(1,016)	299
Capital expenditures	(2,744)	(1,124)	(1,620)	(12,307)	(10,470)	(1,837)
Tenant expenditures	(318)	(837)	519	(6,986)	(2,161)	(4,825)
<b>AFFO from equity accounted investments</b>	<b>\$12,469</b>	<b>\$17,726</b>	<b>(\$5,257)</b>	<b>\$52,211</b>	<b>\$61,402</b>	<b>(\$9,191)</b>

<sup>(1)</sup> These amounts are at the Trusts' proportionate ownership share held through their equity accounted investments.

<sup>(2)</sup> Represents an adjustment to add general or indirect interest incurred in respect of properties under development held in and through equity accounted investments.

FFO from equity accounted investments for the three months and year ended December 31, 2016 compared to the respective 2015 periods decreased by \$4.0 million and \$3.3 million, respectively, primarily due to the sale of Scotia Plaza in June 2016 and Telus Corporation vacating approximately 170,918 square feet (at H&R's ownership interest) in April 2016. This was partially offset by notional interest capitalization relating to the LIC Project and specifically for the year ended December 31, 2016 compared to December 31, 2015, H&R disposing of a 49.5% interest in 16 properties in the U.S. in March 2015 with the remaining 50.5% interest subsequently being accounted for as a joint venture.

ECHO reports its financial results to H&R one month in arrears due to time constraints on its reporting. The above amounts for the three months ended December 31, 2016 and 2015 include ECHO's financial information from September 1 to November 30, of the respective years. The above amounts for the year ended December 31, 2016 and 2015 include ECHO's financial information from December 1, 2015 to November 30, 2016 and December 1, 2014 to November 30, 2015, respectively. In December 2016, ECHO acquired three properties for approximately \$23.5 million, at H&R's share.

**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.

<b>(in thousands of Canadian dollars)</b>	<b>Three months ended December 31, 2016</b>	<b>Year ended December 31, 2016</b>	Year ended December 31, 2015	Year ended December 31, 2014
Cash provided by operations	<b>\$98,020</b>	<b>\$424,196</b>	\$467,354	\$438,347
Net income	<b>140,616</b>	<b>388,745</b>	340,148	424,655
Total distributions <sup>(1)</sup>	<b>96,534</b>	<b>381,106</b>	373,072	366,802
Excess of cash provided by operations over total distributions	<b>1,486</b>	<b>43,090</b>	94,282	71,545
Excess (shortfall) of net income over total distributions	<b>44,082</b>	<b>7,639</b>	(32,924)	57,853

<sup>(1)</sup> Total Distributions include cash distributions to unitholders and unit distributions issued under the DRIP.

Total distributions include unit distributions issued under the DRIP of \$26.6 million and \$106.8 million respectively, for the three months and year ended December 31, 2016, which are non-cash distributions. Total distributions include unit distributions issued under the DRIP of \$105.4 million and \$85.4 million, respectively, for the years ended December 31, 2015 and 2014, which are non-cash distributions. Unit distributions issued under the DRIP result in an increase in the number of Stapled Units outstanding which may result in increased cash distributions in the future assuming a stable cash component of distributions per unit. Distributions exceeded net income for the year ended December 31, 2015, respectively, primarily due to non-cash items. Non-cash items relating to the fair value adjustments on real estate assets, gain (loss) on change in fair value, amortization, unrealized gain (loss) on foreign exchange and deferred income tax expense are deducted from or added to net income 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, 2016, the Trusts are not in default or arrears on any of its obligations including interest or principal payments on debt and any debt covenant.

Excluding equity accounted investments, the Trusts have cash and cash equivalents on hand of \$48.0 million and have the following bank credit facilities as at December 31, 2016:

Operating Facilities (in thousands of Canadian Dollars)	Maturity Date	Total Facility	Bank Indebtedness Drawn	Outstanding Letters of Credit	Available Balance
H&R unsecured operating facility #1 <sup>(a)</sup>	Dec 18, 2018	\$500,000	\$166,089	\$33,052	\$300,859
Primaris secured operating facility <sup>(a)</sup>	Dec 18, 2017	300,000	262,640	1,253	36,107
H&R unsecured operating facility #2 <sup>(b)</sup>	Mar 17, 2021	205,829	205,829	-	-
H&R and CrestPSP secured operating facility <sup>(a)</sup>	Feb 19, 2019	25,000	9,700	-	15,300
H&R Retail co-ownership secured operating facility	Sep 30, 2017	3,514	3,514	-	-
		<b>\$1,034,343</b>	<b>\$647,772</b>	<b>\$34,305</b>	<b>\$352,266</b>

The bank facilities bear interest at a rate approximating the prime rate of a Canadian chartered bank.

<sup>(a)</sup> Can be drawn in either Canadian or U.S. dollars.

<sup>(b)</sup> The total facility as at December 31, 2016 is \$200.0 million, plus a 3% allowance relating to the fluctuation of the foreign exchange rate, and can be drawn in either Canadian or U.S. dollars. H&R entered into an interest rate swap agreement to fix the interest rate at 2.6% per annum on U.S. \$130.0 million of the U.S. dollar denominated borrowing of this facility.

In December 2015, construction financing for the LIC Project for up to U.S. \$640.0 million was secured through a syndicate of lenders. This construction facility can only be used for the LIC Project, and in Q3 2016, H&R made its final contribution to the development prior to drawing on the facility. The construction facility will be used to fund the remaining development costs of the project. As at December 31, 2016, total bank indebtedness drawn was U.S. \$91.6 million. The LIC Project is accounted for as an equity accounted investment and is therefore not included in the table above.

As at December 31, 2016, excluding ECHO, H&R had 112 unencumbered properties, with a fair value of approximately \$3.0 billion. Also, due to H&R's 20-year history and management's conservative strategy of securing long-term financing on individual properties, H&R had numerous other properties with

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very low loan to value ratios. As at December 31, 2016, excluding real estate assets reported in the Trusts' equity accounted investments, H&R had 47 properties valued at approximately \$934.3 million which are encumbered with mortgages totalling \$159.6 million. In this pool of assets, the average loan to value is 17.1%, the minimum loan to value is 4.2% and the maximum loan to value is 29.8%.

The following is a summary of material contractual obligations of H&R including payments due as at December 31, 2016 for the next five years and thereafter:

Contractual Obligations <sup>(1)</sup> (in thousands of Canadian dollars)	Payments Due by Period				Total
	2017	2018- 2019	2020- 2021	2022 and thereafter	
Mortgages payable	\$544,025	\$614,706	\$1,363,858	\$1,801,192	\$4,323,781
Convertible Debentures	-	74,394	99,654	-	174,048
Senior Debentures	175,000	767,500	175,000	200,000	1,317,500
Bank indebtedness <sup>(2)</sup>	266,154	175,789	267,211	-	709,154
<b>Total contractual obligations</b>	<b>\$985,179</b>	<b>\$1,632,389</b>	<b>\$1,905,723</b>	<b>\$2,001,192</b>	<b>\$6,524,483</b>

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

<sup>(2)</sup> Excludes ECHO's bank indebtedness of \$119.9 million which is covered by ECHO's revolving credit facility of U.S. \$380.0 million with an accordion of an additional \$100 million which expires on April 3, 2020.

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 H&R has a credit rating of BBB (high) with a Stable trend as at December 31, 2016. This is the highest Canadian real estate industry rating achieved by only three REITs and one real estate company to date. A credit rating of BBB (high) by DBRS is generally an indication of adequate credit quality, where the capacity for payment of financial obligations is considered acceptable, however the entity may be vulnerable to future events. 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.

H&R has no material capital or operating lease obligations.

### Funding of Future Commitments

Management believes that as at December 31, 2016, through cash on hand of \$48.0 million and the combined amount available under its general operating facilities of \$352.3 million and its unencumbered property pool of approximately \$3.0 billion, it has sufficient funds for future commitments.

The following summarizes the estimated loan to value ratios on properties whose mortgages mature over the next five years, including investments in the Trusts' interests of mortgages relating to equity accounted investments and mortgages classified as held for sale:

Year	Number of Properties	Mortgage Debt due on Maturity (\$000's) <sup>(1)</sup>	Weighted Average Interest Rate on Maturity	Fair Value of Investment Properties (\$000's) <sup>(1)</sup>	Loan to Value
2017	19	391,805	4.7%	901,365	43%
2018	34	148,879	4.8%	529,268	28%
2019	31	146,229	3.6%	466,280	31%
2020	20	372,820	4.4%	1,048,217	36%
2021	36	718,136	4.0%	3,488,445	21%
	140	\$1,777,869	4.3%	\$6,433,575	28%

<sup>(1)</sup> Converting U.S. dollars to Canadian dollars at an exchange rate of \$1.34 as at December 31, 2016.

Based on the low percentage of the projected loan to values of the maturing mortgages, H&R is confident it will be able to refinance these mortgages upon maturity should it choose to do so.

## **OFF-BALANCE SHEET ITEMS**

H&R has co-owners and partners in various projects. As a rule H&R does not provide guarantees or indemnities for these co-owners and partners pursuant to property acquisitions because should such guarantees be provided, recourse would be available against H&R in the event of a default of the co-owners and partners. In such case, H&R would have a claim against the underlying real estate investment. However, in certain circumstances, subject to compliance with H&R's Declaration of Trust and the determination by management that the fair value of the co-owners' or partners' investment is greater than the mortgages payable for which H&R has provided guarantees, such guarantees will be provided. At December 31, 2016, such guarantees amounted to \$171.1 million expiring between 2022 and 2029 (December 31, 2015 - \$269.9 million, expiring between 2016 and 2029), and no amount has been provided for in the Trusts' Financial Statements for these items. These amounts arise where H&R has guaranteed a co-owner's share of the mortgage liability. H&R, however, customarily guarantees or indemnifies the obligations of its nominee companies which hold separate title to each of its properties owned.

In addition, H&R continued 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 H&R's guarantee. At December 31, 2016, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$133.0 million, expiring between 2017 and 2020 (December 31, 2015 - \$146.5 million, expiring between 2016 and 2020). There have been no defaults by the primary obligor for debts on which H&R has provided its guarantees, and as a result, no contingent loss on these guarantees has been recognized in the Trusts' Financial Statements.

In the normal course of operations, H&R has issued letters of credit in connection with developments, financings, operations and acquisitions. As at December 31, 2016, H&R has outstanding letters of credit totalling \$34.3 million (December 31, 2015 - \$62.7 million), including nil (December 31, 2015 - \$18.6 million) which has been pledged as security for certain mortgages payable. The letters of credit are secured in the same manner as the bank indebtedness.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

Where appropriate, H&R, including ECHO and the LIC Project, uses forward contracts to lock-in lending rates on certain anticipated mortgages, debentures and bank borrowings. This strategy provides certainty to the rate of interest on borrowings when H&R is involved in transactions that may close further into the future than usual for typical transactions. At the end of each reporting period, an interest rate swap is marked-to-market, resulting in an unrealized gain or loss recorded in net income.

Where appropriate, H&R 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.

As at December 31, 2016, H&R had the following interest rate swaps outstanding at the Trusts' interests:

		Fair value (liability) asset*		Net gain (loss) on derivative contracts**	
		December 31 2016	December 31 2015	December 31 2016	December 31 2015
Debenture interest rate swap	(a)	\$ 776	\$ -	\$ 776	\$ -
Debenture interest rate swap	(b)	(407)	-	(407)	-
Bank indebtedness interest rate swap	(c)	(3,384)	-	(3,384)	-
Mortgage interest rate swap	(d)	-	-	-	161
Mortgage interest rate swaps	(e)	(945)	(1,209)	226	1,122
Bank indebtedness interest rate swap	(f)	(1,285)	-	(1,265)	-
		<b>(\$5,245)</b>	<b>(\$1,209)</b>	<b>(\$4,054)</b>	<b>\$ 1,283</b>

(a) Series K senior debentures bearing interest at 2.36% per annum, maturing on March 1, 2019.

(b) Series I senior debentures bearing interest at 2.54% per annum, which matured January 23, 2017 and Series J senior debentures bearing interest at 2.04% per annum, maturing on February 9, 2018. The interest rate swap on the Series I senior debentures was settled in January 2017.

(c) U.S. \$130.0 million bank indebtedness bearing interest at 2.56% per annum, maturing on March 17, 2021.

(d) One U.S. mortgage; this interest rate swap was settled in 2015.

(e) ECHO has entered into various interest rate swaps to fix the interest rate on certain mortgages.

(f) LIC construction facility bearing interest at 4.26% per annum.

\* Derivative instruments in asset and liability positions are not presented on a net basis. Derivative instruments in an asset position are recorded in other assets and derivative instruments in a liability position are recorded in accounts payable and accrued liabilities.

\*\* Excludes amounts relating to foreign exchange which have been recorded in accumulated other comprehensive income.

## SECTION IV

### CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Preparation of the Trusts' 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 Trusts' 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 exchangeable units;
- Fair value of cash-settled unit-based compensation;
- Fair value of convertible debentures; and
- Deferred tax asset (liability).



## Use of Judgements

- Business combinations

Accounting for business combinations under IFRS 3, *Business Combinations* (“IFRS 3”) is only applicable if it is determined that a business has been acquired. Under IFRS 3, a business is defined as an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors or lower costs or other economic benefits directly and proportionately to H&R. A business generally consists of inputs, processes applied to those inputs and resulting outputs that are, or will be, used to generate revenues. In the absence of such criteria, a group of assets is deemed to have been acquired. If goodwill is present in a transferred set of activities and assets, the transferred set is presumed to be a business. Judgement is used by management in determining whether the acquisition of an individual property, or a group of properties, qualifies as a business combination in accordance with IFRS 3 or as an asset acquisition.

- Valuations of real estate assets

Real estate assets, which consist of investment properties and properties under development, are carried on the combined statements of financial position at fair value, as determined 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 H&R. Refer to note 4 of the Trusts’ Financial Statements for further information on estimates and assumptions made in the determination of the fair value of real estate assets. Judgement is applied in determining whether certain costs are additions to the carrying value of the real estate assets, identifying the point at which practical completion of the property occurs and identifying the directly attributable borrowing costs to be included in the carrying value of the development properties.

- Leases

H&R’s policy for property rental revenue recognition is described in note 2(f) of the December 31, 2016 Trusts’ Financial Statements. H&R makes judgements in determining whether certain leases, in particular those tenant leases with long contractual terms and long-term ground leases where H&R is the lessor, are operating or finance leases. H&R has determined that all of its leases are operating leases.

- Income taxes

H&R 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, including with respect 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 H&R as at December 31, 2016 in respect of its Canadian entities.

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

- Impairment of equity accounted investments

H&R determines at each reporting date whether there is any objective evidence that the equity accounted investments are impaired. If so, H&R calculates the amount of impairment as the difference between the recoverable amount of the equity accounted investment and its carrying value and recognizes the amount in net income.

## NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

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

(i) Amendments to Statement of Cash Flows ("IAS 7")

In January 2016, the IASB issued amendments to IAS 7, *Statement of Cash Flows*. These amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The Trusts will adopt the amendments to IAS 7 in its combined financial statements for the annual period ending December 31, 2017. The Trusts intend to satisfy the new requirements by providing reconciliations between the opening and closing balances for liabilities from financing activities.

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

In July 2014, the IASB issued IFRS 9 *Financial Instruments: Classification and Measurements* ("IFRS 9"), replacing IAS 39, *Financial instruments: Recognition and Measurement*. IFRS 9 is effective for the annual period beginning on January 1, 2018, with early adoption permitted. The Trusts currently plan to apply IFRS 9 on January 1, 2018. The actual impact of adopting IFRS 9 on the Trusts' Financial Statements in 2018 has not yet been determined.

(iii) Revenue from Contracts with Customers ("IFRS 15")

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. The new standard is effective for annual periods beginning on or after January 1, 2018. IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers, and SIC 31 Revenue - Barter Transactions Involving Advertising Services. The Trusts intend to adopt IFRS 15 in the combined financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

(iv) Amendments to Share-based Payments ("IFRS 2")

In January 2016, the IASB issued amendments to IFRS 2, *Share-based Payment* clarifying how to account for certain types of share-based payment transactions. The Trusts intend to adopt the amendments to IFRS 2 in its combined financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the amendments has not yet been determined.

(v) Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16, *Leases*. The new standard will replace existing lease guidance in IFRS and related interpretations, and requires lessees to bring most leases on-balance sheet. Lessor accounting remains similar to the current standard. The new standard is effective for years beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Each of the Trust's CEO and CFO has designed, or caused to be designed under their direct supervision, the applicable Trusts' disclosure controls and procedures (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 annual filings are being prepared; and (ii) material information required to be disclosed in the annual filings is recorded, processed, summarized and reported on a timely basis. The Trusts' CEO and CFO have each concluded that such disclosure controls and procedures were appropriately designed and were operating effectively as at December 31, 2016. The Trusts' Financial Statements and this MD&A were reviewed and approved by H&R's Audit Committee and the Board of Trustees prior to this publication.

Management of each Trust has reviewed its internal control over financial reporting on an annual basis. The Trusts' management, under the supervision of the CFO, has evaluated the effectiveness of internal control over financial reporting using the framework and criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission in May 2013 (2013 COSO Framework). Based on this evaluation, management has concluded that internal control over financial reporting was effective and in accordance with the criteria established in the 2013 COSO Framework as of December 31, 2016. No changes were made to the design of either Trust's internal control over financial reporting

during the three month period ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, the Trusts' internal control over financial reporting.

Each Trust's management, including the CEO and CFO, does not expect that the applicable Trusts' 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 their 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 H&R's portfolio. The major risk factors including detailed descriptions are outlined below and in H&R's Annual Information Form.

#### **Real Property Ownership**

All real property investments are subject to a degree of risk and uncertainty. Such investments are affected by various factors including general economic conditions, local real estate markets, demand for leased premises, competition from other available premises and various other factors.

The value of real property and any improvements thereto may also depend on the credit and financial stability of the tenants. Distributable cash and H&R's income would be adversely affected if one or more major tenants or a significant number of tenants were to become unable to meet their obligations under their leases or if a significant amount of available space in the properties in which H&R has an interest is not able to be leased on economically favourable lease terms. In the event of default by a tenant, delays or limitations in enforcing rights as lessor may be experienced and substantial costs in protecting H&R's investment may be incurred. Furthermore, at any time, a tenant of any of the properties in which H&R has an interest may seek the protection of bankruptcy, insolvency or similar laws that could result in the rejection and termination of such tenant's lease and thereby cause a reduction in the cash flow available to H&R.

Given the prominence of the oil and gas industry in the province of Alberta, the economy of this province can be significantly impacted by commodity prices. For the year ended December 31, 2016, approximately 26.7% of H&R's Same-Asset property operating income (cash basis) was generated from Alberta. Accordingly, any continuing decline or prolonged weakness in commodity prices, could adversely affect those tenants of H&R that are involved in the oil and gas industry, thereby increasing the credit risk of such tenants to H&R which in turn may adversely affect H&R's operating results.

With respect to the Primaris segment, retail shopping centres have traditionally relied on there being a number of anchor tenants (department stores, discount department stores and grocery stores) in the centre, and therefore they are subject to the risk of such anchor tenants either moving out of the property or going out of business. Within the Primaris segment, certain of the major tenants are permitted to cease operating from their leased premises at any time at their option, however, they remain liable to pay all remaining rent in accordance with their leases. Other major tenants are permitted to cease operating from their leased premises or to terminate their leases if certain events occur. Some commercial retail unit tenants have a right to cease operating from their premises if certain major tenants cease operating from their premises. The exercise of such rights by a tenant may have a negative effect on a property. There can be no assurance that such rights will not be exercised in the future.

The ability to rent unleased space in the properties in which H&R has an interest will be affected by many factors and costs may be incurred in making improvements or repairs to property required by a new tenant. A prolonged deterioration in economic conditions could increase and exacerbate the foregoing risks. The failure to rent unleased space on a timely basis or at all would likely have an adverse effect on H&R's financial condition.

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

H&R may, in the future, be exposed to a general decline of demand by tenants for space in properties. As well, certain of the leases of the properties held by H&R have early termination provisions which, if exercised, would reduce the average lease term. However, such termination rights are generally exercisable at a cost to the tenant only and the amount of space in H&R's portfolio which could be affected is not significant.

A mortgage on any one property may, from time to time, exceed the estimated current market value of the related property. The cash flow from such a property may not be sufficient to cover debt servicing for that property. The cash flow from H&R's portfolio is, however, expected by management to be sufficient to cover any cash flow shortfalls on such a property.

### **Credit Risk and Tenant Concentration**

H&R is exposed to credit risk in the event that borrowers default on the repayment of the amounts owing to H&R. Management mitigates this risk by ensuring adequate security has been provided in support of mortgages receivable.

H&R 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 H&R's holdings so that it owns several categories of properties (office, retail, industrial and residential) 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 H&R are Encana Corporation and Bell Canada. Both of these companies have a public debt rating that is rated with at least a BBB Negative rating by a recognized rating agency.

### **Lease Rollover Risk**

Lease rollover risk arises from the possibility that H&R may experience difficulty renewing leases as they expire. Management attempts to enter into long-term leases to mitigate this risk. Management attempts to mitigate the risk by having staggered lease maturities and entering into longer term leases with built-in rental escalations. The leases for 34.6% of H&R's total commercial leasable area will expire in the next 5 years.

### **Interest and Other Debt-Related Risk**

H&R has been able to leverage off the low interest rate environment that the Canadian and U.S. economy has experienced in recent years which has enhanced its return to unitholders. A reversal of this trend, however, may lead to the Trusts' debt being refinanced at higher rates, thereby reducing net income and cash flows which could ultimately affect the level of distributions. In order to minimize this risk, H&R 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 H&R in the management of its interest rate exposure. In addition, H&R's Declaration of Trust restricts total indebtedness permitted on the portfolio.

### **Construction Risks**

It is likely that, subject to compliance with H&R's Declaration of Trust, H&R will be involved in various development projects. H&R'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 H&R 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. 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.

### **Currency Risk**

The Trusts are 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, H&R's debt on these properties is also denominated in U.S. dollars to act as a natural hedge.

H&R is exposed to foreign exchange fluctuations as a result of the U.S. Holdco Notes, Series J senior debentures and the U.S. bank indebtedness each being denominated in U.S. dollars.

### **Liquidity Risk**

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relationship with demand for and the perceived desirability of such investments. Such illiquidity will tend to limit H&R's ability to vary its portfolio promptly in response to changing economic or investment conditions. If for whatever reason, liquidation of assets is required, there is a risk that sale proceeds realized might be less than the previously estimated market value of H&R's investments or that market conditions would prevent prompt disposition of assets.

### **Financing Credit Risk**

H&R is also exposed to credit risk as a lender on the security of real estate in the event that a borrower is unable to make the contracted payments. Such risk is mitigated through credit checks and related due diligence of the borrowers and through careful evaluation of the worth of the underlying assets.

### **Environmental Risk**

As an owner and manager of real estate assets in Canada and the United States, H&R 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 H&R on or adjacent properties.

In accordance with best management practices, Phase 1 environmental audits are reviewed on all properties prior to acquisition. Further investigation is conducted if Phase 1 tests indicate a potential problem. H&R 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.

### **Co-Ownership Interest in Properties**

In certain situations, H&R may be adversely affected by a default by a co-owner of a property under the terms of a mortgage, lease or other agreement. Although all co-owners agreements entered into by H&R provide for remedies to H&R in such circumstances, such remedies may not be exercisable in all circumstances, or may be insufficient or delayed, and may not cure a default in the event that such default by a co-owner is deemed to be a default of H&R.

### **Joint Arrangement Risks**

H&R has several investments in joint ventures and investments in associates. H&R is subject to risks associated with the management and performance of these joint arrangements. Such risks include any disagreements with its partners relating to the development or operations of a property, as well as differences with respect to strategic decision making. Other risks include partners not meeting their financial or operational obligations. H&R attempts to mitigate these risks by maintaining good working relationships with its partners, and conducting due diligence on their partners to ensure there is a similar alignment of strategy prior to creating a joint arrangement.

### **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 H&R 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 H&R. 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 H&R 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 H&R will also fluctuate in order to result in an aggregate monthly cash distribution as previously outlined. Although H&R 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 H&R will depend on numerous factors including monthly cash distributions paid by Finance Trust, capital market conditions, the financial performance of the properties, H&R's debt covenants and obligations, its working capital requirements, its future capital requirements, its development commitments and fluctuations in interest rates. Cash available to H&R 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. H&R 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 H&R and/or Finance Trust suspends or reduces distributions. H&R's trustees retain the right to re-evaluate the distribution policy from time to time as they consider appropriate.

### **Ability to Access Capital Markets**

As H&R distributes a substantial portion of its income to unitholders, H&R may need to obtain additional capital through capital markets and H&R's ability to access the capital markets through equity issues and forms of secured or unsecured debt financing may affect the operations of H&R 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.

## 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 H&R's Unit Option Plan and Incentive Unit Plan. Any issuance of Stapled Units may have a dilutive effect on the investors of Stapled Units.

## Unitholder Liability

The Declarations of Trust of each of H&R 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 Declaration of Trust of H&R and Finance 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, H&R'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 H&R 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 2018 and 2020 convertible debentures and the Series C, E, F, G, J, K, L, M and N Senior Debentures will receive payments owing to them under the terms of such debentures will depend on the financial health of H&R and its creditworthiness. In addition, such debentures are unsecured obligations of H&R and are subordinate in right of payment to all H&R's existing and future senior indebtedness as defined in each such respective trust indenture. Therefore, if H&R becomes bankrupt, liquidates its assets, reorganizes or enters into certain other transactions, H&R'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 H&R's subsidiaries except to the extent H&R 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 H&R. 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 H&R, holders of indebtedness of H&R (including holders of the convertible debentures), may become subordinate to lenders to the subsidiaries of H&R. The indentures governing such debentures do not prohibit or limit the ability of H&R 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 H&R.

## Tax Risk

The Tax Act includes rules (referred to herein as the "SIFT Rules") which 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" (each as defined in the Tax Act, and collectively, "SIFTs") and their investors. A trust that qualifies as a "real estate investment trust" (as defined in the Tax Act) for a taxation year will not be considered to be a SIFT trust in that year (the "REIT Exemption").

Based on a review of H&R's assets and revenues, management believes that H&R satisfied the tests to qualify for the REIT Exemption for 2016. Management of H&R intends to conduct the affairs of H&R so that it qualifies for the REIT Exemption at all times. However, as the REIT Exemption includes complex revenue and asset tests, no assurances can be provided that H&R will continue to qualify for any subsequent year.

The Tax Act includes rules affecting certain publicly traded stapled securities of SIFTs, REITs and corporations which can result in the denial of a deduction for certain payments made by another entity to a REIT, or to a subsidiary of a REIT (the "Stapled Security Rules"). Management of each of H&R and Finance Trust has reviewed the Stapled Security Rules and has concluded that the Stapled Security Rules should not materially adversely affect H&R, Finance Trust or holders of Stapled Units. However, no assurances can be given in this regard.

There can be no assurance that income tax laws and the treatment of mutual fund trusts will not be changed in a manner which adversely affects holders of Stapled Units. If H&R or Finance Trust ceases to qualify as a “mutual fund trust” under the Tax Act and the units thereof cease to be listed on a designated stock exchange (which currently includes the TSX), H&R Units or Finance Trust Units, as the case may be, will cease to be qualified investments for registered retirement savings plans, deferred profit sharing plans, registered retirement income funds, registered education savings plans, registered disability savings plans and tax-free savings accounts.

Pursuant to rules in the Tax Act, if H&R or Finance Trust experiences a “loss restriction event” (i) it will be deemed to have a year-end for tax purposes (which would result in an unscheduled distribution of undistributed net income and net realized capital gains, if any, at such time to Unitholders to the extent necessary so that such trust is not liable for income tax on such amounts under Part I of the Tax Act), and (ii) it will become subject to the loss restriction rules generally applicable to a corporation that experiences an acquisition of control, including a deemed realization of any unrealized capital losses and restrictions on its ability to carry forward losses. Generally, H&R or Finance Trust will be subject to a loss restriction event if a person becomes a “majority-interest beneficiary”, or a group of persons becomes a “majority-interest group of beneficiaries”, of such trust, each as defined in the affiliated persons rules contained in the Tax Act, with certain modifications. Generally, a majority-interest beneficiary of a trust is a beneficiary of the trust whose beneficial interests in the income or capital of the trust, as the case may be, together with the beneficial interests in the income or capital of the trust, as the case may be, of persons and partnerships with whom such beneficiary is affiliated for the purposes of the Tax Act, represent greater than 50% of the fair market value of all the interests in the income or capital of the trust, as the case may be.

H&R operates in the United States through U.S. Holdco which is capitalized with debt and equity provided by H&R and debt in the form of U.S. Holdco Notes owed to Finance Trust and H&R Portfolio Limited Partnership. As at December 31, 2016, Finance Trust holds U.S. \$220.5 million of U.S. Holdco Notes. During 2016, H&R made loans to U.S. Holdco (“U.S. Holdco Loans”) to indirectly fund additional U.S. Holdco acquisitions of income generating real property and Management anticipates that U.S. Holdco will continue to borrow funds from H&R in the future for similar purposes, to fund its operations or to refinance existing loans. U.S. Holdco treats the U.S. Holdco Notes and U.S. Holdco Loans as indebtedness for U.S. federal income tax purposes. If the IRS or a court were to determine that the U.S. Holdco Notes and/or the U.S. Holdco Loans should be treated for U.S. federal income tax purposes as equity rather than debt, the interest on the U.S. Holdco Notes and/or the U.S. Holdco Loans could be treated as a dividend, and interest on the U.S. Holdco Notes and/or the U.S. Holdco Loans 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 and/or the U.S. Holdco Loans did not represent an arm’s length rate, any excess amount over the arm’s length rate would not be deductible and could be re-characterized 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. Such an increase in tax liability could materially adversely affect U.S. Holdco’s ability to make interest payments on the U.S. Holdco Notes and/or the U.S. Holdco Loans or H&R’s ability to make distributions on its units. Additionally, payments of interest on the U.S. Holdco Notes considered to be paid to non-U.S. holders of Stapled Units as discussed below could be subject to withholding taxes.

On October 13, 2016, the U.S. Treasury and the IRS issued final and temporary regulations under section 385 of the Code (“Section 385 Regulations”) that could potentially apply to recharacterize as equity certain related party indebtedness issued after April 4, 2016. Generally, the Section 385 Regulations (i) establish threshold documentation requirements that must be satisfied for related party indebtedness issued after January 1, 2018 in order for such related party indebtedness to be treated as debt for U.S. federal income tax purposes, (ii) treat related party indebtedness as equity for U.S. federal income tax purposes if such related party indebtedness was issued in certain transactions, including in exchange for stock of a related party or in a distribution and (iii) recharacterize related party indebtedness as equity for U.S. federal income tax purposes in certain circumstances including where the debtor corporation pays a distribution after April 4, 2016 in excess of the accumulated earnings and profits for tax years ending after April 4, 2016, during which the debtor corporation is related to the holder of the debt. In general, the Section 385 Regulations only apply to related party indebtedness debt issued by U.S. corporations after April 4, 2016 and so most of the U.S. Holdco Notes should not be impacted by the Section 385 Regulations. However, the Section 385 Regulations could apply to U.S. Holdco Notes that are refinanced in the future and/or to any issuances of related party indebtedness issued after April 4, 2016, including the U.S. Holdco Loans issued after this date. Management believes that the Section 385 Regulations should not apply to treat the existing U.S. Holdco Loans as equity as the U.S. Holdco Loans were not issued in exchange for stock of a related party or otherwise in a transaction described in the Section 385 Regulations and U.S. Holdco has not paid any distributions to H&R since April 4, 2016 or engaged in any other transaction that would cause such loans to be recharacterized under the Section 385 Regulations. Management does not currently anticipate causing U.S. Holdco to pay distributions in excess of U.S. Holdco’s earnings and profits accumulated in tax years ending after April 4, 2016 or engaging in any other transactions that will cause indebtedness of U.S. Holdco to be treated or recharacterized as equity. However, there can be no assurance that such a distribution or transaction will not occur in the future. In the event that any indebtedness of U.S. Holdco were recharacterized as equity, any interest paid or accrued on such indebtedness would not be deductible by U.S. Holdco and any payments made by U.S. Holdco thereon could be treated as dividends subject to U.S. withholding tax.

To the extent that H&R or a related party provided debt financing to U.S. Holdco (e.g., the U.S. Holdco Loans or 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 H&R or such related party. Section 163(j) of the Code applies to defer U.S. Holdco’s deduction of interest paid on debt to H&R or such related party in years that (i) the debt to equity ratio of U.S. Holdco 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). Section 163(j) is considered in the analysis of interest paid on the U.S. Holdco Loans. With respect to the U.S. Holdco Notes, H&R’s position is 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 H&R and/or 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. Holdco could increase. In such case, the amount of income available for distribution by H&R to its Unitholders could be reduced.

### **Additional Tax Risks Applicable to Unitholders**

H&R is classified as a foreign corporation for United States federal income tax purposes. A foreign corporation will be classified as a 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 H&R are managed by subsidiaries of H&R rather than directly by its own employees. Although H&R's officers and employees oversee the activities of the managers, it is unclear whether H&R will be characterized as a PFIC for U.S. federal income tax purposes. If H&R were treated as a PFIC, then in the absence of certain elections being made by a U.S. Unitholder with respect to such U.S. Unitholder's H&R Units, any distributions in respect of H&R Units which are treated as "excess distribution" under the applicable rules and any gain on a sale or other disposition of H&R Units would be treated as ordinary income and would be subject to special tax rules, including an interest charge. In addition, if H&R were treated as a PFIC, then dividends paid on H&R Units will not qualify for the reduced 20% U.S. federal income tax rate applicable to certain qualifying dividends received by noncorporate taxpayers.

The foregoing adverse consequences of PFIC characterization can be mitigated by making certain elections. U.S. Unitholders 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. If H&R were a PFIC, U.S. Unitholders would be required to file an annual return on IRS Form 8621.

U.S. individuals are required to report an interest in any "specified foreign financial asset" if the aggregate value of such assets owned by the U.S. individual exceeds \$50,000 (or such higher threshold as may apply to a particular taxpayer pursuant to the instructions to IRS Form 8938). H&R Units are treated as a specified foreign financial asset for this purpose.

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 will be treated as payments directly to Unitholders. 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 income taxation at a maximum marginal rate of 39.6% plus an additional 3.8% tax that applies to investment income earned by certain high income non-corporate taxpayer. Interest on the U.S. Holdco Notes paid to Canadian resident Unitholders may be eligible for an exemption from U.S. withholding tax under the *Canada-U.S. Tax Convention* (the "U.S. Treaty") if the applicable limitation on benefit provisions contained in the U.S. Treaty are satisfied. 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.

U.S. Unitholders are required to file an information return on IRS Form 3520 to report their interest in the Finance Trust and to include a copy of their Form 3520-A Foreign Grantor Trust Owner Statement, which is being provided by Finance Trust to its registered U.S. Unitholders. If you have not received a Foreign Grantor Trust Owner Statement, pro forma information to prepare a Form 3520-A Foreign Grantor Trust Owner Statement will be available on our website. You should consult with your own tax advisor regarding the requirements of filing information returns.

A holder of Stapled Units that is a resident of the U.S. for purposes of the Tax Act will generally be subject to Canadian withholding tax under Part XIII of the Tax Act at the rate of 25% on the portion of the income of H&R and Finance Trust paid or credited (whether in cash or *in specie*) in respect of such Stapled Units, subject to reduction under the U.S. Treaty if applicable. In the case of income paid or credited on H&R units, the withholding rate applicable to a U.S. Unitholder entitled to the benefits of the U.S. Treaty in respect of such income would generally be reduced to 15%. In the case of income paid or credited to a U.S. resident holder of Finance Trust Units, there is uncertainty as to the appropriate rate of withholding under the U.S. Treaty and in light of this uncertainty, management of Finance Trust currently applies the 25% withholding rate under the Tax Act to income paid or credited to U.S. residents. U.S. Unitholders may be entitled to a refund of a portion of such withholding tax if the rate applied by Finance Trust were determined to be excessive. You should consult with your own tax advisor regarding the advisability of applying for such a refund.



## 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 February 9, 2017, there were 285,744,257 Stapled Units issued and outstanding (each comprised of an H&R unit and a Finance Trust unit).

As at December 31, 2016, the maximum number of units authorized to be issued under H&R's Unit Option Plan was 28,000,000. Of this amount, 21,402,296 options had been granted, 343,422 have expired and 6,941,126 remain to be granted. Of the amount originally granted, 7,581,757 had been exercised and expired and therefore, 13,820,539 options to purchase Stapled Units were outstanding. As at February 9, 2017, there were 13,820,539 options to purchase Stapled Units outstanding of which 5,186,652 are fully vested.

As at December 31, 2016, the maximum number of units authorized to be granted under H&R's Incentive Unit Plan was 5,000,000. Of this amount, 419,025 had been granted, of which 11,665 had been expired, 4,592,640 remain to be granted and 407,360 incentive units remain outstanding as at December 31, 2016. As at February 9, 2017, there were 500,347 incentive units outstanding.

As at December 31, 2016, there were 16,563,816 exchangeable units outstanding of which 9,500,000 exchangeable units are accompanied by special voting units. As at February 9, 2017, there were 16,563,816 exchangeable units of which 9,500,000 exchangeable units are accompanied by special voting units.

The following table lists the principal outstanding balance of H&R's convertible debentures as at February 9, 2017, and the number of Stapled Units required to convert the convertible debentures to equity:

Convertible Debentures	Principal outstanding as at February 9, 2017	Maximum number of Stapled Units issuable
2018 Convertible Debentures (HR.DB.H)	74.4 million	3,008,249
2020 Convertible Debentures (HR.DB.D)	99.7 million	4,240,595

## SUBSEQUENT EVENTS

- (a) In January 2017, H&R sold a 50% non-managing interest in two enclosed shopping centres which was classified as held for sale as at December 31, 2016, for gross proceeds of approximately \$211.6 million. The purchaser assumed 50% of the existing mortgages of approximately \$126.6 million.
- (b) In January 2017, H&R issued \$150.0 million principal amount of Series M senior debentures maturing on July 23, 2019.
- (c) In January 2017, H&R repaid all of its Series I senior debentures upon maturity for a cash payment of \$60.0 million.
- (d) In January 2017, H&R issued \$200.0 million principal amount of Series N senior debentures maturing January 30, 2024.
- (e) In January 2017, H&R secured a U.S. \$55.0 million increase to a first mortgage for a term of 4.8 years.
- (f) In February 2017, H&R repaid all of its Series B senior debentures upon maturity for a cash payment of \$115.0 million.
- (g) In February 2017, H&R repaid one Canadian mortgage of approximately \$124.4 million.

## ADDITIONAL INFORMATION

Additional information relating to H&R and Finance Trust, including H&R's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com)

Combined Financial Statements of

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

Years ended December 31, 2016 and 2015



KPMG LLP  
Bay Adelaide Centre  
333 Bay Street, Suite 4600  
Toronto ON M5H 2S5  
Canada  
Tel 416-777-8500  
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## INDEPENDENT AUDITORS' REPORT

To the Unitholders 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 (collectively, the "Trusts"), which comprise the combined statements of financial position as at December 31, 2016 and 2015, the combined statements of comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the 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 Trusts' 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 Trusts' 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.



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*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, 2016 and 2015, and their combined financial performance and their combined cash flows for the years then ended in accordance with International Financial Reporting Standards.

*KPMG LLP*

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Chartered Professional Accountants, Licensed Public Accountants

February 15, 2017  
Toronto, Canada

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

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

	Note	December 31 2016	December 31 2015
<b>Assets</b>			
Real estate assets:			
Investment properties	4	\$ 12,564,144	\$ 12,576,075
Properties under development	4	118,268	97,504
		<b>12,682,412</b>	<b>12,673,579</b>
Equity accounted investments	5	1,051,187	1,117,786
Assets classified as held for sale	6	211,550	3,000
Other assets	7	161,842	157,663
Cash and cash equivalents	8	48,021	38,287
		<b>\$ 14,155,012</b>	<b>\$ 13,990,315</b>
<b>Liabilities and Unitholders' Equity</b>			
Liabilities:			
Mortgages payable	9	\$ 4,001,451	\$ 4,537,278
Debentures payable	10	1,491,591	1,550,769
Exchangeable units	11	370,533	334,110
Deferred tax liability	24	386,775	189,658
Liabilities classified as held for sale	6	126,815	-
Loan payable		-	55,717
Bank indebtedness	8	647,772	321,033
Accounts payable and accrued liabilities	12	217,425	176,830
		<b>7,242,362</b>	<b>7,165,395</b>
Unitholders' equity		<b>6,912,650</b>	<b>6,824,920</b>
Commitments and contingencies	25		
Subsequent events	13, 27		
		<b>\$ 14,155,012</b>	<b>\$ 13,990,315</b>

See accompanying notes to the combined financial statements.

Approved on behalf of the Board of 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, 2016 and 2015

	Note	2016	2015
Property operating income:			
Rentals from investment properties	16	\$ 1,196,011	\$ 1,188,314
Property operating costs		(431,271)	(414,801)
		<b>764,740</b>	<b>773,513</b>
Net income from equity accounted investments	5	48,341	841
Other income	17	20,353	-
Finance cost - operations	18	(287,325)	(295,010)
Finance income	18	4,715	3,770
Fair value adjustments on financial instruments	18	(33,830)	36,240
Trust expenses		(29,852)	(9,327)
Fair value adjustment on real estate assets	4	133,738	(178,868)
Loss on sale of real estate assets, net of related costs	4	(8,167)	(5,428)
Gain (loss) on foreign exchange		(8,944)	49,375
Transaction costs		(13,483)	-
Net income before income taxes		<b>590,286</b>	<b>375,106</b>
Income tax expense	24	(201,541)	(34,958)
Net income		<b>388,745</b>	<b>340,148</b>
Other comprehensive income (loss):			
Unrealized gain (loss) on translation of U.S. denominated foreign operations	15	(38,397)	227,430
Transfer of realized loss on cash flow hedges to net income		30	31
		<b>(38,367)</b>	<b>227,461</b>
Total comprehensive income all attributable to unitholders		<b>\$ 350,378</b>	<b>\$ 567,609</b>

See accompanying notes to the combined financial statements.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Combined Statements of Changes in Unitholders' Equity

(In thousands of Canadian dollars)

Years ended December 31, 2016 and 2015

UNITHOLDERS' EQUITY	<i>Note</i>	Value of Units	Accumulated net income	Accumulated distributions	Accumulated other comprehensive income (loss) (note 15)	Total
Unitholders' equity, January 1, 2015		\$ 5,133,757	\$ 3,823,381	\$ (2,548,596)	\$ 119,126	\$ 6,527,668
Proceeds from issuance of units		107,000	-	-	-	107,000
Issue costs		(353)	-	-	-	(353)
Net income		-	340,148	-	-	340,148
Distributions to unitholders	<i>14(d)</i>	-	-	(373,072)	-	(373,072)
Conversion of convertible debentures, net	<i>10(c)</i>	5	-	-	-	5
Units repurchased and cancelled	<i>14(f)</i>	(3,937)	-	-	-	(3,937)
Other comprehensive income		-	-	-	227,461	227,461
Unitholders' equity, December 31, 2015		5,236,472	4,163,529	(2,921,668)	346,587	6,824,920
<b>Proceeds from issuance of units</b>		<b>121,175</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>121,175</b>
<b>Net income</b>		<b>-</b>	<b>388,745</b>	<b>-</b>	<b>-</b>	<b>388,745</b>
<b>Distributions to unitholders</b>	<i>14(d)</i>	<b>-</b>	<b>-</b>	<b>(381,106)</b>	<b>-</b>	<b>(381,106)</b>
<b>Conversion of convertible debentures, net</b>	<i>10(c)</i>	<b>17</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17</b>
<b>Units repurchased and cancelled</b>	<i>14(f)</i>	<b>(2,734)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(2,734)</b>
<b>Other comprehensive loss</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>(38,367)</b>	<b>(38,367)</b>
<b>Unitholders' equity, December 31, 2016</b>		<b>\$ 5,354,930</b>	<b>\$ 4,552,274</b>	<b>\$ (3,302,774)</b>	<b>\$ 308,220</b>	<b>\$ 6,912,650</b>

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, 2016 and 2015

	<i>Note</i>	<b>2016</b>	<b>2015</b>
Cash provided by (used in):			(note 3)
Operations:			
Net income		\$ 388,745	\$ 340,148
Finance cost - operations	18	287,325	295,010
Interest paid		(299,533)	(304,188)
Items not affecting cash:			
Net income from equity accounted investments	5	(48,341)	(841)
Rent amortization of tenant inducements	16	2,241	2,100
(Gain) loss on foreign exchange		8,944	(49,375)
Fair value adjustment on real estate assets	4	(133,738)	178,868
Loss on sale of real estate assets, net of related costs	4	8,167	5,428
Fair value adjustments on financial instruments	18	33,830	(36,240)
Unit-based compensation	14(c)	17,916	(697)
Deferred income taxes	24	199,591	32,617
Change in other non-cash operating items	19	(40,951)	4,524
		<b>424,196</b>	<b>467,354</b>
Investing:			
Properties under development	4, 19	(20,104)	(2,436)
Investment properties:			
Net proceeds on disposition of real estate assets		347,454	355,714
Acquisitions	4	(325,169)	(301,668)
Redevelopment	4, 19	(65,814)	(43,331)
Capital expenditures	4	(58,924)	(41,716)
Leasing expenses and tenant inducements	4	(34,682)	(54,628)
Equity accounted investments, net		92,447	(207,986)
Mortgages receivable		58,363	13,016
Restricted cash	7	5,182	(7,773)
		<b>(1,247)</b>	<b>(290,808)</b>
Financing:			
Bank indebtedness		331,359	197,170
Mortgages payable:			
New mortgages payable		131,949	418,732
Principal repayments		(489,891)	(408,042)
Repayment of loan payable		(54,102)	(119,886)
Proceeds from issuance of debentures payable		198,185	370,752
Repayment of debentures payable	10(c)	(254,983)	(350,000)
Proceeds from issuance of units, net of issue costs		1,266	847
Units repurchased and cancelled	14(f)	(2,734)	(3,937)
Distributions to unitholders	14(d)	(274,264)	(267,650)
		<b>(413,215)</b>	<b>(162,014)</b>
Increase in cash and cash equivalents		9,734	14,532
Cash and cash equivalents, beginning of year	8	38,287	23,755
Cash and cash equivalents, end of year	8	<b>\$ 48,021</b>	<b>\$ 38,287</b>

See note on supplemental cash flow information (note 19).

See accompanying notes to the combined financial statements.



# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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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", together with the REIT, the "Trusts"). 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 and residential 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.

On October 1, 2008, the REIT completed an internal reorganization 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 further resulted in, among other things, the creation of Finance Trust on October 1, 2008. 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.

On October 24, 2013, the Ontario Securities Commission (on its behalf and on behalf of the other provincial securities regulators) issued a decision which permits the REIT and Finance Trust to file one set of combined financial statements rather than separate financial statements. These combined financial statements are being presented on a basis whereby the assets and liabilities of the REIT and Finance Trust have been combined in accordance with the accounting principles applicable to both the REIT and Finance Trust in accordance with International Financial Reporting Standards ("IFRS") to reflect the financial position and results of the REIT and Finance Trust on a combined basis. The combined presentation is useful to the unitholders of the Trusts, for the following reasons:

- The units of the Trusts are stapled (as noted above), resulting in the 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 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 of the REIT on February 15, 2017.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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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 items in the combined statements 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;
- (iv) Convertible debentures; and
- (v) Exchangeable units.

#### (c) Functional currency and presentation

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

The Trusts present their combined statements 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 (note 4);
- Fair value of exchangeable units (note 11);
- Fair value of cash-settled unit-based compensation (note 14(c));
- Fair value of convertible debentures (note 10); and
- Deferred tax asset (liability) (note 24).

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements  
(In thousands of Canadian dollars, except unit and per unit amounts)  
**Years ended December 31, 2016 and 2015**

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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:

- Business combinations

Accounting for business combinations under IFRS 3, *Business Combinations* ("IFRS 3") is only applicable if it is determined that a business has been acquired. Under IFRS 3, a business is defined as an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors or lower costs or other economic benefits directly and proportionately to the REIT. A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. In the absence of such criteria, a group of assets is deemed to have been acquired. If goodwill is present in a transferred set of activities and assets, the transferred set is presumed to be a business. Judgement is used by management in determining whether the acquisition of an individual property, or group of properties, qualifies as a business combination in accordance with IFRS 3 or as an asset acquisition.

- Valuations of real estate assets

Real estate assets, which consist of investment properties and properties under development, are carried on the combined statements of financial position at fair value, as determined 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. Judgement is applied in determining whether certain costs are additions to the carrying value of the real estate assets, identifying the point at which practical completion of the property occurs and identifying the directly attributable borrowing costs to be included in the carrying value of the development properties.

- 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, the REIT would be subject to tax on its taxable income distributed to unitholders.

- Impairment of equity accounted investments

The REIT determines at each reporting date whether there is any objective evidence that the equity accounted investments are impaired. If so, the REIT calculates the amount of impairment as the difference between the recoverable amount of the equity accounted investment and its carrying value and recognizes the amount in net income.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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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 these 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 cash flows 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 translating Finance Trust's U.S. dollar note receivable from U.S. Holdco is not eliminated on combination as it flows through net income on Finance Trust's books and other comprehensive income on the REIT's books. This is because U.S. Holdco is a subsidiary of the REIT and forms part of its net investment in the United States, but is not a subsidiary of Finance Trust.

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 joint operations and records its proportionate share of assets, liabilities, revenues, expenses and cash flows of all joint operations 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, under IAS 40, *Investment Property* ("IAS 40").

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 under IFRS 3, as set out in note 1(d)(ii). 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.

Subsequent capital expenditures are capitalized 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. All other repairs and maintenance costs are expensed when incurred. Leasing costs, such as commissions incurred in negotiating tenant leases, are included in investment properties.

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.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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### 2. Significant accounting policies (continued):

(d) *Properties under development:*

Properties under development for future use as investment property are accounted for as investment property under IAS 40. 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 and liabilities held for sale:*

Non-current assets 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 considered to be 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.

Non-current liabilities that are to be assumed by the buyer on disposition of the non-current asset, are also classified as held for sale. Non-current assets and non-current liabilities held for sale are classified separately from other assets and other liabilities in the statement of financial position. These amounts are not offset or presented as a single amount.

(f) *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 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 as accrued rent receivable, which is included in the investment property balance. Lease incentives granted are recognized as an integral part of total rental income over the term of the lease.

(g) *Income taxes:*

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

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.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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### 2. Significant accounting policies (continued):

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, 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.

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 from 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 2016 and the 2015 comparative year.

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 the REIT's and Finance Trust's distributions are treated as an exemption from taxation as the REIT and Finance Trust have distributed and are committed to continue distributing all of their taxable income to their unitholders.

#### (h) *Unit-based compensation:*

The REIT has a unit option plan and incentive unit plan available for REIT trustees, officers, employees and consultants as disclosed in note 14(c). These plans are 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 and incentive unit 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.

#### (i) *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.

#### (j) *Restricted cash:*

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

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### 2. Significant accounting policies (continued):

(k) *Foreign currency translation:*

The REIT accounts for its investment in U.S. Holdco, a wholly owned subsidiary of the REIT in the United States (“foreign operations”), as a U.S. dollar functional currency foreign operation. Assets and liabilities of foreign operations are translated into Canadian dollars at the exchange rates in effect at the combined statements of financial position 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 senior debenture and bank indebtedness are 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 these obligations are recorded as a foreign currency translation adjustment in accumulated other comprehensive income (loss).

Assets and liabilities denominated in a currency other than the functional currency are translated into the functional currency at the exchange rates in effect at the combined statements of financial position dates and revenue and expenses are translated at the actual exchange rate on the date incurred, with any gain (loss) recorded in net income, unless the asset or liability is designated as a hedge.

(l) *Financial instruments:*

(i) Non-derivative financial assets

Cash and cash equivalents, restricted cash, accounts receivable and mortgages receivable, with fixed or determinable payments that are not quoted in an active market, are non-derivative financial assets classified as loans and receivables. 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 combined statements 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, loan 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 their 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 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 immediately unless the derivative is designated and effective as a hedging instrument. None of the REIT’s derivative instruments, as described in note 13, are accounted for as hedges.

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### 2. Significant accounting policies (continued):

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

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

The convertible debentures and exchangeable units were designated at fair value through net income upon initial recognition. Any gains or losses arising on remeasurement are recognized in net income.

(m) *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 per unit calculation is not presented.

(n) *Finance costs:*

Finance costs are comprised of interest expense on borrowings, distributions on exchangeable units classified as liabilities, gain (loss) on change in fair value of convertible debentures, gain (loss) on change in fair value of exchangeable units and net gain (loss) on derivative instruments.

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

(o) *Investment in associates and joint ventures:*

An associate is an entity over which the Trust has significant influence. Significant influence is the power to participate in an entity's financial and operating policy decisions, which is presumed to exist when an investor holds 20 percent or more of the voting power of another entity. An investment is considered an associate when significant influence exists but there is no joint control over the investment. The Trusts account for investments in associates using the equity method.

The Trusts consider investments in joint arrangements to be joint ventures when they jointly control one or more investment properties with another party and have rights to the net assets of the arrangements. This occurs when the joint arrangement is structured through a separate vehicle, such as a partnership, with separation maintained.

The Trusts' interests in their associates and joint ventures are accounted for using the equity method and are carried on the combined statements of financial position at cost, adjusted for the Trusts' proportionate share of post-acquisition changes in the net assets, less any identified impairment loss. The Trusts' share of profits and losses is recognized in the share of net income from the associate or joint venture investments in the combined statements of comprehensive income and the Trusts' other comprehensive income includes their share of the associate or joint ventures' other comprehensive income.

An associate or a joint venture is considered to be impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the joint venture and that event has a negative impact on the future cash flows of the joint venture that can be reliably estimated.



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### 2. Significant accounting policies (continued):

Effective January 1, 2016, the Trusts adopted the amendments to IFRS 11, *Joint Arrangements* ("IFRS 11"), which require that when an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes a business, it shall apply the principles of business combination accounting (as described by the Trusts in note 2(q)). The Trusts applied this change in accounting policy on a prospective basis. There was no impact of the adoption of the amendments to IFRS 11 on the combined statements of financial position, combined statements of comprehensive income and combined statements of cash flow as at and for the year ended December 31, 2016.

(p) *Joint Operations:*

The Trusts consider investments in joint arrangements to be joint operations when they make operating, financial and strategic decisions over one or more investment properties jointly with another party and have direct rights to the assets and obligations for the liabilities relating to the arrangement. When the arrangement is considered to be a joint operation, the Trusts will include their share of the underlying assets, liabilities, revenue and expenses in their financial results.

(q) *Business Combinations:*

The purchase method of accounting is used for acquisitions meeting the definition of a business. The consideration transferred in a business combination is measured at fair value.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their acquisition date fair values. The excess of the cost of acquisition over the fair value of the REIT's share of the identifiable net assets acquired, if any, is recorded as goodwill. If the cost of acquisition is less than the fair value of the REIT's share of the net assets acquired, the difference is recognized directly in the combined statements of comprehensive income for the year as an acquisition gain. Any transaction costs incurred with respect to the business combination are expensed in the period incurred.

(r) *Levies:*

Under IFRS Interpretations Committee Interpretation, 21, *Levies* ("IFRIC 21") realty taxes payable by the REIT are considered levies. Based on the guidance of IFRIC 21, the REIT recognizes the full amount of annual U.S. realty tax liabilities at the point in time when the realty tax obligation is imposed.

(s) *Subsidiaries*

Subsidiaries are entities controlled by the Trusts. The Trusts control an entity when it is exposed to, or has rights to, variable returns from their involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the combined financial statements from the date on which control commences until the date on which control ceases.

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

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

(i) *Amendments to Statement of Cash Flows ("IAS 7")*

In January 2016, the IASB issued amendments to IAS 7, *Statement of Cash Flows*. These amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The Trusts will adopt the amendments to IAS 7 in its combined financial statements for the annual period ending December 31, 2017. The Trusts intend to satisfy the new requirements by providing reconciliations between the opening and closing balances for liabilities from financing activities.

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### 2. Significant accounting policies (continued):

#### (ii) *Financial Instruments: Classification and Measurement ("IFRS 9")*

In July 2014, the IASB issued IFRS 9 *Financial Instruments: Classification and Measurements* ("IFRS 9"), replacing IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 is effective for the annual period beginning on January 1, 2018, with early adoption permitted. The Trusts currently plan to apply IFRS 9 on January 1, 2018. The actual impact of adopting IFRS 9 on the Trusts' combined financial statements in 2018 has not been determined.

#### (iii) *Revenue from Contracts with Customers ("IFRS 15")*

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. The new standard is effective for annual periods beginning on or after January 1, 2018. IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers, and SIC 31 Revenue - Barter Transactions Involving Advertising Services. The Trusts intend to adopt IFRS 15 in the combined financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

#### (iv) *Amendments to Share-based Payments ("IFRS 2")*

In January 2016, the IASB issued amendments to IFRS 2, *Share-based Payment* clarifying how to account for certain types of share-based payment transactions. The Trusts intend to adopt the amendments to IFRS 2 in its combined financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the amendments has not yet been determined.

#### (v) *Leases ("IFRS 16")*

In January 2016, the IASB issued IFRS 16, *Leases*. The new standard will replace existing lease guidance in IFRS and related interpretations, and requires lessees to bring most leases on-balance sheet. Lessor accounting remains similar to the current standard. The new standard is effective for years beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

### 3. Change in accounting policy:

The combined financial statements reflect the retrospective application of a voluntary change in accounting policy adopted in 2016 to classify interest paid and finance cost-exchangeable unit distributions as an operating activity in the combined statements of cash flows, instead of within financing activities, as previously reported. The change in accounting policy was adopted in accordance with IAS 7, *Statement of Cash Flows*, which provides a policy choice to classify interest paid as either an operating activity or a financing activity. The REIT considers the classification of these interest payments within operating activities to be the most useful to financial statement users when comparing distributions to cash provided by operations and, consequently, that this presentation results in reliable and more relevant information.

The following table outlines the effect of this accounting policy change for the year ended December 31, 2015:

	Previously Reported	Restatement	Restated
Cash provided by operating activities	\$ 771,542	\$ (304,188)	\$ 467,354
Cash used in financing activities	(466,202)	304,188	(162,014)

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#### 4. Real estate assets:

	Note	Investment Properties 2016	Properties Under Development 2016	Investment Properties 2015	Properties Under Development 2015
Opening balance, beginning of year		\$ 12,576,075	\$ 97,504	\$ 12,116,983	\$ 105,006
Acquisitions, including transaction costs		325,169	-	346,914	-
Dispositions		(337,428)	-	(148,680)	(9,938)
Transfer of investment properties to equity accounted investments	5	-	-	(194,970)	-
Transfer of investment properties to assets classified as held for sale	6	(211,550)	-	(3,000)	-
Operating capital					
Capital expenditures		58,924	-	41,716	-
Leasing expenses and tenant inducements		34,682	-	54,628	-
Development capital					
Redevelopment (including capitalized interest)		62,729	-	45,845	-
Additions to properties under development (including capitalized interest)		-	20,764	-	2,436
Amortization of tenant inducements, straight-line rents and blend and extend rents included in revenue		5,585	-	16,861	-
Fair value adjustment on real estate assets		133,738	-	(178,868)	-
Change in foreign exchange		(83,780)	-	478,646	-
Closing balance, end of year		\$ 12,564,144	\$ 118,268	\$ 12,576,075	\$ 97,504

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. In certain cases, 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.

#### Asset acquisitions:

During the year ended December 31, 2016, the REIT acquired four residential properties and a 50% ownership interest in one industrial property (year ended December 31, 2015 - six residential 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 purchase price plus transaction costs of the assets and liabilities as at the respective dates of acquisition:

	December 31 2016	December 31 2015
<b>Assets</b>		
Investment properties	\$ 323,877	\$ 346,822
<b>Liabilities</b>		
Mortgage payable	-	(45,247)
Total net assets settled by cash	\$ 323,877	\$ 301,575

During the year ended December 31, 2016, the REIT incurred additional costs of \$1,292 (December 31, 2015 - \$92) in respect of prior year acquisitions which are not included in the above table.

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#### 4. Real estate assets (continued):

##### Asset dispositions:

During the year ended December 31, 2016, the REIT sold five retail properties, a 50% ownership interest in two industrial properties, a 50% non-managing interest in one office property and a portion of an office property (sold as separate condominium units) and recognized a loss on sale of real estate assets of \$8,167. The loss on sale of real estate assets includes prepayment penalties of \$13,930 to discharge two mortgages. Excluding these costs, the properties sold during the year ended December 31, 2016 generated a gain on sale of \$5,763.

During the year ended December 31, 2015, the REIT sold a 49.5% ownership interest in 16 industrial properties, a 75% ownership interest in one industrial property and a 50% ownership interest in three industrial properties. In addition, the REIT sold two industrial properties, three retail properties, one office property, a parcel of land and a portion of an office property (sold as separate condominium units) and recognized a loss on sale of real estate assets of \$5,428. The loss on sale of real estate assets is primarily due to mark-to-market adjustments on the purchasers' assumption of mortgages on 11 properties of \$4,525 and prepayment penalties of \$1,999 to discharge two mortgages. Excluding these costs, the properties sold during the year ended December 31, 2015 generated a gain of sale of \$1,096.

##### Fair value disclosure:

The estimated fair values of the REIT's real estate assets 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 and capital expenditures for the property utilizing appropriate discount rates and terminal capitalization rates, generally over a projection period of ten years;
- (iii) The direct capitalization method which is based on the conversion of normalized net income 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, 2016, certain properties were valued by professional external independent appraisers. These properties make up 30.2% of the investment properties fair value as at December 31, 2016 (year ended December 31, 2015 - 21.3%). The remainder of the portfolio is valued by the REIT's internal valuation team. The properties that are externally appraised are judgmentally selected by management to form a representative cross section of the REIT's portfolio based on size, geography and the availability of market data. In addition, an external independent appraisal is often obtained for properties acquired or properties where the associated mortgage is being refinanced.

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.

The REIT has utilized the following weighted average discount rates and terminal capitalization rates in estimating the fair value of the investment properties:

	Discount Rates			Terminal Capitalization Rates		
	Canada	United States	Total	Canada	United States	Total
<b>December 31, 2016</b>	<b>6.66%</b>	<b>6.78%</b>	<b>6.69%</b>	<b>6.09%</b>	<b>6.24%</b>	<b>6.13%</b>
December 31, 2015	6.49%	7.25%	6.68%	5.96%	6.84%	6.18%

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#### 4. Real estate assets (continued):

The following weighted average overall capitalization rates as at December 31, 2016 are calculated based on stabilized property operating income for the three months ended December 31, 2016 (December 31, 2015 - based on the three months ended December 31, 2015).

December 31, 2016						
Weighted Average Overall Capitalization Rates	Office	Primaris	H&R Retail	Industrial	Lantower Residential	Total
Canada	5.90%	5.53%	6.61%	6.41%	N/A	5.86%
United States	5.27%	N/A	7.09%	N/A	5.39%	5.85%
Total						5.86%

December 31, 2015						
Weighted Average Overall Capitalization Rates	Office	Primaris	H&R Retail	Industrial	Lantower Residential	Total
Canada	5.96%	5.56%	6.76%	6.79%	N/A	5.93%
United States	6.34%	N/A	7.36%	N/A *	5.82%	6.66%
Total						6.11%

\* The U.S. industrial real estate assets are accounted for as equity accounted investments (note 5).

#### Fair value sensitivity:

The REIT's investment properties are classified as level 3 under the fair value hierarchy, as the inputs in the valuations of these investment properties are not based on observable market data. The following table provides a sensitivity analysis for the weighted average capitalization rate applied as at December 31, 2016:

Capitalization Rate Sensitivity Increase (Decrease)	Weighted Average Overall Capitalization Rate	Fair Value of Investment Properties	Fair Value Variance	% Change
(0.75%)	5.11%	\$ 14,408,196	\$ 1,844,052	14.68%
(0.50%)	5.36%	\$ 13,736,172	\$ 1,172,028	9.33%
(0.25%)	5.61%	\$ 13,124,043	\$ 559,899	4.46%
<b>December 31, 2016</b>	<b>5.86%</b>	<b>\$ 12,564,144</b>	<b>\$ -</b>	<b>0.00%</b>
0.25%	6.11%	\$ 12,050,063	\$ (514,081)	(4.09%)
0.50%	6.36%	\$ 11,576,397	\$ (987,747)	(7.86%)
0.75%	6.61%	\$ 11,138,560	\$ (1,425,584)	(11.35%)

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### 5. Equity accounted investments:

The REIT has entered into a number of arrangements with other parties for the purpose of jointly owning and operating investment properties. In order to determine how these arrangements should be accounted for, the REIT has assessed the structure of the arrangement, and whether the REIT has control over the operations of such properties. The REIT has found that its arrangements fall into two categories: a) joint ventures, where the REIT has joint control over the operations, each investment is structured as a separate vehicle and the REIT has rights to the net assets of the entities; and b) investments in associates, where the REIT has significant influence over the investment but does not have joint control over the operations. Both of these types of arrangements are accounted for using the equity method.

During the year ended December 31, 2016, the REIT acquired a 31.7% net interest in the Hercules property, a joint venture, for \$13,694 and disposed of its 33.3% ownership interests in 100 Yonge and Scotia Plaza for a gain on sale of real estate assets at the REIT's share of \$14,965. During the year ended December 31, 2015, the REIT disposed of a 49.5% ownership interest in 16 industrial properties in the U.S. and the remaining 50.5% interest is now accounted for as a joint venture. The amount transferred into equity accounted investments relating to these properties was \$194,970 (note 4).

	Location	Principal activity	Ownership interest	
			December 31 2016	December 31 2015
Investments in joint ventures: <sup>(a)</sup>				
100 Yonge	Toronto, Ontario	Own and operate investment property	-	33.3%
Scotia Plaza	Toronto, Ontario	Own and operate investment property	-	33.3%
Telus Tower	Calgary, Alberta	Own and operate investment property	50.0%	50.0%
16 industrial properties	United States	Own and operate investment property	50.5%	50.5%
Hercules Development Partners LP ("Hercules")	United States	Develop, own and operate investment property	31.7%	-
Investments in associates: <sup>(b)</sup>				
ECHO Realty LP ("ECHO")	United States	Own and operate investment properties	33.6%	33.6%
LIC Operator Co., L.P. ("LIC")	United States	Develop, own and operate investment property	50.0%	50.0%

(a) Where the REIT has joint control over the operations, each investment is structured as a separate vehicle and the REIT has rights to the net assets of the entities.

(b) Where the REIT has significant influence over the investment but does not have joint control over the operations.

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### 5. Equity accounted investments (continued):

The following tables summarize the total amounts of the financial information of ECHO, LIC, Hercules, 100 Yonge, Scotia Plaza, Telus Tower and the 16 industrial properties in the U.S. and reconciles the summarized financial information to the carrying amount of the REIT's interest in these arrangements. The REIT has determined that it is appropriate to aggregate each of the investments in joint ventures and investments in associates as the individual investments are not individually material:

December 31, 2016	Investments in joint ventures	Investments in associates	Total
<b>Equity accounted investments:</b>			
Investment properties	\$ 553,633	\$ 2,262,258	\$ 2,815,891
Properties under development	43,336	1,002,968	1,046,304
Loan receivable	17,200	-	17,200
Other assets	2,636	93,304	95,940
Cash and cash equivalents	7,115	90,978	98,093
Mortgages payable	(208,636)	(666,763)	(875,399)
Deferred tax liability	(330)	-	(330)
Bank indebtedness	-	(479,807)	(479,807)
Accounts payable and accrued liabilities	(7,888)	(111,302)	(119,190)
Non-controlling interest	-	(57,671)	(57,671)
Net assets	407,066	2,133,965	2,541,031
REIT's share of net assets	196,721	863,066	1,059,787
Elimination of intercompany loans	(8,600)	-	(8,600)
Amount in the combined statements of financial position	\$ 188,121	\$ 863,066	\$ 1,051,187

ECHO reports its financial position to the REIT one month in arrears due to time constraints on its reporting. Therefore, the above amounts include ECHO's financial information as at November 30, 2016. In December 2016, ECHO acquired three properties for approximately \$23,500, at the REIT's share.

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### 5. Equity accounted investments (continued):

December 31, 2015	Investments in joint ventures	Investments in associates	Total
Equity accounted investments:			
Investment properties	\$ 2,001,977	\$ 2,162,079	\$ 4,164,056
Properties under development	-	471,024	471,024
Loan receivable	70,100	83,877	153,977
Other assets	14,681	108,580	123,261
Cash and cash equivalents	18,888	89,509	108,397
Mortgages payable	(906,289)	(667,601)	(1,573,890)
Bank indebtedness	-	(268,248)	(268,248)
Accounts payable and accrued liabilities	(26,262)	(82,563)	(108,825)
Non-controlling interest	-	(61,388)	(61,388)
Net assets	1,173,095	1,835,269	3,008,364
REIT's share of net assets	466,522	713,506	1,180,028
Elimination of intercompany loans	(34,083)	(28,159)	(62,242)
Amount in the combined statements of financial position	\$ 432,439	\$ 685,347	\$ 1,117,786

ECHO reports its financial position to the REIT one month in arrears due to time constraints on its reporting. Therefore, the above amounts include ECHO's financial information as at November 30, 2015. In December 2015, ECHO secured new mortgages on two properties for approximately \$3,900, at the REIT's share.



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### 5. Equity accounted investments (continued):

	Year ended December 31, 2016			Year ended December 31, 2015		
	Investments in joint ventures	Investments in associates	Total	Investments in joint ventures	Investment in associates	Total
<b>Net income (loss) from equity accounted investments:</b>						
Rentals from investment properties	\$ 131,627	\$ 178,715	\$ 310,342	\$ 201,129	\$ 163,146	\$ 364,275
Property operating costs	(51,122)	(39,055)	(90,177)	(79,462)	(31,770)	(111,232)
Net income from equity accounted investments	-	1,573	1,573	-	1,646	1,646
Finance income	1,758	1,487	3,245	2,784	4,570	7,354
Finance cost - operations	(20,943)	(40,481)	(61,424)	(33,437)	(34,755)	(68,192)
Fair value adjustments on financial instruments	-	(1,857)	(1,857)	-	(3,341)	(3,341)
Trust expenses	(381)	(4,212)	(4,593)	(262)	(2,949)	(3,211)
Fair value adjustment on real estate assets	(220,908)	129,436	(91,472)	(142,181)	(12,407)	(154,588)
Loss on sale of real estate assets	(105)	(1,273)	(1,378)	-	(8,435)	(8,435)
Income taxes	(501)	(111)	(612)	(160)	(98)	(258)
Net income (loss)	(160,575)	224,222	63,647	(51,589)	75,607	24,018
Net income attributable to non-controlling interest	-	(1,365)	(1,365)	-	(823)	(823)
Net income (loss) attributable to owners	(160,575)	222,857	62,282	(51,589)	74,784	23,195
REIT's share of net income (loss) attributable to shareholders	(63,903)	98,194	34,291	(21,826)	25,140	3,314
REIT's share of gain on sale of investment in joint venture*	14,965	-	14,965	-	-	-
Elimination of intercompany loan interest	(826)	(89)	(915)	(1,354)	(1,119)	(2,473)
Amount in the combined statements of comprehensive income (loss)	\$ (49,764)	\$ 98,105	\$ 48,341	\$ (23,180)	\$ 24,021	\$ 841

\* During the year ended December 31, 2016, the REIT disposed of its 33.3% ownership interests in 100 Yonge and Scotia Plaza for a gain on sale of investment in joint venture at the REIT's share of \$14,965.

ECHO reports its financial results to the REIT one month in arrears due to time constraints on its reporting. Therefore, the above amounts include ECHO's financial information for December 1, 2015 to November 30, 2016 and December 1, 2014 to November 30, 2015.

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### 6. Assets and liabilities classified as held for sale:

As at December 31, 2016, the REIT has a 50% ownership interest in two Primaris properties (December 31, 2015 - 50% ownership interest in one industrial property) classified as held for sale.

The following table sets forth the combined statement of financial position items associated with investment properties classified as held for sale:

	December 31 2016	December 31 2015
<b>Assets</b>		
Investment properties	\$ 211,550	\$ 3,000
<b>Liabilities</b>		
Mortgages payable	\$ 126,567	\$ -
Accounts payable and accrued liabilities	248	-
	<b>\$ 126,815</b>	<b>\$ -</b>

### 7. Other assets:

	December 31 2016	December 31 2015
	<i>Note</i>	
Restricted cash*	\$ 11,275	\$ 16,457
Derivative instruments	13 776	-
Accounts receivable	12,999	14,686
Prepaid expenses and sundry assets	92,975	23,167
Mortgages receivable**	43,817	103,353
	<b>\$ 161,842</b>	<b>\$ 157,663</b>

\* Included in restricted cash are bank term deposits of nil (December 31, 2015 - \$4,151) at a rate of interest of N/A (December 31, 2015 - 0.75%).

\*\* Mortgages receivable represent vendor take-back financing and other arrangements. As at December 31, 2016, mortgages receivable bear interest at effective rates between 4.40% and 9.00% per annum (December 31, 2015 - between 3.13% and 9.00% per annum) with a weighted average effective rate of 7.99% per annum (December 31, 2015 - 4.74%), and mature between 2020 and 2026 (December 31, 2015 - mature between 2016 and 2026).

Future repayments are as follows:

	December 31 2016
Years ending December 31:	
2017	\$ -
2018	-
2019	-
2020	34,158
2021	-
Thereafter	9,659
	<b>\$ 43,817</b>

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### 8. Cash and cash equivalents and bank indebtedness:

Cash and cash equivalents at December 31, 2016 includes cash on hand of \$47,760 (December 31, 2015 - \$38,021) and bank term deposits of \$261 (December 31, 2015 - \$266) at a rate of interest of 0.43% (December 31, 2015 - 0.44%).

The Trusts have the following bank credit facilities as at December 31, 2016:

Operating Facility		Maturity Date	Total Facility	Bank Indebtedness Drawn	Outstanding Letters of Credit	Available Balance
H&R REIT unsecured operating facility #1	(a)	Dec. 18, 2018	\$ 500,000	\$ 166,089	\$ 33,052	\$ 300,859
Primaris secured operating facility	(a)	Dec. 18, 2017	300,000	262,640	1,253	36,107
H&R REIT unsecured operating facility #2	(b)	Mar. 17, 2021	205,829	205,829	-	-
H&R REIT and CrestPSP secured operating facility	(a)	Feb. 19, 2019	25,000	9,700	-	15,300
H&R REIT co-ownership secured operating facility		Sept. 30, 2017	3,514	3,514	-	-
			\$ 1,034,343	\$ 647,772	\$ 34,305	\$ 352,266

The bank facilities bear interest at a rate approximating the prime rate of a Canadian chartered bank.

(a) Can be drawn in either Canadian or U.S. dollars.

(b) The total facility as at December 31, 2016 is \$200,000, plus a 3% allowance relating to the fluctuation of the foreign exchange rate, and can be drawn in either Canadian or U.S. dollars. The REIT entered into an interest swap agreement to fix the interest rate at 2.56% per annum on U.S. \$130,000 of the U.S. dollar denominated borrowing of this facility (note 13).

Included in bank indebtedness at December 31, 2016 are U.S. dollar denominated amounts of \$441,000 (December 31, 2015 - U.S. \$115,500). The Canadian equivalent of these amounts is \$590,940 (December 31, 2015 - \$159,390).

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### 9. Mortgages payable:

The mortgages payable are secured by real estate assets and letters of credit in certain cases, that generally bear fixed interest rates with a contractual weighted average rate of 4.41% (December 31, 2015 - 4.60%) per annum and mature between 2017 and 2033 (December 31, 2015 - maturing between 2016 and 2033). Included in mortgages payable at December 31, 2016 are U.S. dollar denominated mortgages of U.S. \$1,024,869 (December 31, 2015 - U.S. \$1,165,504). The Canadian equivalent of these amounts is \$1,373,324 (December 31, 2015 - \$1,608,396).

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:

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	December 31
	2016
Years ending December 31:	
2017	\$ 516,782
2018	226,705
2019	259,616
2020	497,332
2021	825,835
Thereafter	1,670,972
	<b>3,997,242</b>
Financing costs and mark-to-market adjustment arising on acquisitions	4,209
	<b>\$ 4,001,451</b>

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### 10. Debentures payable:

The full terms of the debentures are contained in the trust indenture and supplemental trust indentures; the following table summarizes the key terms:

						December 31	December 31
						2016	2015
	Maturity	Contractual interest rate	Effective interest rate	Conversion price	Principal amount	Carrying value	Carrying value
Convertible Debentures (a)							
2016 Convertible Debentures (HR.DB.E) <sup>(1)</sup>	December 31, 2016	4.50%	4.50%	\$ 25.70	\$ -	\$ -	\$ 75,188
2018 Convertible Debentures (HR.DB.H)	November 30, 2018	5.40%	5.40%	24.73	74,394	76,254	76,016
2020 Convertible Debentures (HR.DB.D)	June 30, 2020	5.90%	5.90%	23.50	99,654	102,644	102,145
		5.69%	5.69%		174,048	178,898	253,349
Senior Debentures (b)							
Series D Senior Debentures <sup>(2)</sup>	July 27, 2016	4.78%	4.96%	-	-	-	179,862
Series I Senior Debentures <sup>(3)</sup>	January 23, 2017	2.54%	-%	-	60,000	59,992	59,891
Series B Senior Debentures <sup>(4)</sup>	February 3, 2017	5.90%	6.06%	-	115,000	114,992	114,815
Series E Senior Debentures	February 2, 2018	4.90%	5.22%	-	100,000	99,705	99,449
Series J Senior Debentures <sup>(5)</sup>	February 9, 2018	2.04%	-%	-	167,500	167,278	172,050
Series G Senior Debentures	June 20, 2018	3.34%	3.54%	-	175,000	174,511	174,186
Series C Senior Debentures	December 1, 2018	5.00%	5.30%	-	125,000	124,350	124,009
Series K Senior Debentures <sup>(6)</sup>	March 1, 2019	2.36%	-%	-	200,000	199,331	199,036
Series F Senior Debentures	March 2, 2020	4.45%	4.63%	-	175,000	174,316	174,122
Series L Senior Debentures	May 6, 2022	2.92%	3.11%	-	200,000	198,218	-
		3.57%	3.71%		1,317,500	1,312,693	1,297,420
		3.84%	3.95%		\$ 1,491,548	\$ 1,491,591	\$ 1,550,769

The Convertible Debentures (as defined below) are measured at fair value, with fair value determined using the quoted price on the TSX on December 31, 2016 and December 31, 2015.

- (1) In December 2016, the REIT repaid all of its 2016 convertible debentures (HR.DB.E) upon maturity for a cash payment of \$75,000.
- (2) In July 2016, the REIT repaid all of its Series D senior debentures upon maturity for a cash payment of \$180,000.
- (3) Bears interest at a rate equal to 3-month Canadian Dealer Offered Rate plus 165 basis points. The REIT entered into an interest rate swap on the Series I senior debentures to fix the interest rate at 2.54% per annum. In January 2017, the REIT repaid all of its Series I senior debentures upon maturity for a cash payment of \$60,000.
- (4) In February 2017, the REIT repaid all of its Series B senior debentures upon maturity for a cash payment of \$115,000.
- (5) Denominated as \$125,000 U.S. dollars and bears interest at a rate equal to 3-month London Interbank Offered Rate plus 108 basis points. The REIT entered into an interest rate swap on the Series J senior debentures to fix the interest rate at 2.04% (note 13).
- (6) Bears interest at a rate equal to 3-month Canadian Dealer Offered Rate plus 143 basis points. The REIT entered into an interest rate swap on the Series K senior debentures to fix the interest rate at 2.36% per annum (note 13).

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### 10. Debentures payable (continued):

- (a) *2016 Convertible Debentures, 2018 Convertible Debentures and 2020 Convertible Debentures (collectively, the "Convertible Debentures"):*

In July 2010, the REIT completed a public offering of \$100,000 Series D convertible unsecured subordinated debentures (the "2020 Convertible Debentures"). 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. Interest on the 2020 Convertible Debentures is payable semi-annually on June 30 and December 31.

In November 2011, the REIT completed a public offering of \$75,000 Series E convertible unsecured subordinated debentures (the "2016 Convertible Debentures"). Interest on the 2016 Convertible Debentures was payable semi-annually on June 30 and December 31. The 2016 Convertible Debentures were repaid upon maturity in December 2016 for a cash payment of \$74,983.

On April 4, 2013, the REIT assumed all of Primaris's outstanding convertible debentures. On or after December 1, 2016 and prior to the maturity date, the 2018 Convertible Debentures may be redeemed by the REIT, in whole or in part, at a price equal to the principal amount plus accrued interest. Interest on the 2018 Convertible Debentures is payable semi-annually on May 31 and November 30.

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.

- (b) *Series B Senior Debentures, Series C Senior Debentures, Series D Senior Debentures, Series E Senior Debentures, Series F Senior Debentures, Series G Senior Debentures, Series I Senior Debentures, Series J Senior Debentures, Series K Senior Debentures and Series L Senior Debentures (collectively, the "Senior Debentures"):*

In November 2016, the REIT issued \$200,000 Series L unsecured senior debentures (the "Series L Senior Debentures"). Interest on the Series L Senior Debentures is payable semi-annually on May 6 and November 6. On issuance, the REIT recorded a liability of \$198,185 net of issue costs of \$1,815.

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 principal amount of the then outstanding Senior Debentures.

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### 10. Debentures payable (continued):

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.

(c) *A summary of the changes in the carrying value of debentures payable is as follows:*

	December 31 2016	December 31 2015
<b>Convertible Debentures</b>		
Carrying value, beginning of year	\$ 253,349	\$ 261,438
Conversion - 2016 Convertible Debentures	(17)	-
Conversion - 2018 Convertible Debentures	-	(5)
Repaid - 2016 Convertible Debentures (HR.DB.E)	(74,983)	-
(Gain) loss on change in fair value	549	(8,084)
Carrying value, end of year	178,898	253,349
<b>Senior Debentures</b>		
Carrying value, beginning of year	1,297,420	1,274,400
Repaid - Series A Senior Debentures	-	(115,000)
Repaid - Series D Senior Debentures	(180,000)	-
Repaid - Series H Senior Debentures	-	(235,000)
Issued - Series J Senior Debentures	-	171,855
Issued - Series K Senior Debentures	-	198,897
Issued - Series L Senior Debentures	198,185	-
Change in foreign exchange	(4,987)	-
Accretion adjustment	2,075	2,268
Carrying value, end of year	1,312,693	1,297,420
	<b>\$ 1,491,591</b>	<b>\$ 1,550,769</b>

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### 11. Exchangeable units:

Certain of the REIT's subsidiaries have in aggregate 16,563,816 (December 31, 2015 - 16,663,816) exchangeable units outstanding which are puttable instruments where, upon redemption, the REIT has a contractual obligation to issue Stapled Units. A subsidiary of the REIT also holds 433,174 (December 31, 2015 - 433,174) Stapled Units to mirror these exchangeable units. Therefore, when such exchangeable units are exchanged for Stapled Units, the number of outstanding Stapled Units will not increase. Holders of all exchangeable units are entitled to receive the economic equivalence of distributions on a per unit amount equal to a per Stapled Unit amount provided to holders of Stapled Units. These puttable instruments are classified as a liability under IFRS and are measured at fair value through net income. Fair value is determined by using the quoted prices for the Stapled Units as the exchangeable units are exchangeable into Stapled Units at the option of the holder. The quoted price as at December 31, 2016 was \$22.37 per Stapled Unit (December 31, 2015 - \$20.05).

A summary of the carrying value of exchangeable units is as follows:

	December 31 2016	December 31 2015
Carrying value, beginning of year	\$ 334,110	\$ 362,105
Exchangeable units of H&R Portfolio Limited Partnership ("HRLP") exchanged for Stapled Units	(2,295)	-
(Gain) loss on fair value of exchangeable units	38,718	(27,995)
Carrying value, end of year	\$ 370,533	\$ 334,110

The REIT and Finance Trust have entered into various exchange and support agreements that provide, among other things, the mechanics whereby exchangeable units may be exchanged for Stapled Units.

### 12. Accounts payable and accrued liabilities:

	Note	December 31 2016	December 31 2015
Current:			
Other accounts payable and accrued liabilities		\$ 141,984	\$ 117,181
Mortgage interest payable		10,595	11,561
Prepaid rent		20,757	22,883
Unit-based compensation payable	14(c)	10,432	4,594
Debenture interest payable		10,495	13,207
Derivative instruments	13	3,791	-
Non-current:			
Security deposits		4,932	4,038
Unit-based compensation payable	14(c)	14,439	3,366
		\$ 217,425	\$ 176,830



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### 13. Derivative instruments:

		Fair value (liability) asset *		Net gain on derivative contracts**	
		December 31 2016	December 31 2015	December 31 2016	December 31 2015
Debenture interest rate swap	(a)	\$ 776	\$ -	\$ 776	\$ -
Debenture interest rate swap	(b)	(407)	-	(407)	-
Bank indebtedness interest rate swap	(c)	(3,384)	-	(3,384)	-
Mortgage interest rate swap	(d)	-	-	-	161
		\$ (3,015)	\$ -	\$ (3,015)	\$ 161

The REIT entered into interest rate swaps as follows:

- (a) Series K senior debentures bearing interest at 2.36% per annum, maturing on March 1, 2019.
- (b) Series I senior debentures bearing interest at 2.54% per annum, which matured on January 23, 2017 and Series J senior debentures bearing interest at 2.04% per annum, maturing on February 9, 2018. The interest rate swap on the Series I senior debentures was settled in January 2017.
- (c) U.S. \$130,000 bank indebtedness (note 8) bearing interest at 2.56% per annum, maturing on March 17, 2021.
- (d) One U.S. mortgage; this interest rate swap was settled in 2015.

\* Derivative instruments in asset and liability positions are not presented on a net basis. Derivative instruments in an asset position are recorded in other assets and derivative instruments in a liability position are recorded in accounts payable and accrued liabilities.

\*\* Excludes amounts relating to foreign exchange which have been recorded in accumulated other comprehensive income (note 15).

### 14. Unitholders' equity:

The REIT is an unincorporated open-ended trust. The beneficial interests in the REIT are divided into two classes of trust units: units of the REIT and special voting units.

#### (a) Description of units:

Each unit of the REIT and special voting unit carries a single vote at any meeting of unitholders. Holders of special voting units do not have any additional rights than those of holders of units of the REIT. The aggregate number of units of the REIT which the REIT may issue is unlimited and the aggregate number of special voting units which the REIT may issue is 9,500,000. The units of the REIT carry the right to participate pro rata in any distributions. As at December 31, 2016, 9,500,000 special voting units are issued and outstanding (December 31, 2015 - 9,500,000 special voting units).

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 14(e)).

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### 14. Unitholders' equity (continued):

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 of the REIT may only be transferred 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.

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.

#### (b) Unit Purchase Plan and Dividend Reinvestment Plan (the "DRIP"):

The Trusts offer holders of Stapled Units and holders of exchangeable units resident in Canada the opportunity to participate in its DRIP. The DRIP allows participants to have their monthly cash distributions reinvested in additional Stapled Units 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.

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### 14. Unitholders' equity (continued):

Changes in the issued and outstanding number of Stapled Units during the years ended December 31, 2016 and 2015 are as follows:

As at January 1, 2015	274,773,334
Issued under the DRIP	4,943,820
Options exercised	72,167
2018 Convertible Debentures converted into Stapled Units	202
Repurchased through normal course issuer bid	(179,400)
As at December 31, 2015	279,610,123
<b>Issued under the DRIP</b>	<b>5,610,389</b>
<b>Options exercised</b>	<b>100,334</b>
<b>2016 Convertible Debentures converted into Stapled Units</b>	<b>661</b>
<b>Exchangeable units exchanged into Stapled Units</b>	<b>100,000</b>
<b>Repurchased through normal course issuer bid</b>	<b>(141,800)</b>
<b>As at December 31, 2016</b>	<b>285,279,707</b>

The weighted average number of basic Stapled Units for the year ended December 31, 2016 is 282,215,659 (December 31, 2015 - 276,795,506).

#### (c) Unit-based compensation:

In order to provide long-term compensation to the REIT's trustees, officers, employees and consultants, there may be grants of options and incentive units, which are each subject to certain restrictions.

##### (i) Unit option plan:

As at December 31, 2016, a maximum of 28,000,000 (December 31, 2015 - 28,000,000) options to purchase Stapled Units were authorized to be issued, of which 21,402,296 options (December 31, 2015 - 14,056,429 options) have been granted, 343,422 options (December 31, 2015 - 343,422 options) have expired and 6,941,126 options (December 31, 2015 - 14,286,993 options) remain to be 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.

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### 14. Unitholders' equity (continued):

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

	December 31, 2016		December 31, 2015	
	Units	Weighted average exercise price	Units	Weighted average exercise price
Outstanding, beginning of year	6,575,006	\$ 21.57	5,295,567	\$ 21.41
Granted	7,345,867	18.98	1,628,363	21.94
Exercised	(100,334)	11.74	(72,167)	15.74
Expired	-	-	(276,757)	22.02
Outstanding, end of year	13,820,539	\$ 20.26	6,575,006	\$ 21.57
Options exercisable, end of year	5,186,652	\$ 21.66	4,001,868	\$ 21.18

The options outstanding at December 31, 2016 are exercisable at varying prices ranging from \$9.30 to \$23.18 (December 31, 2015 - \$9.30 to \$23.18) with a weighted average remaining life of 7.7 years (December 31, 2015 - 7.0 years). The vested options are exercisable at varying prices ranging from \$9.30 to \$23.18 (December 31, 2015 - \$9.30 to \$23.18) with a weighted average remaining life of 5.6 years (December 31, 2015 - 6.0 years).

(ii) *Incentive unit plan:*

As at December 31, 2016, a maximum of 5,000,000 (December 31, 2015 - 5,000,000) incentive units exchangeable into Stapled Units were authorized to be issued under the incentive unit plan. Of this amount, 419,025 incentive units (December 31, 2015 - 314,655 incentive units) have been granted, of which 11,665 incentive units (December 31, 2015 - 11,665 incentive units) have expired, 4,592,640 incentive units (December 31, 2015 - 4,697,010 incentive units) remain to be granted and 407,360 incentive units remain outstanding (December 31, 2015 - 302,990 incentive units).

Incentive units are recognized based on the grant date fair value. The grant agreements provide that the awards will be satisfied in cash, unless the holder elects to have them satisfied in Stapled Units issued from treasury, with the result that the awards are classified as cash-settled unit-based payments and presented as liabilities. 100% of the incentive units vest on the third anniversary of the grant date and are subject to forfeiture until the recipients of the awards have held office with or provided services to the REIT for a specified period of time. The incentive units may, if specified at the time of grant, accrue cash distributions during the vesting period and accrued distributions will be paid when the incentive units vest. These incentive units are recognized as liabilities, which are indexed to changes in fair value of the Stapled Units.

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### 14. Unitholders' equity (continued):

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

	December 31 2016	December 31 2015
	Units	Units
Outstanding, beginning of year	302,990	162,332
Granted	104,370	152,323
Expired	-	(11,665)
Outstanding, end of year	407,360	302,990

The fair value of the vested unit options and incentive units payable are as follows:

	December 31 2016	December 31 2015
Options	\$ 17,912	\$ 4,594
Incentive units	6,959	3,366
	\$ 24,871	\$ 7,960

Unit-based compensation expense (benefit) included in trust expenses is as follows:

	2016	2015
Options	\$ 14,323	\$ (2,774)
Incentive units	3,593	2,077
	\$ 17,916	\$ (697)

#### (d) 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. For the year ended December 31, 2016, the REIT declared per unit distributions of \$1.23 (December 31, 2015 - \$1.23).

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 \$0.12 for the year ended December 31, 2016 (December 31, 2015 - \$0.12).

The details of the distributions are as follows:

	2016	2015
Cash distributions to unitholders	\$ 274,264	\$ 267,650
Unit distributions (issued under the DRIP)	106,842	105,422
	\$ 381,106	\$ 373,072

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### 14. Unitholders' equity (continued):

(e) 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, Incentive Unit 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.

In the event that the REIT issues additional REIT units, pursuant to the Support Agreement, the REIT and Finance Trust will co-ordinate 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.

(f) Normal course issuer bid:

On July 8, 2016, the Trusts received approval from the TSX for the renewal of their normal course issuer bid ("NCIB"), allowing the Trusts to purchase for cancellation up to a maximum of 5,000,000 Stapled Units on the open market until the earlier of July 13, 2017 or the date on which the Trusts have purchased the maximum number of Stapled Units permitted under the NCIB. During the year ended December 31, 2016, the Trusts purchased and cancelled 141,800 Stapled Units at a weighted average price of \$19.28 per unit, for a total cost of \$2,734. During the year ended December 31, 2015, under a previous NCIB, the Trusts purchased and cancelled 179,400 Stapled Units at a weighted average price of \$21.94 per unit, for a total cost of \$3,937.

### 15. Accumulated other comprehensive income:

Items that are or may be reclassified subsequently to net income:

	Cash flow hedges	Foreign operations	Total
Balance as at January 1, 2015	\$ (373)	\$ 119,499	\$ 119,126
Transfer of realized loss on cash flow hedges to net income	31	-	31
Unrealized gain on translation of U.S. denominated foreign operation	-	227,430	227,430
Balance as at December 31, 2015	(342)	346,929	346,587
<b>Transfer of realized loss on cash flow hedges to net income</b>	<b>30</b>	<b>-</b>	<b>30</b>
<b>Unrealized loss on translation of U.S. denominated foreign operation</b>	<b>-</b>	<b>(38,397)</b>	<b>(38,397)</b>
<b>Balance as at December 31, 2016</b>	<b>\$ (312)</b>	<b>\$ 308,532</b>	<b>\$ 308,220</b>

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### 16. Rentals from investment properties:

	2016	2015
Rental income	\$ 1,193,471	\$ 1,174,591
Straight-lining of contractual rent	4,781	15,823
Rent amortization of tenant inducements	(2,241)	(2,100)
	<b>\$ 1,196,011</b>	<b>\$ 1,188,314</b>

#### *Operating Leases:*

The REIT leases its investment properties under operating leases (note 2(f)). The future minimum lease payments under non-cancellable leases are as follows:

	2016	2015
Less than 1 year	\$ 665,873	\$ 689,438
Between 1 and 5 years	2,324,926	2,439,767
More than 5 years	3,827,411	4,265,096
	<b>\$ 6,818,210</b>	<b>\$ 7,394,301</b>

### 17. Other income:

On January 15, 2015, Target Corporation announced plans to discontinue operating stores in Canada through its subsidiary Target Canada Co. ("Target"). Primaris has an interest in nine malls where Target was a tenant: a 50% interest in four of these malls and a 100% interest in the other five malls. Three of the leases were guaranteed by Target Corporation, the U.S. parent of Target.

In March 2016, Primaris entered into binding agreements with Target and Target Corporation concluding the terms of settlement relating to the leases that were disclaimed pursuant to the *Companies' Creditors Arrangement Act*. The binding agreements were approved by the courts in June 2016.

An initial distribution in respect of the settlement proceeds, in the amount of \$18,899, was received on July 4, 2016. A further distribution in respect of the settlement proceeds, in the amount of \$1,454, was received on October 25, 2016.

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### 18. Finance costs:

	2016	2015
Finance cost - operations		
Contractual interest on mortgages payable	\$ 196,228	\$ 204,568
Contractual interest on debentures payable	60,019	64,715
Effective interest rate accretion	(2,595)	(4,337)
Bank interest and charges	13,302	7,568
Exchangeable unit distributions	22,480	22,496
	<b>289,434</b>	<b>295,010</b>
Capitalized interest*	(2,109)	-
	<b>287,325</b>	<b>295,010</b>
Finance income	(4,715)	(3,770)
Fair value adjustments on financial instruments	33,830	(36,240)
	<b>\$ 316,440</b>	<b>\$ 255,000</b>

In addition, \$13,930 was incurred as prepayment penalties on selling certain properties (note 4).

\* The weighted average rate of borrowings for the capitalized interest is 4.75% (December 31, 2015 - N/A).

### 19. Supplemental cash flow information:

	2016	2015
Straight-lining of contractual rent	\$ (7,828)	\$ (19,047)
Prepaid expenses and sundry assets	(69,808)	(1,411)
Accounts receivable	1,687	(2,423)
Accounts payable and accrued liabilities	34,998	27,405
	<b>\$ (40,951)</b>	<b>\$ 4,524</b>



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### 19. Supplemental cash flow information (continued):

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

	<i>Note</i>	<b>2016</b>	2015
Non-cash items:			
Non-cash distributions to unitholders in the form of DRIP units	<i>14(d)</i>	<b>\$ 106,842</b>	\$ 105,422
Non-cash conversion of convertible debentures	<i>10(c)</i>	<b>17</b>	5
Non-cash distributions to exchangeable unitholders in the form of DRIP units		<b>9,767</b>	-
Non-cash adjustment to proceeds on options exercised		<b>1,005</b>	378
Non-cash release of mortgage payable on disposition of investment properties		-	(77,295)
Mortgages receivable from the sale of investment properties		-	37,135
Exchangeable units exchanged for Stapled Units	<i>11</i>	<b>2,295</b>	-
Acquisition of investment property through assumption of mortgage payable, net of mark-to-market adjustment		-	45,246
Other items:			
(Increase) decrease in accounts payable on redevelopment		<b>4,534</b>	(2,514)
(Increase) Decrease in accounts payable included in finance cost - operations		<b>3,341</b>	(4,841)
Capitalized interest on redevelopment		<b>(1,449)</b>	-
Capitalized interest on properties under development		<b>(660)</b>	-

### 20. 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:

	<b>December 31</b>	December 31
	<b>2016</b>	2015
Mortgages payable	<b>\$ 4,001,451</b>	\$ 4,537,278
Debentures payable	<b>1,491,591</b>	1,550,769
Exchangeable units	<b>370,533</b>	334,110
Loan payable	-	55,717
Bank indebtedness	<b>647,772</b>	321,033
Unitholders' equity	<b>6,912,650</b>	6,824,920
	<b>\$ 13,423,997</b>	\$ 13,623,827

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.

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### 20. Capital risk management (continued):

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 total assets ratio of 65% (for this purpose "indebtedness" excludes, Convertible Debentures and U.S. Holdco notes payable to Finance Trust). As at December 31, 2016, this ratio was 43.1% (December 31, 2015 - 44.4%). Management uses this ratio as a key indicator in managing the REIT's capital.

In addition to the above key ratio, the REIT's general operating facilities (note 8), debentures payable (note 10) and certain mortgages have various covenants calculated as defined within these agreements. The REIT monitors these covenants and is in compliance as at December 31, 2016 and December 31, 2015.

### 21. Risk management:

#### (a) Credit risk:

The REIT is exposed to credit risk in the event that borrowers default on the repayment of the amounts owing to the REIT. Management mitigates this risk by ensuring adequate security has been provided in support of mortgages receivable.

The REIT is exposed to credit risk as an owner of investment properties in that tenants may become unable to pay the contracted rent. 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. The REIT has two tenants which individually account for more than 5% of the rentals from investment properties of the REIT: Encana Corporation and Bell Canada. Both of these companies have a public debt rating that is rated with at least a BBB Negative rating by a recognized rating agency.

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

	<i>Note</i>	<b>December 31 2016</b>	December 31 2015
Mortgages receivable	7	<b>\$ 43,817</b>	\$ 103,353
Accounts receivable	7	<b>12,999</b>	14,686
		<b>\$ 56,816</b>	\$ 118,039

#### (b) Liquidity risk:

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

The Trusts manage liquidity risk by:

- Ensuring appropriate lines of credit available are available. As at December 31, 2016 the combined amounts available under its general operating facilities is \$352,266 (note 8);
- Maintaining a large unencumbered asset pool. As at December 31, 2016, there are 112 unencumbered properties with a fair value of approximately \$3,014,001.

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### 21. Risk management (continued):

- Entering into long-term mortgages on most of the REIT's properties, whereby a significant amount of principal has been repaid at the time of maturity which enables the REIT to refinance the debt; and
- Structuring its financing so as to stagger the maturities of its debt, thereby minimizing exposure to liquidity risk in any one year (notes 8, 9 and 10).

Management monitors its liquidity risk through review of financial covenants contained in general operating facilities, debt agreements and in accordance with the REIT's Declaration of Trust.

The Trusts' liquidity risk is as follows:

	Note	2017	Thereafter	Total
Mortgages payable*	9	\$ 516,782	\$ 3,480,460	\$ 3,997,242
Debentures payable*	10	175,000	1,316,548	1,491,548
Bank indebtedness*	8	266,154	381,618	647,772
Accounts payable and accrued liabilities**	12, 14(c)	191,603	7,910	199,513
		<b>\$ 1,149,539</b>	<b>\$ 5,186,536</b>	<b>\$ 6,336,075</b>

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

\*\* Excludes options payable (note 14(c)).

#### (c) Market risk:

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

##### (i) Currency risk:

Foreign exchange risk is the risk that the fair value or future cash flows of an exposure will fluctuate because of changes in foreign exchange rates. 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 denominated in U.S. dollars to act as a natural hedge. Additionally, the REIT has designated the Series J senior debentures and the U.S. bank indebtedness as part of the net investment hedge of its U.S. operations.

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.32 for the year ended December 31, 2016 (December 31, 2015 - \$1.28) as well as the Canadian dollar exchange rate as at December 31, 2016 of \$1.34 (December 31, 2015 - \$1.38) would have decreased other comprehensive income (loss) by approximately \$116,600 (December 31, 2015 - \$101,900) and decreased net income by approximately \$26,700 (December 31, 2015 - \$7,100). 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, 2015 would have had the equal but opposite effect).

##### (ii) Interest rate risk:

The Trusts are exposed to interest rate risk on its borrowings. It minimizes this risk by obtaining long-term fixed interest rate debt. At December 31, 2016, the percentage of fixed rate debt to total debt was 91.1% (December 31, 2015 - 86.8%). Therefore, a change in interest rates at the reporting date would not have a material impact on net income as the majority of the Trust's borrowings are through fixed rate instruments.

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### 21. Risk management (continued):

The bank indebtedness is subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2016 would have decreased net income by approximately \$3,800 (December 31, 2015 - \$1,800). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

The REIT entered into interest rate swaps on the floating rate senior debentures in 2016. In 2015, the floating rate senior debentures were subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2015 would have decreased December 31, 2015 net income by approximately \$2,900. This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

The floating rate mortgages payable are subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2016 would have decreased net income by approximately \$1,000 (December 31, 2015 - \$500). 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 Trusts' 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 combined financial instruments.

The fair value of the mortgages receivable 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.

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.

The fair value of the Senior Debentures 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.

The fair value of the loan payable to ECHO approximates the carrying value as the loan payable was repaid in February 2016.

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

Assets and liabilities measured at fair value in the combined statements of financial position, or disclosed in the notes to the financial statements, 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).

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### 21. Risk management (continued):

December 31, 2016	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value
<b>Assets measured at fair value</b>						
Investment properties	4	\$ -	\$ -	\$ 12,564,144	\$ 12,564,144	\$ 12,564,144
Properties under development	4	-	-	118,268	118,268	118,268
Derivative instruments	13	-	776	-	776	776
<b>Assets for which fair values are disclosed</b>						
Mortgages receivable		-	-	47,402	47,402	43,817
		-	776	12,729,814	12,730,590	12,727,005
<b>Liabilities measured at fair value</b>						
Convertible debentures	10	(178,898)	-	-	(178,898)	(178,898)
Exchangeable units	11	(370,533)	-	-	(370,533)	(370,533)
Derivative instruments	13	-	(3,791)	-	(3,791)	(3,791)
<b>Liabilities for which fair values are disclosed</b>						
Mortgages payable		-	-	(4,181,006)	(4,181,006)	(4,001,451)
Senior debentures		-	-	(1,352,637)	(1,352,637)	(1,312,693)
		(549,431)	(3,791)	(5,533,643)	(6,086,865)	(5,867,366)
		\$ (549,431)	\$ (3,015)	\$ 7,196,171	\$ 6,643,725	\$ 6,859,639
<b>December 31, 2015</b>						
	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value
<b>Assets measured at fair value</b>						
Investment properties	4	\$ -	\$ -	\$ 12,576,075	\$ 12,576,075	\$ 12,576,075
Properties under development	4	-	-	97,504	97,504	97,504
<b>Assets for which fair values are disclosed</b>						
Mortgages receivable		-	-	105,183	105,183	103,353
		-	-	12,778,762	12,778,762	12,776,932
<b>Liabilities measured at fair value</b>						
Convertible debentures	10	(253,349)	-	-	(253,349)	(253,349)
Exchangeable units	11	(334,110)	-	-	(334,110)	(334,110)
<b>Liabilities for which fair values are disclosed</b>						
Mortgages payable		-	-	(4,726,118)	(4,726,118)	(4,537,278)
Senior debentures		-	-	(1,351,590)	(1,351,590)	(1,297,420)
		(587,459)	-	(6,077,708)	(6,665,167)	(6,422,157)
		\$ (587,459)	\$ -	\$ 6,701,054	\$ 6,113,595	\$ 6,354,775

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### 22. Compensation of key management personnel:

Key management personnel are those individuals that have the authority and responsibility for planning, directing and controlling the REIT's activities, directly or indirectly.

	2016	2015
Salaries and short-term employee benefits	\$ 4,435	\$ 4,913
Unit-based compensation	13,375	(1,038)
	<b>\$ 17,810</b>	<b>\$ 3,875</b>

### 23. Segmented disclosures:

#### (i) Operating segments:

The Trusts have six reportable operating segments (Office, which also includes the Trusts' head office and Finance Trust, Primaris, H&R Retail, ECHO, Industrial and Residential (operating as Lantower Residential)), in two geographical locations (Canada and the United States). The operating segments derive their revenue primarily from rental income from leases. The segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker, determined to be the Chief Executive Officer ("CEO") of the Trusts. The CEO measures and evaluates the performance of the Trusts based on property operating income which is presented by property type and geographical location below and on a proportionately consolidated basis for the Trusts' equity accounted investments. The CEO also reviews the real estate assets of the Trusts' by operating and geographical segment, with the equity accounted investments on a proportionally consolidated basis. The accounting policies of the segments presented here are consistent with the Trusts' accounting policies as described in the Trusts' combined financial statements.

Real estate assets by reportable segment for the years ended December 31, 2016 and December 31, 2015 are as follows:

December 31, 2016	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Number of investment properties	37	31	126	215	101	12	522
Real estate assets:							
Investment properties	\$ 6,495,994	\$ 3,154,000	\$ 1,547,286	\$ 767,579	\$ 1,102,016	\$ 755,358	\$ 13,822,233
Properties under development	-	-	-	10,240	118,268	500,287	628,795
	6,495,994	3,154,000	1,547,286	777,819	1,220,284	1,255,645	14,451,028
Less: assets classified as held for sale	-	(211,550)	-	-	-	-	(211,550)
Less: Trusts' proportionate share of real estate assets relating to equity accounted investments	(62,500)	-	-	(777,819)	(216,460)	(500,287)	(1,557,066)
	<b>\$ 6,433,494</b>	<b>\$ 2,942,450</b>	<b>\$ 1,547,286</b>	<b>\$ -</b>	<b>\$ 1,003,824</b>	<b>\$ 755,358</b>	<b>\$ 12,682,412</b>

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

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

**Years ended December 31, 2016 and 2015**

### 23 Segmented disclosure (continued):

December 31, 2015	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Number of investment properties	39	31	131	205	103	8	517
Real estate assets:							
Investment properties	\$ 7,043,480	\$ 3,205,150	\$ 1,621,292	\$ 734,188	\$ 1,064,535	\$ 422,791	\$ 14,091,436
Properties under development	-	-	-	18,940	97,504	207,554	323,998
	7,043,480	3,205,150	1,621,292	753,128	1,162,039	630,345	14,415,434
Less: assets classified as held for sale	-	-	-	-	(3,000)	-	(3,000)
Less: Trusts' proportionate share of real estate assets relating to equity accounted investments	(557,500)	-	-	(753,128)	(220,673)	(207,554)	(1,738,855)
	\$ 6,485,980	\$ 3,205,150	\$ 1,621,292	\$ -	\$ 938,366	\$ 422,791	\$ 12,673,579

Property operating income by reportable segment for the year ended December 31, 2016 and December 31, 2015 is as follows:

	Office*	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Sub-total	Less: Equity Accounted Investments	December 31 2016
Property operating income:									
Rentals from investment properties	\$ 655,856	\$ 300,883	\$ 142,432	\$ 59,999	\$ 98,197	\$ 52,801	\$ 1,310,168	\$ (114,157)	\$ 1,196,011
Property operating costs	(237,782)	(129,975)	(31,842)	(13,112)	(27,327)	(24,294)	(464,332)	33,061	(431,271)
	\$ 418,074	\$ 170,908	\$ 110,590	\$ 46,887	\$ 70,870	\$ 28,507	\$ 845,836	\$ (81,096)	\$ 764,740

	Office*	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Sub-total	Less: Equity Accounted Investments	December 31 2015
Property operating income:									
Rentals from investment properties	\$ 679,174	\$ 309,968	\$ 146,172	\$ 54,772	\$ 103,822	\$ 26,379	\$ 1,320,287	\$ (131,973)	\$ 1,188,314
Property operating costs	(242,901)	(130,351)	(32,967)	(10,667)	(25,663)	(12,291)	(454,840)	40,039	(414,801)
	\$ 436,273	\$ 179,617	\$ 113,205	\$ 44,105	\$ 78,159	\$ 14,088	\$ 865,447	\$ (91,934)	\$ 773,513

\* Includes the Trusts' head office.

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## H&R FINANCE TRUST

Notes to Combined Financial Statements  
(In thousands of Canadian dollars, except unit and per unit amounts)  
**Years ended December 31, 2016 and 2015**

### 23. Segmented disclosure (continued):

#### (ii) Geographical locations:

The Trusts operate in Canada and the United States.

Investment properties and properties under development are attributed to countries based on the location of the properties.

	December 31 2016	December 31 2015
Real estate assets:		
Canada	\$ 9,335,849	\$ 10,098,153
United States	5,115,179	4,317,281
	14,451,028	14,415,434
Less: assets classified as held for sale	(211,550)	(3,000)
Less: Trusts' proportionate share of investment properties and properties under development relating to equity accounted investments	(1,557,066)	(1,738,855)
	<b>\$ 12,682,412</b>	<b>\$ 12,673,579</b>

	2016	2015
Rentals from investment properties:		
Canada	\$ 943,965	\$ 989,525
United States	366,203	330,762
	1,310,168	1,320,287
Less: Trusts' proportionate share of rentals relating to equity accounted investments	(114,157)	(131,973)
	<b>\$ 1,196,011</b>	<b>\$ 1,188,314</b>



# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements  
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### 24. Income tax expense:

	2016	2015
Income tax computed at the Canadian statutory rate of nil applicable to the REIT for 2016 and 2015	\$ -	\$ -
Current U.S. income taxes	1,950	2,341
Deferred income taxes applicable to U.S. Holdco	199,591	32,617
<b>Income tax expense in the determination of net income</b>	<b>\$ 201,541</b>	<b>\$ 34,958</b>

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, such as the REIT.

The REIT has certain subsidiaries in the United States that are subject to tax on their taxable income at a rate of approximately 37.5%. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	December 31 2016	December 31 2015
Deferred tax assets:		
Net operating losses and deferred interest deductions	\$ 79,159	\$ 84,889
Accounts payable and accrued liabilities	2,320	2,146
Other assets	1,787	938
	<b>83,266</b>	<b>87,973</b>
Deferred tax liabilities:		
Investment properties	404,881	254,178
Equity accounted investments	65,160	23,453
	<b>470,041</b>	<b>277,631</b>
<b>Deferred tax liability</b>	<b>\$ (386,775)</b>	<b>\$ (189,658)</b>

As at December 31, 2016, U.S. Holdco had accumulated net operating losses and deferred interest deductions available for carryforward for U.S. income tax purposes of \$211,028 (December 31, 2015 - \$228,687). The net operating losses will expire between 2031 and 2032. The deferred interest deductions and the deductible temporary differences do not generally expire under current tax legislation.

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements  
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### 25. Commitments and contingencies:

- (a) 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, 2016, the REIT has outstanding letters of credit totalling \$34,305 (December 31, 2015 - \$62,675), including nil (December 31, 2015 - \$18,577) which has been pledged as security for certain mortgages payable. The letters of credit are secured in the same manner as the bank indebtedness (note 8).
- (b) The REIT provides guarantees on behalf of third parties, including co-owners. As at December 31, 2016, the REIT issued guarantees amounting to \$171,064 (December 31, 2015 - \$269,899), which expire between 2022 and 2029 (December 31, 2015 - expire between 2016 and 2029), 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 guarantees. At December 31, 2016, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$133,040 (December 31, 2015 - \$146,541) which expires between 2017 and 2020 (December 31, 2015 - expires between 2016 and 2020). 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.

- (c) The REIT is obligated, under certain contract terms, to construct and develop investment properties.
- (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.

### 26. Subsidiaries:

Significant subsidiaries of the REIT are as follows:

Name of Entity	Place of Business	Ownership interest	
		December 31 2016	December 31 2015
Bow Centre Street Limited Partnership	Canada	100%	100%
H&R Portfolio Limited Partnership	Canada	100%	100%
H&R REIT Management Services Limited Partnership	Canada	100%	100%
H&R REIT (U.S.) Holdings Inc.	United States	100%	100%
Primaris Management Inc.	Canada	100%	100%
PRR Trust	Canada	100%	100%

# H&R REAL ESTATE INVESTMENT TRUST

## H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of Canadian dollars, except unit and per unit amounts)

**Years ended December 31, 2016 and 2015**

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### 27. Subsequent events:

- (a) In January 2017, the REIT sold a 50% non-managing interest in two enclosed shopping centres which was classified as held for sale as at December 31, 2016, for gross proceeds of approximately \$211,550. The purchaser assumed 50% of the existing mortgages of approximately \$126,600.
- (b) In January 2017, the REIT issued \$150,000 principal amount of Series M senior debentures maturing on July 23, 2019.
- (c) In January 2017, the REIT repaid all of its Series I senior debentures upon maturity for a cash payment of \$60,000.
- (d) In January 2017, the REIT issued \$200,000 principal amount of Series N senior debentures maturing January 30, 2024.
- (e) In January 2017, the REIT secured a U.S. \$55,000 increase to a first mortgage for a term of 4.8 years.
- (f) In February 2017, the REIT repaid all of its Series B senior debentures upon maturity for a cash payment of \$115,000.
- (g) In February 2017, the REIT repaid one Canadian mortgage of approximately \$124,400.

## **Unitholder Distribution Reinvestment Plan and Unit Purchase Plan**

H&R offers holders of Stapled Units and holders of Exchangeable Units resident in Canada the opportunity to participate in its Unitholder Distribution Reinvestment Plan (the "DRIP") and Unit Purchase Plan.

The DRIP allows participants to have their monthly cash distributions reinvested in additional Stapled Units at 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. In addition, participants will be entitled to receive an additional distribution equal to 3% of each cash distribution reinvested pursuant to the DRIP which will be reinvested in additional Stapled Units.

The 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 Unit Purchase Plan, please contact us by email through the "Contact Us" webpage of our website or contact the plan agent: CST Trust Company, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario M5C 2W9, Tel: 416-643-5500 (or for callers outside of the 416 area code: 1-800-387-0825), Fax: 416-643-5501, Email: [inquiries@canstockta.com](mailto:inquiries@canstockta.com), Website: [www.canstockta.com](http://www.canstockta.com).

## Corporate Information

### H&R REIT Board of Trustees

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

### H&R Finance Trust Board of Trustees

Thomas J. Hofstedter, President and Chief Executive Officer, H&R Real Estate Investment Trust  
Shimshon (Stephen) Gross <sup>(2)</sup>, President, LRG Holdings Inc.  
Marvin Rubner <sup>(2)</sup>, Manager and Founder, YAD Investments Limited.  
Neil Sigler <sup>(2)</sup>, 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)  
Pat Sullivan, Chief Operating Officer (Primaris)  
Philippe Lapointe, Chief Operating Officer (Lantower Residential)  
Cheryl Fried, Executive Vice-President, Finance (H&R REIT)  
Blair Kundell, Vice-President, Operations (H&R REIT)  
Jason Birken, Vice-President, Finance (H&R REIT)

**Auditors:** KPMG LLP

**Legal Counsel:** Blake, Cassels & Graydon LLP

**Taxability of Distributions:** The 2016 distributions by H&R REIT were comprised of capital gains (53.8%), other taxable income (27.7%), foreign non-business income (11.5%) and tax deferred return of capital (6.9%). The 2016 distributions by H&R Finance Trust were comprised of foreign non-business income (82.7%) and tax deferred return of capital (17.3%). For a Canadian resident unitholder, only 67.7% of the 2016 distributions on a Stapled Unit are subject to tax when considering these allocations and the non-taxable portion of the capital gains.

**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.D and HR.DB.H.

**Unitholder Distribution Reinvestment Plan and Direct Unit Purchase Plan:** H&R REIT offers holders of Stapled Units and holders of exchangeable 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:** CST 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@canstockta.com](mailto:inquiries@canstockta.com), Website: [www.canstockta.com](http://www.canstockta.com).

**Contact Information:** Investors, investment analysts and others seeking financial information should go to our website at [www.hr-reit.com](http://www.hr-reit.com), or e-mail [info@hr-reit.com](mailto: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, Toronto, Ontario, Canada, M3K 1N4



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



**Cortona Gardens, Dallas**



**Sunridge Mall, Calgary**



**Gotham Center, New York**