



**H&R Real Estate Investment Trust
2018 Annual Report**



The Bow, Calgary



Orchard Park, Kelowna

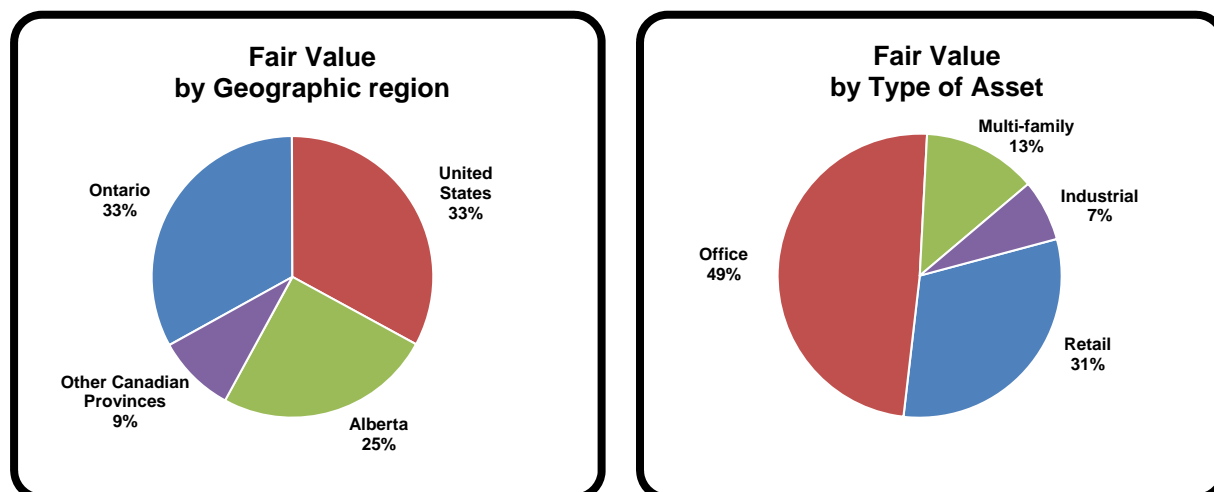


Airport Road, Brampton – Sleep Country

H&R Profile

H&R REIT is one of Canada's largest real estate investment trusts with total assets of approximately \$14.7 billion at December 31, 2018. H&R REIT has ownership interests in a North American portfolio of high quality office, retail, industrial and residential properties comprising over 42 million square feet.

Additional information regarding H&R REIT is available at www.hr-reit.com and on 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 from a high quality portfolio. We achieve our primary objectives and mitigate risks through long-term property leasing and financing, combined with conservative management of assets and liabilities.



February 14, 2019

Fellow Unitholders,

Looking back on 2018, H&R REIT (“H&R”) made significant progress towards the goals set out in our Letter to Unitholders a year ago. These goals include streamlining and simplifying our portfolio and recycling capital into higher growth properties, while enhancing the profile of H&R to our unitholders. In 2018 we sold approximately \$1 billion of lower growth assets, including substantially all of our U.S. retail portfolio, and made significant investments into our attractive and well-advanced development projects and our U.S. residential rental portfolio, structurally enhancing the growth profile of the portfolio. While this capital reallocation program has had an impact on our financial results, we are pleased to note that it is essentially behind us. H&R returned to a single trust structure through the wind up of H&R Finance Trust, thereby simplifying H&R from the previous Stapled Unit structure. In 2018, we also repaid our final series of convertible debentures, eliminating the related potential future dilution and simplifying our capital structure.

Building on the governance improvements made in recent years, we have implemented a sustainability policy focused on increasing energy efficiency and reducing waste, consumption and pollution at our properties. We are also proud to have also updated our diversity policy to include a new target for board composition reflecting a minimum target for women to comprise at least 25% of our board members by the 2021 annual general meeting.

We believe the steps we have taken to simplify and streamline H&R’s portfolio and increase our internal growth profile will contribute to positive Funds from Operations (“FFO”) per unit and net asset value (“NAV”) per unit growth. In 2019 and 2020, this enhanced growth profile will be complemented by Sears and Target replacement tenancies commencing by lease-up of four recently built Lantower Residential properties, and by the contribution of Jackson Park, which is expected to reach stabilization later this year. We will continue to pursue opportunities to simplify and streamline our portfolio and enhance the REIT’s growth prospects in 2019, but believe the significant actions taken to date have already successfully elevated H&R’s growth profile.

Developments

Property development is a key contributor to H&R’s strategy of growing per-unit NAV and FFO. The scale and quality of our portfolio provides the stability and resilience of cash flow that, when paired with our balance sheet strength, allows H&R to pursue significant value creating developments. These investments enhance our existing portfolio by delivering value creation through the development process, increasing NAV per unit, and raising the growth profile of our overall portfolio. Our development projects all share the following characteristics: gateway city and/or primary market locations; strong prospects for rental rate growth over time driven by positive demand-growth and supply-constrained market fundamentals; and high-quality construction and profile, placing these properties at the top of their respective markets.

Last year we added more detail to our disclosure of our development pipeline, including Jackson Park, our flagship 1,871-unit luxury residential rental development in Long Island City, New York (“LIC”). With this project well into lease-up and achieving rents slightly above our pro forma projections, we have already seen significant value creation delivered to our unitholders and expect cash flow contribution to increase throughout 2019 and into 2020. The appraised value of this project stands at U.S. \$800 million at our 50% ownership interest, approximately U.S. \$260 million more than our total investment to date.

Amazon’s November 2018 announcement that LIC had been selected as one of its HQ2 locations included plans to invest \$2.5 billion and create 25,000 new high-paying jobs in this market. Despite the excitement created by Amazon’s announcement, we have conservatively taken the position that it remains too early to forecast how Amazon’s plans might impact Jackson Park. The assumptions used to support the appraised value, and our future cash flow forecast for the property do not take into account Amazon’s announcement.

What Amazon’s announcement has done however, is highlight the appealing characteristics of LIC, which are the same factors that drove our investment in Two Gotham and Jackson Park. These two properties sit at what we believe is the single best location in LIC, atop the Queens Plaza Subway Station - the gateway to LIC as the nexus of 3 main New York City subway lines. Our investment in LIC, along with Corus Quay in Toronto and River Landing in Miami, are notable examples of how H&R has identified and made significant investments in attractive, gentrifying urban areas early in their development cycle, subsequently benefitting from the emergence of these locations as prime nodes.



Construction is well advanced on our River Landing development in Miami. This 100% owned mixed-use urban infill project is located in the Miami Health District, two miles from downtown Miami, with 1,000 feet of waterfront on the Miami River. With a U.S. \$425 million construction budget, this development includes office and retail components aggregating 482,000 sq.ft., and 529 luxury residential rental units. We expect an attractive 5.7% yield on cost, and strong growth in residential and commercial rents over time, as the local market intensifies and develops. Occupancy is expected to commence in Q2 2020.

The completion of Jackson Park will contribute to H&R's overall growth in property operating income and FFO in 2019 and 2020. In addition to Jackson Park and River Landing, H&R has several other developments in the gateway cities of San Francisco, Seattle, Dallas, Austin, Los Angeles and Toronto in various stages of development.

Significant Intensification Opportunities

With more than 460 properties, H&R's portfolio includes many properties with the potential for higher and better use, as their locations have evolved since they were acquired by the REIT, including some owned since the REIT's IPO over 23 years ago. Our Toronto portfolio in particular holds numerous significant opportunities among its 47 properties aggregating over 12 million square feet. While we have long considered these properties prime candidates for eventual intensification, the economics of these intensifications and redevelopments have only recently become attractive, and in some cases extraordinarily so. We plan to explore options to capitalize on these opportunities in the years ahead, including redevelopments, intensifications and/or dispositions.

Outlook

We believe that continuing to streamline and simplify our property portfolio into fewer but more significant segments, and increasing the focus on trophy and flagship properties in primary markets will not only enhance the growth prospects of our portfolio, but also improve the profile and transparency of H&R to its unitholders.

The market volatility and economic uncertainty we witnessed in the final quarter of 2018 and the beginning of 2019 are reminders of the need for prudent and conservative strategic principles. For H&R REIT, these prudent and conservative principles are incorporated into all aspects of our strategy. High-quality and well located assets, a strong and diverse portfolio of credit tenants, long-term leases, a strong and flexible balance sheet with low leverage, a large pool of unencumbered properties, and the scale and stability provided by interests in over 460 properties across 42 million square feet, are all evidence of the steps we have taken to protect and grow your investment.

As we continue to build on H&R's strengths, we would like to thank our employees who have all contributed to the progress we have made over our 22-year history. Each member of our team has been crucial to the progress we have made and are the foundation of H&R's bright future.

The board, management and their families collectively own more than \$400 million of equity in H&R REIT, and firmly believe that the units are deeply undervalued. We will continue our efforts to improve H&R's investment profile, enhance our internal growth prospects, capitalize on opportunities within our portfolio, and narrow the gap between our unit price and NAV.

Respectfully,

A handwritten signature in blue ink, appearing to be 'R. Rutman', written over a horizontal line.

Ronald C. Rutman
Chairman

A handwritten signature in black ink, appearing to be 'T. Hofstedter', written over a horizontal line.

Thomas J. Hofstedter
President & Chief Executive Officer

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

For the Year ended December 31, 2018

Dated: February 14, 2019

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SECTION I

BASIS OF PRESENTATION

Management's Discussion and Analysis ("MD&A") of the results of operations and financial position of H&R Real Estate Investment Trust ("H&R" or the "REIT") for the year ended December 31, 2018 includes material information up to February 14, 2019. This MD&A also includes the results of operations of H&R Finance Trust ("Finance Trust" and together with H&R, the "Trusts") on a combined basis, up to August 31, 2018, the date of termination of Finance Trust (see "Overview" on page 4). The comparative periods ended December 31, 2017 and December 31, 2016 continue to reflect the financial position and results of the REIT and Finance Trust on a combined basis as previously reported, as units of the Trusts were previously stapled ("Stapled Units"). Financial data for the years ended December 31, 2018 and 2017 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 financial statements of the REIT and appended notes for the year ended December 31, 2018 ("REIT's Financial Statements"). The REIT's Financial Statements are defined to refer to the financial statements for the REIT or the Trusts for the applicable period. 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. For the periods prior to August 31, 2018, references to Units (as defined below) or calculations involving Units should be read as referring to Stapled Units.

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" and "Risks and Uncertainties" relating to the H&R's objectives, strategies to achieve those objectives, H&R's 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 statements made under the heading "Summary of Significant 2018 Activity" including with respect to the streamlining of H&R's operations, H&R's future plans, including significant development projects, dispositions, acquisitions and the repurchase and cancellation of Units, and management's expectations that the reinvestment of sale proceeds and H&R's enhanced growth profile will result in positive property operating income and FFO growth in 2019 and beyond, expectations for property operating income or rental growth from Lantower Residential and Primaris, H&R's expectation with respect to the activities of its development properties, including redevelopment of existing properties and building of new properties, the expected total cost and lease-up of Jackson Park, the expected stabilized property operating income from Jackson Park, and the anticipated projected amounts of net income and FFO in 2019-2020 resulting from Jackson Park, the total cost and timing of the Hercules Project, The Pearl, Esterra Park and Shoreline, the expected total cost and stabilized property operating income from River Landing, expected capital and tenant expenditures, including 160 Elgin St., Ottawa, ON, the expected annual base rent from former Sears and Target space, management's expectations regarding future distributions, management's belief that H&R has sufficient funds for future commitments and management's expectation to be able to meet all of its ongoing obligations and to finance short-term development commitments through its lines of credit and the adoption of new accounting policies. 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 H&R's 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 H&R's estimates and assumptions that are subject to risks, uncertainties and other factors including those risks and uncertainties described below under "Risks and Uncertainties" and those discussed in H&R's materials filed with the Canadian securities regulatory authorities from time to time, which could cause the actual results, performance or achievements of H&R to differ materially from the forward-looking statements contained in this MD&A. Factors that could cause actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include, but not are limited to, the general economy is stable; local real estate conditions are stable; interest rates are relatively stable; and equity and debt markets continue to provide access to capital. Additional 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, cyber security 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. H&R cautions that these lists of factors, risks and uncertainties are not exhaustive. Although the forward-looking statements contained in this MD&A are based upon what H&R believes 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'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 to differ materially from the forward-looking statements contained in this MD&A. None of the former trustees or officers of Finance Trust, 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 former trustees or officers to disclose events or facts which may have occurred or which may have affected 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 14, 2019 and the REIT, except as required by applicable Canadian law, assumes no obligation to update or revise them to reflect new information or the occurrence of future events or circumstances.

NON-GAAP FINANCIAL MEASURES

The REIT's Financial Statements are prepared in accordance with IFRS. However, in this MD&A, a number of measures are presented that are not measures under generally accepted accounting principles ("GAAP") in accordance with 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. Furthermore, the REIT's 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 REIT's proportionate share

H&R accounts for investments in joint ventures and associates as equity accounted investments in accordance with IFRS. The REIT's proportionate share is a non-GAAP measure that adjusts the REIT's Financial Statements to reflect H&R's equity accounted investments and its share of net income (loss) from equity accounted investments on a proportionately consolidated basis at H&R's ownership interest of the applicable investment. Management believes this measure is important for investors as it is consistent with how H&R reviews and assesses operating performance of its entire portfolio. Throughout this MD&A, the balances at the REIT's proportionate share have been reconciled back to relevant GAAP measures.

H&R does not independently control its unconsolidated joint ventures, and the presentation of pro-rata assets, liabilities, revenue, and expenses may not accurately depict the legal and economic implications of the REIT's interest in its joint ventures and associates.

(b) Same-Asset property operating income (cash basis)

Same-Asset property operating income (cash basis) is a non-GAAP financial measure used by H&R to assess period-over-period performance for properties owned and operated since January 1, 2017. Same-Asset property operating income (cash basis) adjusts property operating income to include property operating income from equity accounted investments on a proportionately consolidated basis at H&R's ownership interest of the applicable investment and excludes two non-cash items;

- Straight-lining of contractual rent; by excluding the impact of straight-lining of contractual rent, rentals from investment properties will consist primarily of actual rents collected by H&R.
- Realty taxes accounted for under IFRS Interpretations Committee Interpretation 21, *Levies* ("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.

It further excludes:

- Acquisitions, business combinations, dispositions and transfers of properties under development to investment properties during the two-year period ended December 31, 2018 (collectively, "Transactions").

Management believes that this measure is useful for investors as it adjusts property operating income (including property operating income from equity accounted investments on a proportionately consolidated basis) for non-cash items which allows investors to better understand period-over-period changes due to occupancy, rental rates, realty taxes and operating costs, before evaluating the changes attributable to Transactions. Furthermore, it is also used as a key input in determining the value of investment properties. Refer to the "Property Operating Income" section in this MD&A for a reconciliation of Property operating income to Same-Asset property operating income (cash basis).

(c) Funds from operations (“FFO”) and Adjusted Funds from Operations (“AFFO”)

FFO and AFFO are non-GAAP financial measures widely used in the real estate industry as a measure of operating performance particularly by those publicly traded entities that own and operate investment properties. H&R presents its consolidated FFO and AFFO calculations in accordance with the Real Property Association of Canada (REALpac) February 2018 *White Paper on Funds From Operations and Adjusted Funds From Operations for IFRS*. 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. Management believes FFO to be a useful earnings measure for investors as it adjusts net income for items 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. AFFO is calculated by adjusting FFO for the following items: straight-lining of contractual rent, capital expenditures, tenant expenditures and leasing costs. Although capital and tenant expenditures can vary from quarter to quarter due to tenant turnovers, vacancies and the age of a property, H&R has elected to deduct actual capital and tenant expenditures in the period. This may differ from others in the industry that deduct a normalized amount of capital and tenant expenditures, based on historical activity, 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. H&R’s method of calculating FFO and AFFO may differ from other issuers’ calculations. FFO and AFFO should not be construed as an alternative to net income or any other operating or liquidity measure prescribed under IFRS. Management uses FFO and AFFO to better understand and assess operating performance since net income includes several non-cash items which management believes are not fully indicative of the REIT’s performance. Refer to the “Funds From Operations and Adjusted Funds From Operations” section of this MD&A for a reconciliation of Net income to FFO and AFFO.

(d) Interest coverage ratio

The interest coverage ratio is a non-GAAP measure that is calculated by dividing the total of: (i) property operating income (excluding straight-lining of contractual rent and IFRIC 21); (ii) finance income and (iii) trust expenses (excluding unit-based compensation) by finance costs from operations (excluding effective interest rate accretion and exchangeable unit distributions). This excludes other income, transaction costs, gain (loss) on sale of investments and unrealized gains (losses) that may be taken into account under IFRS. Management uses this ratio and believes it is useful for investors as it is an operational measure used to evaluate the REIT’s ability to service the interest requirements of its outstanding debt. Interest coverage ratio is presented in the “Financial Highlights” and “Liabilities and Unitholders’ Equity” sections of this MD&A.

(e) Debt to total assets at the REIT’s proportionate share

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 REIT’s Financial Statements. H&R also presents this ratio at the REIT’s proportionate share which is a non-GAAP measure. Debt includes mortgages payable, debentures payable, unsecured term loans and lines of credit. Management uses this ratio to determine the REIT’s flexibility to incur additional debt. Management believes this is useful for investors in order to assess the REIT’s leverage and debt obligations. Refer to the “Financial Highlights” and “Liabilities and Unitholders’ Equity” sections of this MD&A for debt to total assets per the REIT’s Financial Statements and at the REIT’s proportionate share.

(f) Payout ratio per Unit as a % of FFO

Payout Ratio per Unit as a % of FFO is a non-GAAP measure which assesses the REIT’s ability to pay distributions and is calculated by dividing distributions per Unit (or Stapled Unit, where applicable) by FFO per Unit (or Stapled Unit, where applicable) for the respective period. H&R uses this ratio amongst other criteria to evaluate the REIT’s ability to maintain current distribution levels or increase future distributions as well as assess whether sufficient cash is being held back for operational and capital expenditures. Refer to the “Financial Highlights” and “Funds From Operations and Adjusted Funds From Operations” sections of this MD&A for the REIT’s payout ratio per Unit as a % of FFO.

(g) Net Asset Value (“NAV”) per Unit

NAV per Unit is a non-GAAP measure that management believes is a useful indicator of fair value of the net tangible assets of H&R. NAV per Unit is calculated by dividing the sum of: (i) Unitholders’ equity, (ii) value of exchangeable units, and (iii) deferred tax liability by the total number of Units and exchangeable units outstanding. The rationale for including exchangeable units and the deferred tax liability are as follows: (i) under IFRS, exchangeable units are classified as debt, however, these units are not required to be repaid and each holder of these units has the option to convert their exchangeable units into Units, and therefore H&R considers this to be equivalent to equity; and (iii) the deferred tax liability is an undiscounted liability that would be crystallized in the event that U.S. properties are sold. H&R plans to continue to take advantage of U.S. tax legislation in order to further defer taxes owing on sold properties. H&R’s method of calculating NAV per Unit may differ from other issuers’ calculations.

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 units (“Units”) redeemed at any time on demand payable in cash (subject to monthly limits) and/or *in specie*. The Units are listed and posted for trading on the Toronto Stock Exchange (“TSX”) under the symbol HR.UN.

On August 31, 2018, the REIT and Finance Trust effected a reorganization (“Reorganization”) by way of plan of arrangement involving the REIT, Finance Trust and certain of the REIT’s subsidiaries resulting in, among other things, (i) Finance Trust transferring debt owed to it by H&R REIT (U.S.) Holdings Inc. (“U.S. Holdco”) to the REIT for nil consideration and (ii) unitholders subsequently transferring their Finance Trust units to the REIT for nominal consideration and retaining their Units. Following these transactions, Finance Trust was terminated, resulting in the Units no longer being stapled to units of Finance Trust and unitholders holding only REIT Units.

H&R has two primary objectives:

- to maximize NAV 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; and
- 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.

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 leased by creditworthy tenants.

H&R’s strategy to mitigate risk includes 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 and Lantower Management Services LP, both subsidiaries 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 and developing multi-family residential rental properties in the United States. H&R therefore has six operating segments and management assesses the results of these operations separately.

SECTION II

FINANCIAL HIGHLIGHTS

(in thousands of Canadian dollars except per Unit amounts)	December 31, 2018	December 31, 2017	December 31, 2016
Total assets	\$14,691,009	\$14,558,863	\$14,155,012
Debt to total assets per the REIT's Financial Statements ⁽¹⁾	44.6%	44.6%	44.3%
Debt to total assets at the REIT's proportionate share ⁽¹⁾⁽²⁾	47.1%	46.6%	46.0%
Unitholders' equity	7,200,100	7,179,763	6,912,650
Units outstanding	285,678	291,320	285,280
Unitholders' equity per Unit	\$25.20	\$24.65	\$24.23
NAV per Unit ⁽²⁾⁽³⁾	\$26.30	\$25.57	\$25.45
Unit price	\$20.65	\$21.36	\$22.37

	Three months ended			Year ended		
	Dec. 31, 2018	Dec. 31, 2017	% Change	Dec. 31, 2018	Dec. 31, 2017	% Change
Rentals from investment properties	\$297,416	\$298,042	(0.2%)	\$1,176,558	\$1,168,454	0.7%
Property operating income	192,009	199,414	(3.7%)	733,932	741,441	(1.0%)
Same-Asset property operating income (cash basis) - Canada ⁽²⁾	137,493	134,546	2.2%	535,621	528,285	1.4%
Same-Asset property operating income (cash basis) - U.S. in U.S. dollars ⁽²⁾	37,203	36,330	2.4%	150,158	149,106	0.7%
Same-Asset property operating income (cash basis) total in Canadian dollars ⁽²⁾	186,987	180,646	3.5%	730,826	722,122	1.2%
Net income from equity accounted investments	148,165	118,337	25.2%	169,409	167,407	1.2%
Net income	61,115	325,213	(81.2%)	337,918	667,870	(49.4%)
FFO ⁽²⁾	130,470	137,447	(5.1%)	525,696	560,090	(6.1%)
Weighted average number of basic Units for FFO ⁽²⁾	301,200	306,629	(1.8%)	302,605	304,462	(0.6%)
FFO per basic Unit ⁽²⁾	0.433	0.448	(3.3%)	1.737	1.840	(5.6%)
Distributions paid per Unit	0.345	0.345	-%	1.380	1.380	-%
Payout ratio per Unit as a % of FFO ⁽²⁾	79.7%	77.0%	2.7%	79.4%	75.0%	4.4%
Interest coverage ratio ⁽²⁾	3.06	2.99	2.3%	3.03	3.00	1.0%

Net income is reconciled to FFO. See page 31.

⁽¹⁾ Debt includes mortgages payable, debentures payable, unsecured term loans and lines of credit.

⁽²⁾ These are non-GAAP measures. See the "Non-GAAP Financial Measures" section of this MD&A.

⁽³⁾ See page 21 for a detailed calculation of NAV per Unit.

KEY PERFORMANCE DRIVERS

The following table is presented at the REIT's proportionate share and includes investment properties classified as assets held for sale:

<i>OPERATIONS</i>		Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential ⁽³⁾	Total
<i>Occupancy as at December 31</i>	2018	98.5%	84.9% ⁽⁴⁾	98.2%	95.5%	98.5%	88.0% ⁽⁶⁾	94.0%
	2017	97.0%	92.6%	97.4%	94.1%	98.4%	90.0%	95.6%
<i>Occupancy – Same-Asset as at December 31⁽¹⁾</i>	2018	98.5%	84.9% ⁽⁴⁾	98.2%	95.3%	98.4%	92.7%	94.9%
	2017	98.3%	92.6%	97.7%	94.6%	98.7%	93.6%	96.5%
<i>Average contractual rent per sq.ft. for the year ended December 31-Canadian properties⁽²⁾</i>	2018	\$26.41	\$25.44	\$11.74	N/A	\$6.86	N/A	\$18.80
	2017	\$25.92	\$23.36	\$11.75	N/A	\$6.65	N/A	\$18.10
<i>Average contractual rent per sq.ft. for the year ended December 31-U.S. properties (USD)⁽²⁾</i>	2018	\$35.78	N/A	\$47.15⁽⁵⁾	\$15.48	\$3.37	\$16.94	\$19.04
	2017	\$35.75	N/A	\$13.11	\$15.17	\$3.54	\$15.99	\$16.77
<i>Average remaining term to maturity of leases as at December 31 (in years)</i>	2018	11.1	4.8	8.4	10.1	6.7	N/A	9.0
	2017	11.8	4.9	6.1	10.6	7.2	N/A	9.1
<i>Average remaining term to maturity of mortgages payable as at December 31 (in years)</i>	2018	4.1	3.3	3.6	10.7	6.5	8.3	5.5
	2017	5.0	4.2	5.0	11.0	6.0	8.4	5.6

⁽¹⁾ Same-Asset refers to those properties owned by H&R for the two-year period ended December 31, 2018.

⁽²⁾ Excludes properties sold in their respective year.

⁽³⁾ Jackson Park has been excluded from the Key Performance Drivers above

⁽⁴⁾ Primaris Occupancy and Occupancy-Same Asset as at December 31, 2017 includes eight Sears' store locations totalling 609,749 square feet which closed and became vacant in January 2018. Primaris Occupancy would have been 92.6% had these eight Sears store locations been occupied as at December 31, 2018.

⁽⁵⁾ In June 2018, H&R sold 63 of its 79 U.S. retail properties owned as at December 31, 2017 which resulted in average contractual rent per sq.ft. in U.S. dollars increasing from \$13.11 for the year ended December 31, 2017 to \$47.15 for the year ended December 31, 2018.

⁽⁶⁾ Lantower Residential had four properties in lease-up with a weighted average occupancy rate of 67.5% as at December 31, 2018. Excluding these four properties, occupancy would have been 92.5% as at December 31, 2018.

SUMMARY OF SIGNIFICANT 2018 ACTIVITY

During 2018, H&R actively pursued its capital reallocation program through property dispositions, acquisitions, developments and the repurchase and cancellation of Units. The objectives of this program include 1) simplifying H&R by focusing on fewer property types and increasing the contributions from its core portfolio; 2) making H&R easier for investors to understand, analyze and value; and 3) enhancing the REIT's internal growth profile. The following 2018 transactions highlight H&R's progress in achieving the strategic objectives identified in its letter to unitholders included in H&R's 2017 Annual Report:

- Sold 63 lower growth U.S. retail assets for U.S. \$633.0 million;
- Sold H&R's ownership interest in F1RST Tower in Calgary, AB for \$53.5 million;
- Sold H&R's ownership interest in five non-core Canadian industrial assets and two non-core Canadian retail assets for \$72.1 million;
- Reinvested sales proceeds in higher growth assets by acquiring residential rental assets in the U.S. for U.S. \$340.6 million;
- Further advanced and expanded the development pipeline to \$1.5 billion of properties under development;
- Purchased and cancelled 6.6 million Units at an average price of \$20.62 per Unit for a total cost of \$136.3 million; and
- Eliminated Finance Trust and the Stapled Unit structure to return H&R to a single trust in line with industry peers.

Developments

Management believes that H&R's development pipeline is an important driver of growth in NAV and FFO per Unit over time. H&R's scale, low leverage and high quality tenant base serve as a competitive advantage enabling the REIT to pursue large format development opportunities not available to smaller entities, while managing risk exposures. During 2018, H&R has made significant progress in advancing its value-creating development program, with a well-staggered pipeline of projects.

Jackson Park, the 1,871 luxury residential rental unit development in Long Island City, NY, in which H&R has a 50% ownership interest, is nearing completion and expected to be transferred to investment properties in Q1 2019. H&R's trophy project is on budget and slightly ahead of the development lease-up schedule. As at December 31, 2018, 1,274 leases had been entered into and 1,231 units were occupied. The remaining lease-up is expected to occur during the balance of 2019 with stabilized occupancy expected to be achieved during Q3 2019. Upon stabilization, the first full year's property operating income at H&R's ownership interest is projected to be U.S. \$35.9 million, equating to a 6.2% yield on budgeted cost of U.S. \$580.7 million. Jackson Park, at the 100% level, has been valued at approximately U.S. \$1.6 billion as at December 31, 2018 compared to costs to date of approximately U.S. \$1.1 billion, resulting in a fair value increase of U.S. \$522.6 million since the start of the project.

The following table presents net income and FFO for Jackson Park for the three months and year ended December 31, 2018 as well as projections through 2020:

	Q4 2018 (Actual)	YTD Dec 31, 2018 (Actual)	Annual 2019 (Projected)	Annual 2020 (Projected)
(H&R's ownership interest)				
(in thousands of U.S. dollars)				
Property operating income	\$2,554	\$1,988	\$27,004	\$35,921
Finance cost - operations	(2,999)	(5,475)	(13,191)	(13,600)
Fair value adjustment on financial instruments	(1,699)	1,549	-	-
Fair value adjustment on real estate assets	107,718	107,718	-	-
Net income	105,574	105,780	13,813	22,321
Fair value adjustment on financial instruments	1,699	(1,549)	-	-
Fair value adjustment on real estate assets	(107,718)	(107,718)	-	-
Notional interest capitalization	601	5,777	232	-
FFO	\$156	\$2,290	\$14,045	\$22,321

For Q4 2018, net income from Jackson Park exceeded the projection as at September 30, 2018 primarily due to a fair value increase to the property of U.S. \$107.7 million at H&R's ownership interest which was supported by an independent third party appraisal. FFO for Q4 2018 was lower than projected as at September 30, 2018 by \$0.4 million primarily due to higher initial operating expenses.

In April 2018, H&R acquired a 33.3% non-managing ownership interest in a residential development site zoned for 263 residential rental units for U.S. \$8.7 million at the 100% level located in Seattle, WA. This development, known as "Esterra Park", is part of a larger master planned community and is adjacent to Microsoft, Inc.'s headquarters, bus transit and future light rail which is expected to be completed in 2021. Construction commenced in November 2018 and the total budget is approximately U.S. \$95.7 million at the 100% level. As at December 31, 2018, H&R's investment was approximately U.S. \$6.2 million.

In June 2018, H&R converted its mortgage receivable secured against the urban in-fill development site in Miami, FL, known as "River Landing" into a wholly-owned property under development. River Landing, with approximately 1,000 feet of waterfront on the Miami River, is adjacent to the Health District and is two miles from downtown Miami. River Landing is a mixed-use development including approximately 346,000 square feet of retail space, approximately 136,000 square feet of office space and 529 residential rental units. To date, 66.0% of the retail space has been leased, with a further 10.1% under executed non-binding letters of intent. Construction is underway with occupancy scheduled to commence in Q2 2020. The total cost of the project is expected to be U.S. \$424.8 million and as at December 31, 2018, approximately U.S. \$196.0 million had been invested in the development. Upon stabilized occupancy, the first full year's property operating income is projected to be U.S. \$24.4 million, equating to a 5.7% yield on budgeted cost.

In June 2018, H&R purchased a 100% ownership interest in 20.3 acres of land in Prosper, TX, a suburb of Dallas ("Prosper") for U.S. \$14.6 million. The location along Dallas North Tollway enables quick access to the acclaimed Legacy West Development, home to major corporate employers including the regional headquarters of Toyota North America, Federal Express, Inc., Liberty Mutual Regional and JP Morgan Chase. The site is expected to consist of 1,000 residential rental units.

In July 2018, H&R acquired a 30.9% non-managing ownership interest in the development of a 315 luxury residential rental unit tower, with 6,450 square feet of retail space for a total of U.S. \$15.0 million, at the 100% level. Located in Long Beach, CA, "Shoreline Gateway" will become the tallest residential tower in Long Beach with 35 floors enjoying views overlooking the Pacific Ocean. Construction commenced in November 2018 and the total budget is approximately U.S. \$227.1 million at the 100% level. As at December 31, 2018, H&R's investment was approximately U.S. \$6.4 million.

In December 2018, H&R acquired a 100% interest in approximately 3.3 acres of land in downtown Dallas, TX ("2214 Bryan St.") for approximately U.S. \$23.5 million. The site was purchased for the future development of luxury residential rental units. The location benefits from great connectivity as the Pearl/Arts District DART (public rail) station is adjacent to the site.

For a complete list of H&R's current development projects, see page 14 of this MD&A.

Retail

In June 2018, H&R sold 63 lower-growth U.S. retail properties, totaling 4,235,943 square feet for U.S. \$633.0 million and realized a loss on sale of U.S. \$19.6 million which was primarily due to mortgage prepayment penalties and closing costs. H&R used the proceeds from dispositions to repay 48 mortgages totaling U.S. \$205.3 million, repay bank debt of approximately U.S. \$152.4 million and fund Lantower Residential acquisitions of U.S. \$255.7 million. The sale of H&R's 63 U.S. retail assets reduced net income and FFO during the remainder of 2018.

During 2018, H&R completed lease renewals for 15 single-tenanted properties totaling 1,207,474 square feet with an average lease extension of 13.2 years.

Office

Property operating income and Same-Asset property operating income (cash basis) from the Office segment increased by 0.2% and 1.8%, respectively, for the year ended December 31, 2018 compared to the respective 2017 period, primarily due to an increase in occupancy, contractual rental escalations and renewed leases at higher rents from H&R's Ontario Office properties. The Office portfolio is leased on a long-term basis to creditworthy tenants, with 81.2% of Office revenue from tenants with investment grade ratings.

In April 2018, H&R sold its 50% ownership interest in FIRST Tower in Calgary, AB for gross proceeds of \$53.5 million and repaid the associated mortgage of \$40.0 million at H&R's ownership interest. As at December 31, 2018, H&R's Alberta Office portfolio consists of four single tenant properties, all of which are fully leased to investment grade tenants, with a weighted average remaining lease term to maturity of 17.4 years.

Primaris

Property operating income and Same-Asset property operating income (cash basis) from the Primaris segment grew by 0.9% and 0.8%, respectively, for the year ended December 31, 2018 compared to the respective 2017 period, despite the decline in occupancy from 92.6% at December 31, 2017 to 84.9% at December 31, 2018. This reflects the relative low rents Sears had been paying on the vacated space in 2017, the commencement of new leases on the previous Target space as well as the strength of the remainder of the tenant base.

Redevelopment of the former Sears stores has commenced, however, since each store is part of an existing property, they continue to be classified as investment properties. During the three months and year ended December 31, 2018, H&R capitalized \$0.5 million and \$1.1 million, respectively, of property operating costs and \$1.0 million and \$2.8 million, respectively, of finance costs attributable to the former Target and Sears space. Management expects positive rental growth from Primaris as the lease-up of the former Target and Sears space is expected to generate approximately \$1.0 million, \$5.4 million and \$3.0 million of additional annual base rent in 2019, 2020 and 2021, respectively.

In August 2018, Primaris sold a 44,158 square foot multi-tenant retail property known as Sherwood Park Plaza in Sherwood Park, AB for \$13.3 million.

Lantower Residential

Property operating income and Same-Asset property operating income (cash basis) from Lantower Residential, now H&R's third largest segment, grew by 60.2% and 4.4%, respectively, for the year ended December 31, 2018 compared to the respective 2017 period. The growth in property operating income was primarily due to 11 property acquisitions during 2017 and 2018. Growth in Same-Asset property operating income (cash basis) was primarily due to rental growth.

During 2018, Lantower Residential acquired five properties totalling 1,638 residential rental units for an aggregate purchase price of U.S. \$340.6 million. As at December 31, 2018, Lantower Residential has a portfolio of 22 properties comprising 7,271 residential rental units. Eleven properties are in Texas, seven are in Florida and four are in North Carolina.

In December 2018, Apple Inc. announced it will be building a new 133-acre campus in Austin, TX to accommodate an additional 5,000 jobs with the capacity to grow to 15,000 jobs. This campus is located within a six-mile radius of Lantower Residential's four properties in Austin, TX.

As at December 31, 2018, Lantower Residential had four properties in lease-up with a weighted average occupancy rate of 67.5%. During the three months and year ended December 31, 2018, these properties contributed U.S. \$1.2 million and U.S. \$2.0 million, respectively, to property operating income. All four properties are targeted for stabilization by Q4 2019 and are expected to contribute an additional U.S. \$7.8 million to property operating income in 2019.

Industrial

During 2018, H&R acquired ownership interests in two Canadian industrial properties for a total purchase price of \$17.3 million at H&R's ownership interest and H&R sold interests in five Canadian industrial properties for total proceeds of \$51.3 million at H&R's ownership interest.

Debt Highlights*Debentures:*

During 2018, H&R issued the following debentures:

	Maturity	Contractual Interest Rate	Principal Amount
Series O Senior Debentures	January 23, 2023	3.42%	\$250,000
Series P Senior Debentures ⁽¹⁾	February 13, 2020	3.00%	170,000
			\$420,000

⁽¹⁾ Denominated as U.S. \$125.0 million and bearing interest at a rate equal to 3-month London Interbank Offered Rate plus 79 basis points. The average interest rate for the year ended December 31, 2018 was 3.00%. In December 2018, H&R entered into an interest rate swap on the Series P senior debentures to fix the interest rate at 2.88% per annum.

During 2018, the following debentures matured or were redeemed:

	Maturity/Redemption	Contractual Interest Rate	Principal Amount
Series E Senior Debentures	February 2, 2018	4.90%	\$100,000
Series J Senior Debentures ⁽¹⁾	February 9, 2018	2.04%	157,500
Series G Senior Debentures	June 20, 2018	3.34%	175,000
Series C Senior Debentures	December 1, 2018	5.00%	125,000
2020 Convertible Debentures (HR.DB.D)	March 12, 2018	5.90%	99,582
			\$657,082

⁽¹⁾ Denominated as U.S. \$125.0 million.

Mortgages:

During 2018, H&R secured 14 new mortgages totalling \$603.7 million at a weighted average interest rate of 4.1% for an average term of 9.3 years. In addition to repaying the 48 mortgages totalling \$266.9 million (U.S. \$205.3 million) on the U.S. retail assets that were sold in June 2018, H&R also repaid 19 other mortgages totalling \$138.2 million. Together, these mortgages had a weighted average interest rate of 4.8%.

Unsecured Term Loan:

In December 2018, H&R borrowed \$250.0 million by way of an unsecured term loan maturing in January 2026. Through an interest rate swap, H&R fixed the interest rate at 3.9% for the full seven-year term.

Lines of Credit:

As at December 31, 2018, H&R had \$768.2 million of unused borrowing capacity available under its lines of credit.

As at December 31, 2018, debt to total assets was 44.6% unchanged from December 31, 2017. The weighted average interest rate of H&R's debt as at December 31, 2018 was 3.8% with an average term to maturity of 4.4 years.

Unwinding of H&R's Stapled Unit Structure

On August 31, 2018, the REIT and Finance Trust effected a Reorganization by way of plan of arrangement involving the REIT, Finance Trust and certain of the REIT's subsidiaries resulting in, among other things, the termination of Finance Trust. Accordingly, H&R's Units are no longer stapled to units of Finance Trust with unitholders now only holding H&R Units, thereby returning H&R to a single trust in line with industry peers.

Suspension of DRIP and Unit Purchase Plan

In February 2018, the Trusts announced the suspension of its DRIP and Unit Purchase Plan until further notice. Commencing with the March 2018 distribution, unitholders who elected to participate in the DRIP received the full cash distributions on their Units. If H&R elects to reinstate the DRIP in the future, unitholders that were enrolled in the DRIP at the time of its suspension and remain enrolled at the time of its reinstatement will automatically resume participation in the DRIP. Unitholders who elected to participate in the Unit Purchase Plan will no longer have funds withdrawn for purchases of Units. H&R is well capitalized and has a strong balance sheet with significant financial flexibility. Accordingly, the trustees of H&R and management wish to assert greater control over when and on what terms H&R raises capital to fund its business. The trustees of H&R and management particularly wish to avoid issuing equity at a price below NAV per Unit, something that can occur from time to time under the DRIP.

Normal Course Issuer Bid (“NCIB”)

With an increased focus on recycling capital into investments with higher risk-adjusted returns and the availability of excess capital generated from asset dispositions, H&R has taken advantage of the opportunity to acquire Units through its NCIB at what management believes to be significantly discounted trading prices. During the year ended December 31, 2018, the Trusts purchased and cancelled 6,609,420 Units at a weighted average price of \$20.62 per Unit, for a total amount of \$136.3 million.

SECTION III

The following foreign exchange rates have been used throughout this MD&A when converting U.S. dollars to Canadian dollars except where otherwise noted:

	As at December 31		Three months ended December 31		Year ended December 31	
	2018	2017	2018	2017	2018	2017
For each U.S. \$1.00	\$1.36 CAD	\$1.26 CAD	\$1.33 CAD	\$1.27 CAD	\$1.30 CAD	\$1.30 CAD

FINANCIAL POSITION

(in thousands of Canadian dollars)	December 31, 2018	December 31, 2017
Assets		
Real estate assets		
Investment properties	\$12,683,709	\$13,074,123
Properties under development	404,814	83,132
	13,088,523	13,157,255
Equity accounted investments	1,284,985	1,125,135
Assets classified as held for sale	110,940	-
Other assets	153,488	234,189
Cash and cash equivalents	53,073	42,284
	\$14,691,009	\$14,558,863
Liabilities and Unitholders' Equity		
Liabilities		
Debt	\$6,546,072	\$6,493,617
Exchangeable units	329,482	341,321
Deferred tax liability	392,214	325,131
Accounts payable and accrued liabilities	223,141	219,031
	7,490,909	7,379,100
Unitholders' equity	7,200,100	7,179,763
	\$14,691,009	\$14,558,863

ASSETS

Real Estate Assets:

Change in Investment Properties (in thousands of Canadian dollars)	REIT's Financial Statements	Plus: equity accounted investments	REIT's proportionate share⁽¹⁾
Opening balance, January 1, 2018	\$13,074,123	\$846,431	\$13,920,554
Acquisitions, including transaction costs	463,299	6,240	469,539
Dispositions	(933,403)	(2,111)	(935,514)
Transfer of investment properties to assets classified as held for sale	(110,940)	-	(110,940)
Operating capital:			
Capital expenditures	57,825	2,754	60,579
Leasing expenses and tenant inducements	32,441	2,730	35,171
Redevelopment (including capitalized interest)	60,892	1,030	61,922
Amortization of tenant inducements, straight-lining of contractual rents and blend and extend rents included in revenue	3,088	(733)	2,355
Transfer of properties under development that have reached substantial completion to investment properties	-	13,932	13,932
Fair value adjustment on real estate assets	(246,967)	(8,474)	(255,441)
Change in foreign exchange	283,351	68,500	351,851
Closing balance, December 31, 2018	\$12,683,709	\$930,299	\$13,614,008

⁽¹⁾ The REIT's proportionate share is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

2018 Acquisitions: Property	Year Built	Segment	Date Acquired	Number of Residential Rental Units	Purchase Price (\$ Millions)⁽¹⁾	Ownership Interest Acquired
504 East Pettigrew St., Durham, NC	2018	Residential	Jun 1, 2018	305	98.9	100%
190 Goodrich Dr., Kitchener, ON ⁽²⁾	1980	Industrial	Jun 1, 2018	-	4.0	50%
15175 Integra Junction, Odessa, FL	2017	Residential	Jun 11, 2018	322	74.9	100%
14201 N. Interstate, 35 Frontage Rd., Austin, TX	2018	Residential	Sep 17, 2018	328	62.9	100%
3300-70th Ave., Leduc, AB ⁽³⁾	2018	Industrial	Oct 1, 2018	-	13.3	33.3%
6000 Elevate Circle, Cary, NC	2018	Residential	Oct 16, 2018	308	95.4	100%
6101 Ardrey Kell Rd., Charlotte, NC	2016	Residential	Dec 3, 2018	375	111.4	100%
Total				1,638	\$460.8	

⁽¹⁾ U.S. acquisitions have been translated to Canadian dollars at the exchange rate as at the date acquired.

⁽²⁾ Purchase price is stated at H&R's ownership interest. The square footage at H&R's ownership interest is 36,562.

⁽³⁾ Purchase price is stated at H&R's ownership interest. The square footage at H&R's ownership interest is 134,883.

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2017 Acquisitions: Property	Year Built	Segment	Date Acquired	Number of Residential Rental Units	Purchase Price (\$ Millions) ⁽¹⁾	Ownership Interest Acquired
14233 The Lakes Blvd., Austin, TX	2016	Residential	Apr 7, 2017	375	\$69.5	100%
14301 N. Interstate Hwy. 35, Austin, TX	2017	Residential	May 26, 2017	370	71.3	100%
1810 Sweetbroom Circle, Lutz, FL	2010	Residential	Oct 10, 2017	451	98.6	100%
11660 Westwood Blvd., Orlando, FL	2017	Residential	Nov 15, 2017	282	76.2	100%
10440 Sanderling Shores Dr., Tampa, FL	2016	Residential	Dec 11, 2017	450	121.3	100%
2600 Lake Ridge Rd., Lewisville, TX	2016	Residential	Dec 12, 2017	301	64.1	100%
Total				2,229	\$501.0	

⁽¹⁾ U.S. acquisitions have been translated to Canadian dollars at the exchange rate as at the date acquired.

2018 Dispositions: Property	Segment	Date Sold	Square Feet	Selling Price (\$ Millions) ⁽¹⁾	Ownership Interest Sold
7350 Catherine St., Windsor, ON	H&R Retail	Jan 31, 2018	102,997	\$7.5	100%
1880 Matheson Blvd. E., Mississauga, ON ⁽²⁾	Industrial	Feb 20, 2018	194,657	31.3	50%
1377 The Queensway, Toronto, ON ⁽²⁾	Industrial	Feb 23, 2018	92,449	7.0	50%
411 1st Street, Calgary, AB ⁽²⁾	Office	Apr 10, 2018	353,140	53.5	50%
10300 Rue Henri Bourassa, St. Laurent, QC ⁽²⁾	Industrial	Apr 19, 2018	40,750	3.6	50%
U.S. Retail portfolio - 63 properties	H&R Retail	June 2018	4,235,943	823.3	100%
380 Spinnaker Way, Vaughan, ON ⁽²⁾	Industrial	Jul 11, 2018	24,763	4.6	75%
650 Catarauqui Woods Dr., Kingston, ON ⁽²⁾	Industrial	Jul 31, 2018	88,328	4.8	50%
101 Granada Blvd., Sherwood Park, AB	Primaris	Aug 1, 2018	44,158	13.3	100%
Total			5,177,185	\$948.9	

⁽¹⁾ U.S. dispositions have been translated to Canadian dollars at the exchange rate as at the date sold.

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

2017 Dispositions: Property	Segment	Date Sold	Square Feet	Selling Price (\$ Millions) ⁽¹⁾	Ownership Interest Sold
Place du Royaume, Chicoutimi, QC ⁽²⁾⁽³⁾	Primaris	Jan 16, 2017	301,859	\$109.0	50%
Catarauqui Town Centre, Kingston, ON ⁽²⁾⁽³⁾	Primaris	Jan 16, 2017	310,311	102.6	50%
914 E. North Ave., Belton, MO	H&R Retail	Jan 27, 2017	88,248	13.9	100%
2940 N. Broadway, Anderson, IN	H&R Retail	Mar 31, 2017	39,877	2.7	100%
8766 E. 96th St., Fishers, IN	H&R Retail	Mar 31, 2017	80,960	5.3	100%
2800 Skymark Ave., Mississauga, ON ⁽⁴⁾	Office	Q2-Q3 2017	12,202	1.6	100%
189/203 Queen St. N., Tilbury, ON ⁽²⁾	Industrial	Aug 21, 2017	85,068	3.8	50%
12510 South Green Dr., Houston, TX ⁽⁵⁾	Residential	Sep 27, 2017	323,568	39.9	100%
Total			1,242,093	\$278.8	

⁽¹⁾ U.S. dispositions have been translated to Canadian dollars at the exchange rate as at the date sold.

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

⁽³⁾ H&R retained an ownership interest of 50% in these properties.

⁽⁴⁾ As at December 31, 2017, all condominium units have been sold.

⁽⁵⁾ Property consisted of 428 units.

Investment Properties and Properties under Development by Segment and Region:

The following tables disclose the fair values of the investment properties and properties under development by operating segment and geographic location, excluding assets held for sale:

December 31, 2018							
Operating Segment (in millions of Canadian dollars)	REIT's Financial Statements			Equity Accounted Investments			REIT's proportionate share ⁽¹⁾
	Investment Properties	Properties Under Development	Sub Total	Investment Properties	Properties Under Development	Sub Total	
Office	\$6,659	\$ -	\$6,659	\$ -	\$ -	\$ -	\$6,659
Primaris	2,733	-	2,733	-	-	-	2,733
H&R Retail	570	-	570	-	-	-	570
ECHO	-	-	-	870	12	882	882
Industrial	966	86	1,052	60	-	60	1,112
Lantower Residential	1,756	319	2,075	-	1,133	1,133	3,208
Total	\$12,684	\$405	\$13,089	\$930	\$1,145	\$2,075	\$15,164

(1) The REIT's proportionate share is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

December 31, 2018							
Geographic Location (in millions of Canadian dollars)	REIT's Financial Statements			Equity Accounted Investments			REIT's proportionate share ⁽¹⁾
	Investment Properties	Properties Under Development	Sub Total	Investment Properties	Properties Under Development	Sub Total	
Ontario	\$4,421	\$86	\$4,507	\$ -	\$ -	\$ -	\$4,507
Alberta	3,404	-	3,404	-	-	-	3,404
Other	1,259	-	1,259	-	-	-	1,259
Canada	9,084	86	9,170	-	-	-	9,170
United States	3,600	319	3,919	930	1,145	2,075	5,994
Total	\$12,684	\$405	\$13,089	\$930	\$1,145	\$2,075	\$15,164

(1) The REIT's proportionate share is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

H&R has utilized the following capitalization rates in estimating the fair value of the investment properties excluding assets classified as held for sale. The capitalization rates disclosed below are reported by segment and geographic location at the REIT's proportionate share which differs from the REIT's Financial Statements.

Weighted Average Overall Capitalization Rates:

December 31, 2018	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Canada	5.54%	6.00%	6.44%	-	5.68%	-	5.73%
United States	5.27%	-	11.25%	6.69%	8.55%	5.09%	5.68%

December 31, 2017	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Canada	5.58%	5.54%	6.38%	-	5.85%	-	5.63%
United States	5.36%	-	7.36%	6.78%	8.06%	5.12%	5.98%

Properties Under Development:

As at December 31, 2018			At H&R Ownership Interest			Expected Yield on Cost	Expected Completion Date
Development Name (in thousands of Canadian dollars)	Ownership Interest	Number of Acres	Total Development Budget	Properties Under Development	Costs Remaining to Complete		
<u>U.S. projects</u>							
River Landing, Miami, FL ⁽¹⁾	100.0%	8.1	\$424,815	\$196,022	\$228,793	5.7%	Q2 2020
Prosper, Dallas, TX (Phase 1) ⁽²⁾⁽³⁾	100.0%	20.3		15,103			
2214 Bryan St., Dallas, TX ⁽²⁾	100.0%	3.3		23,616			
Total in U.S. Dollars		31.7	424,815	234,741	228,793		
Total U.S. projects in Canadian Dollars			577,748	319,247	311,158		
<u>Canadian projects</u>							
Industrial Lands, Caledon, ON ⁽²⁾⁽⁴⁾	100.0%	144.0		85,567			
Total per the REIT's Financial Statements		175.7	\$577,748	\$404,814	\$311,158		
Equity accounted investments:							
<u>U.S. projects</u>							
Jackson Park, Long Island City, NY ⁽⁵⁾	50.0%	2.7	\$580,654	\$529,872	\$27,760	6.2%	Q1 2019
Jackson Park, Long Island City, NY (Fair Value Increase)	50.0%	-		261,293		-	-
Shoreline, Long Beach, CA ⁽⁶⁾	30.9%	0.9	70,096	9,704	60,392	6.2%	Q1 2021
Hercules Project (Block N - Phase 1), Hercules, CA ⁽⁷⁾	31.7%	2.2	26,041	7,312	18,729	6.5%	Q2 2020
Hercules Project (Remaining Phases), Hercules, CA ⁽²⁾⁽⁷⁾	31.7%	36.2		11,721			
The Pearl, Austin, TX ⁽⁸⁾	33.3%	5.0	23,201	6,519	16,682	6.2%	Q2 2020
Esterra Park, Seattle, WA ⁽⁹⁾	33.3%	1.1	31,859	6,354	25,505	6.0%	Q3 2020
ECHO: 11 properties under development ⁽²⁾	33.6%			9,150			
Total in U.S. Dollars		48.1	731,851	841,925	149,068		
Total U.S. projects in Canadian Dollars			995,317	1,145,018	202,732		
Total per the REIT's proportionate share		223.8	\$1,573,065	\$1,549,832	\$513,890		

⁽¹⁾ Mixed use development consisting of 529 residential rental units, approximately 346,000 square of retail space and 136,000 square feet of office space.

⁽²⁾ Development budget metrics have not been determined as at December 31, 2018.

⁽³⁾ Total development to be approximately 1,000 residential rental units over several phases in a master planned community, along the Dallas North Tollway in north Dallas.

⁽⁴⁾ 2.7 million square feet of industrial property is expected to be built. Costs spent to date relate to land only.

⁽⁵⁾ 1,871 luxury residential rental units. Stabilized occupancy is expected to be achieved in Q3 2019. The fair value of this property under development is U.S. \$800.0 million at H&R's ownership interest as at December 31, 2018, which includes amounts grouped in other assets. The total development budget less properties under development as at December 31, 2018 differs from costs remaining to complete as certain amounts spent have been accounted for as other assets or through net income.

⁽⁶⁾ 35-storey residential tower consisting of 315 luxury residential rental units and 6,450 square feet of retail.

⁽⁷⁾ Total project spans 38.4 acres and 1,081 residential rental units are expected to be built. Construction commenced on Phase 1 of this project which will consist of 172 residential rental units.

⁽⁸⁾ 383 residential rental units. Close to major technology employers including Apple, IBM, Oracle & Samsung as well as the University of Texas at Austin and downtown Austin.

⁽⁹⁾ 7-storey residential tower consisting of 263 residential rental units. Part of a larger master planned community and is adjacent to transit, Microsoft, Inc.'s headquarters, and future light rail which is expected to be completed in 2021.

Equity Accounted Investments:

(in thousands of Canadian dollars)	December 31, 2018									December 31, 2017
	ECHO	Jackson Park	Six U.S. Industrial Properties	Hercules Project	The Pearl	Esterra Park	Shoreline	Scotia Plaza ⁽¹⁾	Total ⁽²⁾	Total ⁽²⁾
Investment properties	\$870,032	\$ -	\$60,267	\$ -	\$ -	\$ -	\$ -	\$ -	\$930,299	\$846,431
Properties under development	12,445	1,075,984	-	25,884	8,866	8,642	13,197	-	1,145,018	815,472
Other assets	13,970	17,160	174	-	-	34	-	38	31,376	83,416
Cash and cash equivalents	11,075	26,563	3,734	490	111	335	190	99	42,597	64,820
Debt	(376,293)	(379,108)	(19,122)	(6,029)	-	-	-	-	(780,552)	(613,585)
Other liabilities	(47,234)	(31,174)	(659)	(1,832)	(245)	(597)	(726)	(1,286)	(83,753)	(71,419)
Equity accounted investments	\$483,995	\$709,425	\$44,394	\$18,513	\$8,732	\$8,414	\$12,661	(\$1,149)	\$1,284,985	\$1,125,135

(1) On June 30, 2016, H&R sold its 33.3% freehold and leasehold interests in Scotia Plaza and 100 Yonge.

(2) Each of these line items represent the REIT's proportionate share of equity accounted investments which are reconciled to the total equity accounted investments per the REIT's Financial Statements. This is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

ECHO

H&R owns a 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, primarily in Pennsylvania and Ohio. ECHO reports its financial results to H&R one month in arrears. ECHO's financial information has been disclosed as at November 30, 2018 and November 30, 2017, respectively.

During the twelve months ended November 30, 2018, ECHO acquired three investment properties totalling 28,616 square feet and eight properties under development for an aggregate purchase price of U.S. \$10.5 million, at H&R's ownership interest. During this period, Echo sold two investment properties totalling 23,722 square feet for gross proceeds of U.S. \$1.0 million and transferred two properties under development to investment properties totalling 35,199 square feet for a total value of U.S. \$10.1 million, at H&R's ownership interest.

During the twelve months ended November 30, 2017, ECHO acquired 11 investment properties and three land parcels totalling 176,500 square feet for an aggregate purchase price of U.S. \$41.4 million, at H&R's ownership interest. Major tenants at these properties include Acme Supermarket, Giant Foods, Redner's Supermarket, Publix Supermarket and Harris Teeter. During this period, Echo sold an investment property for gross proceeds of U.S. \$2.5 million, at H&R's ownership interest.

Long Island City Project-Jackson Park

Jackson Park, the 1,871 luxury residential rental unit development in Long Island City, NY, in which H&R has a 50% ownership interest, is nearing completion and expected to be transferred to investment properties in Q1 2019. H&R's trophy project is on budget and slightly ahead of the development lease-up schedule. During Q4 2018, 162 leases were entered into and 194 tenants began occupancy. As at December 31, 2018, 1,274 leases had been entered into and 1,231 units were occupied. The remaining lease-up is expected to occur during the balance of 2019 with stabilized occupancy expected to be achieved during Q3 2019. The five-storey 45,000 square foot amenity building known as "The Club at Jackson Park" is complete and open to residents. Upon stabilized occupancy, the first full year's property operating income at H&R's ownership interest is projected to be U.S. \$35.9 million, equating to a 6.2% yield on budgeted cost of U.S. \$580.7 million. Jackson Park, at the 100% level, has been valued at approximately U.S. \$1.6 billion as at December 31, 2018 compared to costs to date of approximately U.S. \$1.1 billion, resulting in a fair value increase of U.S. \$522.6 million since the start of the project. Please refer to page 7 for an update on expected net income and FFO during the lease-up period.

Six U.S. Industrial Properties

As at December 31, 2018, H&R owns a 50.5% interest in six industrial properties through a joint venture with its partners, all of which are located in the United States (December 31, 2017 - 6 properties). During 2017, this joint venture sold the following nine properties:

Property	Segment	Date Sold	Square Feet ⁽¹⁾	Selling Price (\$ Millions) ⁽¹⁾⁽²⁾	Ownership Interest Sold
11 Cermak Blvd., Saint Peters, MO	Industrial	Aug 21, 2017	71,710	\$5.9	50.5%
827 Graham Dr., Fremont, OH	Industrial	Aug 21, 2017	43,634	2.9	50.5%
15573 Oakwood Dr., Romulus, MI	Industrial	Aug 21, 2017	50,740	4.2	50.5%
12090 Sage Point Ct., Reno, NV	Industrial	Nov 30, 2017	348,450	18.7	50.5%
930 Sherwin Pkwy., Buford, GA	Industrial	Dec 14, 2017	231,679	15.8	50.5%
One Nestle Crt., McDonough, GA	Industrial	Dec 14, 2017	395,195	25.9	50.5%
1915-B Fairview Dr., Dekalb, IL	Industrial	Dec 14, 2017	434,774	35.1	50.5%
13600 Independence Pkwy., Fort Worth, TX	Industrial	Dec 14, 2017	264,747	25.9	50.5%
950 Stelzer Rd., Columbus, OH	Industrial	Dec 14, 2017	242,785	14.5	50.5%
Total			2,083,714	\$148.9	

⁽¹⁾ Square feet and selling price are based on the ownership interest disposed.

⁽²⁾ U.S. dispositions have been translated to Canadian dollars at the exchange rate as at the date sold.

As at December 31, 2017, this joint venture had cash on hand of \$51.8 million and restricted cash of \$51.5 million which was primarily due to Section 1031 exchanges and U.S. tax planning relating to the nine properties sold during 2017. In January 2018, these funds were disbursed to the respective partners.

Hercules Project

H&R has a 31.7% non-managing ownership interest in 38.4 acres of land located in Hercules, CA, adjacent to San Pablo Bay, northeast of San Francisco, for the future development of residential rental units ("Hercules Project"). This waterfront, multi-phase, master-planned, in-fill mixed-use development surrounds a future intermodal transit centre, including train and ferry service, and is adjacent to an 11-acre waterfront future regional park. The initial investment to purchase the land was approximately U.S. \$10.0 million (at H&R's ownership interest). As at December 31, 2018, H&R's investment was approximately U.S. \$13.6 million. Phase 1 of the Hercules Project, known as "Block N – Creekside Apartments" will consist of 172 residential rental units, including lofts and townhomes and 13,979 square feet of ground level retail. The four-storey podium project sits on 2.2 acres over a one-level subterranean parking garage. Construction commenced in June 2018. The total budget for this phase is expected to be approximately U.S. \$82.1 million and construction financing of U.S. \$57.5 million was secured in July 2018, both at the 100% level. In addition, in July 2018, the Hercules Project obtained a U.S. \$14.0 million land loan, at the 100% level, secured against the remaining land parcels.

The Pearl

H&R has a 33.3% non-managing ownership interest in approximately 5.0 acres of land in Austin, TX for the future development of 383 residential rental units which will be known as "The Pearl". This residential development site is close to major technology employers including Apple, IBM, Oracle, and Samsung, as well as the University of Texas at Austin and downtown Austin. Construction commenced in October 2018. The total budget for this project is approximately U.S. \$69.7 million and construction financing of U.S. \$47.9 million was secured in October 2018, both at the 100% level. As at December 31, 2018, H&R's investment was approximately U.S. \$6.4 million.

Esterra Park

In April 2018, H&R acquired a 33.3% non-managing ownership interest in a residential development site zoned for 263 residential rental units for U.S. \$8.7 million, at the 100% level, located in Seattle, WA. This development, known as "Esterra Park", is part of a larger master planned community and is adjacent to Microsoft, Inc.'s headquarters, bus transit and future light rail which is expected to be completed in 2021. Construction commenced in November 2018. The total budget for this project is approximately U.S. \$95.7 million and construction financing of U.S. \$66.5 million was secured in October 2018, both at the 100% level. As at December 31, 2018, H&R's investment was approximately U.S. \$6.2 million.

Shoreline

In July 2018, H&R acquired a 30.9% non-managing ownership interest in the development of a 315 luxury residential rental unit tower with 6,450 square feet of retail space for a total of U.S. \$15.0 million, at the 100% level. Located in Long Beach, CA, "Shoreline Gateway" will become the tallest residential tower in Long Beach with 35 floors enjoying views overlooking the Pacific Ocean. Construction commenced in November 2018. The total budget for this

project is approximately U.S. \$227.1 million and construction financing of U.S. \$132.0 million was secured in December 2018, both at the 100% level. As at December 31, 2018, H&R's investment was approximately U.S. \$6.4 million.

Assets Classified as Held for Sale

As at December 31, 2018, H&R had a 50% ownership interest in one industrial property and a 100% ownership interest in one U.S. office property totalling \$110.9 million (December 31, 2017 - no properties) classified as held for sale.

Other Assets

(in thousands of Canadian dollars)	December 31, 2018	December 31, 2017
Mortgages receivable	\$96,909	\$153,211
Prepaid expenses and sundry assets	25,861	33,554
Restricted cash	12,872	25,311
Accounts receivable	12,401	15,739
Derivative instruments	5,445	6,374
	\$153,488	\$234,189

Mortgages receivable decreased by \$56.3 million to \$96.9 million as at December 31, 2018 primarily due to the River Landing and 2214 Bryan St. mortgages, which had a total balance of \$100.6 million as at December 31, 2017, being converted into 100% wholly-owned properties under development during 2018. This was partially offset by a new mortgage receivable of \$34.1 million issued as part of the sale of F1RST Tower in Calgary, AB and an increase of \$6.9 million relating to 2217 Bryan St., which had a balance outstanding of \$44.7 million as at December 31, 2018 (U.S. \$32.9 million).

Prepaid expenses and sundry assets decreased by \$7.7 million to \$25.9 million as at December 31, 2018 primarily due to the release of acquisition and new mortgage deposits in 2018.

Restricted cash decreased by \$12.4 million to \$12.9 million as at December 31, 2018 primarily due to \$13.3 million of funds held in escrow from the sale of a U.S. residential property in Q3 2017 being released in Q1 2018 due to a Section 1031 property exchange.

LIABILITIES AND UNITHOLDERS' EQUITY

	December 31, 2018	December 31, 2017
Debt to total assets per the REIT's Financial Statements ⁽¹⁾	44.6%	44.6%
Debt to total assets at the REIT's proportionate share ⁽¹⁾⁽²⁾	47.1%	46.6%
Unencumbered assets ⁽³⁾ (in thousands of Canadian dollars)	\$3,438,151	\$3,614,735
Unsecured debt ⁽³⁾ (in thousands of Canadian dollars)	\$2,069,419	\$2,144,992
Unencumbered asset to unsecured debt coverage ratio ⁽³⁾	1.66	1.69
Interest coverage ratio ⁽²⁾	3.03	3.00
Weighted average interest rate of debt ⁽¹⁾	3.8%	3.9%
Weighted average term to maturity of debt (in years) ⁽¹⁾	4.4	4.2

⁽¹⁾ Debt includes mortgages payable, debentures payable, unsecured term loans and lines of credit.

⁽²⁾ These are non-GAAP measures. See the "Non-GAAP Financial Measures" section of this MD&A.

⁽³⁾ Unencumbered assets are investment properties and properties under development without encumbrances for mortgages or lines of credit. Unsecured debt includes senior debentures, unsecured term loans and unsecured lines of credit.

Debt

H&R's debt consists of the following items:

(in thousands of Canadian dollars)	December 31, 2018	December 31, 2017
Mortgages payable	\$4,150,459	\$3,958,631
Debentures payable	1,613,040	1,852,790
Unsecured term loans	450,629	186,629
Lines of credit	331,944	495,567
	\$6,546,072	\$6,493,617

Mortgages Payable (in thousands of Canadian dollars)	REIT's Financial Statements	Plus: Equity accounted investments	REIT's proportionate share ⁽¹⁾
Opening balance, January 1, 2018	\$3,958,631	\$198,550	\$4,157,181
Principal repayments:			
Scheduled amortization on mortgages	(129,145)	(17,056)	(146,201)
Mortgage repayments	(407,763)	(4,760)	(412,523)
New mortgages	619,788	-	619,788
Effective interest rate accretion on mortgages	382	(467)	(85)
Change in foreign exchange rates	108,566	15,843	124,409
Closing balance, December 31, 2018	\$4,150,459	\$192,110	\$4,342,569

⁽¹⁾ The REIT's proportionate share is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

Future Mortgage Principal Payments	Periodic Amortized Principal (\$000's)	Principal on Maturity (\$000's)	Total Principal (\$000's)	% of Total Principal	Weighted Average Interest Rate on Maturity
2019	\$126,503	\$50,679	\$177,182	4.3	3.8%
2020	124,829	366,368	491,197	11.8	4.5%
2021	109,366	839,231	948,597	22.8	3.9%
2022	71,103	539,953	611,056	14.7	3.9%
2023	61,436	391,746	453,182	10.9	3.9%
Thereafter			1,483,616	35.5	
			4,164,830	100%	
Financing costs and mark-to-market adjustments arising on acquisitions ⁽¹⁾			(14,371)		
Total balance outstanding as at December 31, 2018			\$4,150,459		

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

The mortgages outstanding as at December 31, 2018 bear interest at a weighted average rate of 4.2% (December 31, 2017 - 4.3%) and mature between 2019 and 2032 (December 31, 2018 – maturing between 2018 and 2033). The weighted average term to maturity of the REIT's mortgages is 5.2 years (December 31, 2017 - 5.4 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".

<u>Debentures Payable</u>	(in thousands of Canadian dollars)
Opening balance, January 1, 2018	\$1,852,790
Series O and P Senior Debenture issuances	409,205
Senior Debenture redemptions	(557,500)
2020 Convertible Debenture redemption (HR.DB.D)	(99,582)
Conversion - 2020 Convertible Debentures (HR.DB.D)	(70)
Gain on change in fair value	(3,488)
Change due to foreign exchange rates	8,737
Accretion adjustment	2,948
Closing balance, December 31, 2018	\$1,613,040

<u>Unsecured Term Loans</u>	Maturity	December 31,
(in thousands of Canadian Dollars)	Date	2018
H&R unsecured term loan #1 ⁽¹⁾	March 17, 2021	\$200,629
H&R unsecured term loan #2 ⁽²⁾	January 6, 2026	250,000
		\$450,629

(1) The total facility as at December 31, 2018 is \$200.0 million, plus a 3.00% 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 2.56% per annum on U.S. \$130.0 million of the U.S. dollar denominated borrowing of this facility, maturing March 17, 2021.

(2) The REIT entered into an interest rate swap to fix the interest rate at 3.91% per annum, maturing January 6, 2026.

<u>Lines of Credit</u>	Maturity	Total	Amount	Outstanding	Available
(in thousands of Canadian Dollars)	Date	Facility	Drawn	Letters of Credit	Balance
Revolving unsecured operating lines of credit:					
H&R revolving unsecured line of credit #1	September 30, 2022	\$150,000	\$ -	\$ -	\$150,000
H&R revolving unsecured line of credit #2	January 31, 2023	200,000	-	-	200,000
H&R revolving unsecured line of credit #3	September 20, 2023	350,000	(5,750)	(2,330)	341,920
H&R revolving unsecured letter of credit facility		60,000	-	(23,439)	36,561
Sub-total		760,000	(5,750)	(25,769)	728,481
Revolving secured operating lines of credit⁽¹⁾					
H&R co-ownership revolving secured line of credit	September 30, 2019	3,514	(3,514)	-	-
H&R and CrestPSP revolving secured line of credit	April 30, 2020	62,500	(49,000)	(105)	13,395
Primaris revolving secured line of credit	July 1, 2020	300,000	(273,680)	-	26,320
Sub-total		366,014	(326,194)	(105)	39,715
December 31, 2018		\$1,126,014	(\$331,944)	(\$25,874)	\$768,196

(1) Secured by certain investment properties.

The lines of credit can be drawn in either Canadian or U.S. dollars and bear interest at a rate approximating the prime rate of a Canadian chartered bank.

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 Units to participating vendors upon redemption. These puttable instruments are classified as a liability under IFRS and are measured at fair value through profit or loss.

At the end of each period the fair value is determined by using the quoted prices of Units on the TSX as the exchangeable units are exchangeable into 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 Unit amount provided to holders of Units.

During the year ended December 31, 2018, there were 23,889 exchangeable units exchanged for Units (year ended December 31, 2017 - 584,386 exchanged for Units).

	Number of Exchangeable Units	Quoted Price of Units	Amounts per the REIT's Financial Statements (\$000's)
The following number of exchangeable units are issued and outstanding:			
As at December 31, 2018	15,955,541	\$20.65	\$329,482
As at December 31, 2017	15,979,430	\$21.36	\$341,321

A subsidiary of H&R also holds 0.4 million Units to mirror certain of these exchangeable units. Therefore, when the approximately 0.4 million exchangeable units are exchanged for Units, the number of outstanding Units will not increase. 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 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 combined federal and state tax rate of approximately 24.3% in 2018 (2017 - 37.5%). As a result of U.S. Tax Reform (further discussed on page 49), deferred income taxes have been measured based upon a 21.0% federal income tax rate.

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

(in millions of Canadian dollars)	December 31, 2018	December 31, 2017
Deferred tax assets:		
Net operating losses	\$22.6	\$6.9
Accounts payable and accrued liabilities	0.6	1.4
Other assets	1.4	2.3
	24.6	10.6
Deferred liabilities:		
Investment properties	284.0	256.5
Equity accounted investments	132.8	79.2
	416.8	335.7
Deferred tax liability	(\$392.2)	(\$325.1)

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. Deferred tax liability increased by \$67.1 million from \$325.1 million as at December 31, 2017 to \$392.2 million as at December 31, 2018 primarily due to a fair value increase to Jackson Park and the weakening of the Canadian dollar. The exchange rate as at December 31, 2018 was \$1.36 for each U.S. \$1.00 (December 31, 2017 - \$1.26).

Unitholders' Equity

Unitholders' equity increased by \$20.3 million from \$7,179.8 million as at December 31, 2017 to \$7,200.1 million as at December 31, 2018. The increase is primarily due to net income, other comprehensive income and proceeds from the issuance of Units under the Distribution Reinvestment and Unit Purchase Plan ("DRIP") and Unit Option Plan, partially offset by distributions paid to unitholders and Units repurchased and cancelled under the NCIB.

Units issued under the DRIP and Unit Purchase Plan previously resulted in an increase in the number of Units. In February 2018, the Trusts announced the suspension of the DRIP and Unit Purchase Plan until further notice, commencing with the March 2018 distribution.

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

NCIB

On December 14, 2018, the REIT received approval from the TSX for the renewal of its NCIB, allowing the REIT to purchase for cancellation up to a maximum of 15.0 million Units on the open market until the earlier of December 16, 2019 or the date on which the REIT purchased the maximum number of Units permitted under the NCIB.

With an increased focus on recycling capital into investments with higher risk-adjusted returns and the availability of excess capital generated from asset dispositions, H&R has taken advantage of the opportunity to acquire Units through its NCIB at what management believes to be significantly discounted prices. During the year ended December 31, 2018, under a previous NCIB, the Trusts purchased and cancelled 6,609,420 Units at a weighted average price of \$20.62 per Unit, for a total amount of \$136.3 million. During the year ended December 31, 2017, under a previous NCIB, the Trusts purchased and cancelled 755,420 Units at a weighted average price of \$21.10 per Unit, for a total cost of \$15.9 million.

Unitholders' Equity per Unit and NAV per Unit	December 31, 2018	December 31, 2017
Unitholders' equity	\$7,200,100	\$7,179,763
Exchangeable units	329,482	341,321
Deferred tax liability	392,214	325,131
Total	\$7,921,796	\$7,846,215
Units outstanding	285,678	291,320
Exchangeable units outstanding	15,522	15,546
Total	301,200	306,866
Unitholders' equity per Unit ⁽¹⁾	\$25.20	\$24.65
NAV per Unit ⁽²⁾	\$26.30	\$25.57
Unit Price	\$20.65	\$21.36

⁽¹⁾ Unitholders' equity per Unit is calculated by dividing Unitholders' equity by Units outstanding.

⁽²⁾ This is a Non-GAAP measure. See the "Non-GAAP Financial Measures" section of this MD&A.

RESULTS OF OPERATIONS

(in thousands of Canadian dollars)	Three months ended December 31		Year ended December 31	
	2018	2017	2018	2017
Property operating income:				
Rentals from investment properties	\$297,416	\$298,042	\$1,176,558	\$1,168,454
Property operating costs	(105,407)	(98,628)	(442,626)	(427,013)
	192,009	199,414	733,932	741,441
Net income from equity accounted investments	148,165	118,337	169,409	167,407
Other income	-	1,040	-	1,040
Finance costs - operations	(65,834)	(69,003)	(267,087)	(270,358)
Finance income	2,254	1,407	8,638	4,999
Trust expenses	(8,648)	(4,383)	(18,271)	(18,111)
Fair value adjustments on financial instruments	(17,332)	9,553	11,197	27,049
Fair value adjustment on real estate assets	(151,884)	3,984	(246,967)	1,796
Loss on sale of real estate assets	(267)	(70)	(19,602)	(7,729)
Gain (loss) on foreign exchange	-	2,263	6,886	(17,903)
Net income before income taxes	98,463	262,542	378,135	629,631
Income tax recovery (expense)	(37,348)	62,671	(40,217)	38,239
Net income	61,115	325,213	337,918	667,870
Other comprehensive income (loss):				
Items that are or may be reclassified subsequently to net income	139,335	10,253	194,876	(131,272)
Total comprehensive income attributable to unitholders	\$200,450	\$335,466	\$532,794	\$536,598

Net income before income taxes decreased by \$164.1 million and \$251.5 million for the three months and year ended December 31, 2018 compared to the respective 2017 periods, primarily due to non-cash items including fair value adjustments, gain (loss) on sale of real estate assets and foreign exchange. Excluding these items, net income before income taxes increased by \$21.1 million from \$246.8 million in Q4 2017 to \$267.9 million in Q4 2018 and by \$0.2 million from \$626.4 million for the year ended December 31, 2017 to \$626.6 million for the year ended December 31, 2018. The increase of \$21.1 million was primarily due to net income from equity accounted investments increasing by \$29.8 million for Q4 2018 compared to the respective 2017 period.

PROPERTY OPERATING INCOME

Property operating income consists of rentals from investment properties less property operating costs. Management believes that property operating income is a useful measure for investors in assessing the performance of H&R's properties before financing costs and other sources of income and expenditures which are not directly related to the day-to-day operations of a property. Same-Asset property operating income (cash basis) adjusts property operating income (including property operating income from equity accounted investments on a proportionately consolidated basis) to exclude straight-lining of contractual rent and realty taxes accounted for under IFRIC 21. "Same-Asset" refers to those properties owned by H&R for the entire two-year period ended December 31, 2018. It excludes acquisitions, business combinations, dispositions and transfers of properties under development to investment properties during the two-year period ended December 31, 2018 (collectively, "Transactions"). Management believes that this measure is useful for investors as it adjusts property operating income (including property operating income from equity accounted investments on a proportionately consolidated basis) for non-cash items which allows investors to better understand period-over-period changes due to occupancy, rental rates, realty taxes and operating costs, before evaluating the changes attributable to Transactions. Furthermore, it is also used as a key input in determining the value of investment properties.

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Rentals	\$297,416	\$298,042	(\$626)	\$1,176,558	\$1,168,454	\$8,104
Property operating costs	(105,407)	(98,628)	(6,779)	(442,626)	(427,013)	(15,613)
Property operating income	192,009	199,414	(7,405)	733,932	741,441	(7,509)
Adjusted for:						
Proportionate share of property operating income from equity accounted investments ⁽¹⁾	20,165	16,066	4,099	60,939	70,045	(9,106)
Straight-lining of contractual rent at the REIT's proportionate share ⁽¹⁾	1,175	605	570	3,683	5,373	(1,690)
Realty taxes in accordance with IFRIC 21 at the REIT's proportionate share ⁽¹⁾	(11,166)	(12,003)	837	-	-	-
Property operating income (cash basis) from Transactions at the REIT's proportionate share ⁽¹⁾	(15,196)	(23,436)	8,240	(67,728)	(94,737)	27,009
Same-Asset property operating income (cash basis) ⁽²⁾	\$186,987	\$180,646	\$6,341	\$730,826	\$722,122	\$8,704

⁽¹⁾ The REIT's proportionate share is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

⁽²⁾ Same-Asset property operating income (cash basis) is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

Property operating income per the REIT's Financial Statements decreased by \$7.4 million and \$7.5 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods primarily due to the sale of 63 U.S. retail properties in June 2018, partially offset by an increase in property operating income from Lantower Residential as a result of properties acquired throughout 2017 and 2018.

SEGMENTED INFORMATION

Operating Segments and Geographic Locations:

H&R has six reportable operating segments (Office, which also includes the REIT's head office, Primaris, H&R Retail, ECHO, Industrial and Residential (operating as Lantower Residential)), in two geographic 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 REIT. The CEO measures and evaluates the performance of H&R based on property operating income on a proportionately consolidated basis for the REIT's equity accounted investments.

H&R's Office portfolio is comprised of 35 properties throughout Canada and in select markets in the United States, aggregating 11.9 million square feet, at H&R's ownership interest, with an average lease term to maturity of 11.1 years as at December 31, 2018. The office portfolio is leased on a long-term basis to creditworthy tenants, with 81.2% of office revenue from tenants with investment grade ratings. With a very long average lease term and high credit tenants, this segment tends to generate very stable, gradual growth in property operating income driven by contractual rental rate increases, and to a lesser extent, lease renewals.

The Primaris segment consists of 30 properties throughout Canada aggregating 8.0 million square feet, at H&R's ownership interest, of enclosed shopping centres and multi-tenant retail plazas with an average lease term to maturity of 4.8 years as at December 31, 2018. Primaris continues to receive strong

tenant demand having completed 419 new lease and renewal transactions for the twelve months ended December 31, 2018. Occupancy was 84.9% as at December 31, 2018, rising to 87.5% including tenants committed, but not yet open.

H&R's Retail segment consists of 43 retail properties in Canada and 16 properties in the United States aggregating 2.8 million square feet, at H&R's ownership interest, with an average lease term to maturity of 8.4 years as at December 31, 2018.

As at December 31, 2018, ECHO segment is a portfolio of 230 grocery anchored shopping centres in select markets in the United States aggregating 3.2 million square feet, at H&R's ownership interest. The ECHO segment's average lease term to maturity was 10.1 years.

The Industrial segment consists of 84 industrial properties throughout Canada and six properties in the United States comprising 9.7 million square feet, at H&R's ownership interest, with an average lease term to maturity of 6.7 years as at December 31, 2018.

As at December 31, 2018, Lantower Residential segment consists of 22 residential properties in select markets in the United States comprising 7,271 residential rental units, at H&R's ownership interest. The investment policy of the Lantower Residential segment is to acquire properties in strong employment markets and where rents are increasing annually.

Further disclosure of segmented information for property operating income can be found in the REIT's Financial Statements.

(in thousands of Canadian dollars)	Property operating income						Occupancy	
	Three months ended December 31			Year ended December 31			As at December 31	
	2018	2017	% Change	2018	2017	% Change	2018	2017
Operating Segment:								
Office ⁽¹⁾	\$101,721	\$101,060	0.7%	\$389,856	\$389,147	0.2%	98.5%	97.0%
Primaris	42,674	41,814	2.1%	158,650	157,264	0.9%	84.9%	92.6%
H&R Retail	10,792	27,488	(60.7%)	66,104	96,584	(31.6%)	98.2%	97.4%
ECHO	15,275	13,623	12.1%	53,388	57,294	(6.8%)	95.5%	94.1%
Industrial	16,111	17,615	(8.5%)	62,884	71,254	(11.7%)	98.5%	98.4%
Lantower Residential	25,601	13,880	84.4%	63,989	39,943	60.2%	88.0%	90.0%
The REIT's proportionate share	212,174	215,480	(1.5%)	794,871	811,486	(2.0%)	94.0%	95.6%
Less: equity accounted investments	(20,165)	(16,066)	25.5%	(60,939)	(70,045)	(13.0%)	96.6%	95.6%
The REIT's Financial Statements	\$192,009	\$199,414	(3.7%)	\$733,932	\$741,441	(1.0%)	93.7%	95.6%
Geographic Location:								
Canada ⁽²⁾	\$138,238	\$137,152	0.8%	\$538,141	\$535,968	0.4%	94.6%	95.7%
United States ⁽²⁾	73,936	78,328	(5.6%)	256,730	275,518	(6.8%)	92.8%	97.4%
The REIT's proportionate share	212,174	215,480	(1.5%)	794,871	811,486	(2.0%)	94.0%	95.6%
Less: equity accounted investments	(20,165)	(16,066)	25.5%	(60,939)	(70,045)	(13.0%)	96.6%	95.6%
The REIT's Financial Statements	\$192,009	\$199,414	(3.7%)	\$733,932	\$741,441	(1.0%)	93.7%	95.6%

⁽¹⁾ Includes the REIT's head office.

⁽²⁾ Property operating income relating to corporate entities has been included in Canada for Canadian properties and the United States for U.S. properties.

Property operating income at the REIT's proportionate share for the three months and year-ended December 31, 2018 decreased by 1.5% and 2.0%, respectively, due to the following: (i) the H&R Retail segment selling 63 U.S. retail properties in June 2018; (ii) the Industrial segment selling nine U.S. properties and six Canadian properties throughout 2017 and 2018; and (iii) the ECHO segment (United States) receiving lease termination fees in Q3 2017 of \$5.5 million at H&R's ownership interest from tenants who terminated their leases which negatively impacted H&R's year-over-year results. This was partially offset by an increase in property operating income from the Lantower Residential segment (United States) which was due to properties acquired throughout 2017 and 2018.

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The following segmented information has been presented at the REIT's proportionate share which is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

(in thousands of Canadian dollars)	Same-Asset property operating income (cash basis) ⁽¹⁾						Occupancy (same asset)	
	Three months ended December 31			Year ended December 31			As at December 31	
	2018	2017	% Change	2018	2017	% Change	2018	2017
Operating Segment:								
Office ⁽²⁾	\$98,545	\$95,125	3.6%	\$388,639	\$381,594	1.8%	98.5%	98.3%
Primaris	41,326	41,222	0.3%	156,085	154,831	0.8%	84.9%	92.6%
H&R Retail	10,951	10,555	3.8%	42,905	42,238	1.6%	98.2%	97.7%
ECHO	12,657	11,426	10.8%	48,527	50,517	(3.9%)	95.3%	94.6%
Industrial	15,292	14,560	5.0%	59,557	59,315	0.4%	98.4%	98.7%
Lantower Residential	8,216	7,758	5.9%	35,113	33,627	4.4%	92.7%	93.6%
The REIT's proportionate share (page 23)	\$186,987	\$180,646	3.5%	\$730,826	\$722,122	1.2%	94.9%	96.5%
Geographic Location:								
Ontario ⁽³⁾	\$64,136	\$62,264	3.0%	\$250,569	\$244,329	2.6%	95.5%	96.0%
Alberta	51,932	51,390	1.1%	203,823	203,190	0.3%	93.8%	97.5%
Other Canada	21,425	20,892	2.6%	81,229	80,766	0.6%	93.1%	96.6%
Total – Canada	137,493	134,546	2.2%	535,621	528,285	1.4%	94.5%	96.6%
United States ⁽³⁾	49,494	46,100	7.4%	195,205	193,837	0.7%	96.1%	96.2%
The REIT's proportionate share (page 23)	\$186,987	\$180,646	3.5%	\$730,826	\$722,122	1.2%	94.9%	96.5%
United States in U.S. dollars:								
Office ⁽²⁾	\$17,948	\$17,758	1.1%	\$71,817	\$70,729	1.5%	100.0%	100.0%
H&R Retail	2,562	2,522	1.6%	10,277	9,950	3.3%	100.0%	100.0%
ECHO	9,522	9,019	5.6%	37,328	38,859	(3.9%)	95.3%	94.6%
Industrial	1,012	911	11.1%	3,726	3,701	0.7%	100.0%	100.0%
Lantower Residential	6,159	6,120	0.6%	27,010	25,867	4.4%	92.7%	93.6%
U.S. total in U.S. dollars	\$37,203	\$36,330	2.4%	\$150,158	\$149,106	0.7%	96.1%	96.2%

⁽¹⁾ Same-Asset property operating income (cash basis) is a non-GAAP measure defined in the "Non-GAAP Financial Measures" section of this MD&A.

⁽²⁾ Includes the REIT's head office.

⁽³⁾ 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 the Office segment increased by 3.6% and 1.8%, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods, primarily due to an increase in occupancy, contractual rental escalations and renewed leases at higher rents from H&R's Ontario Office properties.

Same-Asset property operating income (cash basis) from the ECHO segment in U.S. dollars, increased by 5.6% for the three months ended December 31, 2018 compared to the respective 2017 period primarily due to an increase in occupancy and contractual rental escalations. Same-Asset property operating income (cash basis) from the ECHO segment in U.S. dollars, decreased by 3.9% for the year ended December 31, 2018 compared to the respective 2017 period, primarily due to ECHO receiving lease termination fees in Q3 2017 of U.S. \$2.4 million at H&R's ownership interest from two tenants who terminated their leases, partially offset by an increase in occupancy and contractual rental escalations.

Same-Asset property operating income (cash basis) from the Industrial segment increased by 5.0% for the three months ended December 31, 2018 compared to the respective 2017 period primarily due to a new tenant paying higher rent, as well as lease termination payments received for two U.S. properties in 2018.

Same-Asset property operating income (cash basis) from the Lantower Residential segment in U.S. dollars increased 0.6% and 4.4%, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods primarily due to rental growth, partially offset by an increase in property taxes to five properties which are currently under appeal. Subsequent to December 31, 2018, Lantower Residential has successfully appealed two of the five properties and is expecting a refund of U.S. \$0.2 million in Q1 2019.

Same-Asset property operating income (cash basis) from the Primaris segment increased by 0.3% and 0.8%, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods, primarily due to new lease commencements for former Target space, offset by the impact of Sears Canada's 2017 bankruptcy filing.

Redevelopment of the former Sears stores has commenced, however, since each store is part of an existing property, they have not been transferred to properties under development. During the three months and year ended December 31, 2018, H&R capitalized \$0.5 million and \$1.1 million, respectively, of property operating costs and \$1.0 million and \$2.8 million, respectively, of finance costs attributable to the former Target and Sears space. Management expects positive rental growth from Primaris as the lease-up of the former Target and Sears space is expected to generate approximately \$1.0 million, \$5.4 million and \$3.0 million of additional annual base rent in 2019, 2020 and 2021, respectively.

The Primaris portfolio all store and same store sales were relatively stable for the rolling 12 months ended December 31, 2018 compared to the respective 2017 period. Management monitors tenant sales and actively pursues the replacement of tenants experiencing declining sales trends. Remerchandising at many of the properties continues to impact sales as the replacement of tenants may have a negative impact in the short term but a positive impact in the long term.

Primaris Enclosed Shopping Centres	Location	All Store Sales (in thousands of Canadian dollars)			Same Store Sales (per square foot)		
		Rolling 12 month ended December 31			Rolling 12 month ended December 31		
		2018	2017	% Change	2018	2017	% Change
Cataraqui Town Centre ⁽¹⁾⁽²⁾	Kingston, ON	\$88,315	\$86,340	2.3%	\$526	\$527	(0.2%)
Dufferin Mall	Toronto, ON	116,551	121,296	(3.9)	682	699	(2.4)
Grant Park ⁽¹⁾	Winnipeg, MB	26,367	26,662	(1.1)	458	463	(1.1)
Kildonan Place ⁽¹⁾⁽²⁾	Winnipeg, MB	80,923	80,876	0.1	538	539	(0.2)
McAllister Place ⁽¹⁾⁽²⁾	Saint John, NB	55,427	53,280	4.0	467	461	1.3
Medicine Hat Mall ⁽²⁾	Medicine Hat, AB	49,036	50,572	(3.0)	408	433	(5.8)
Orchard Park Shopping Centre ⁽²⁾	Kelowna, BC	171,110	167,793	2.0	702	688	2.0
Park Place Shopping Centre ⁽²⁾	Lethbridge, AB	81,669	84,789	(3.7)	599	609	(1.6)
Peter Pond Mall	Fort McMurray, AB	71,551	71,857	(0.4)	713	725	(1.7)
Place d'Orleans ⁽¹⁾	Orleans, ON	90,472	94,301	(4.1)	509	515	(1.2)
Place du Royaume ⁽¹⁾	Chicoutimi, QC	87,426	89,298	(2.1)	433	437	(0.9)
Regent Mall ⁽¹⁾⁽²⁾	Fredericton, NB	80,841	81,109	(0.3)	585	587	(0.3)
Sherwood Park Mall	Sherwood Park, AB	42,751	46,079	(7.2)	479	505	(5.1)
St. Albert Centre	St. Albert, AB	34,025	31,365	8.5	495	479	3.3
Stone Road Mall ⁽²⁾	Guelph, ON	111,664	112,683	(0.9)	678	685	(1.0)
Sunridge Mall	Calgary, AB	93,839	96,237	(2.5)	525	518	1.4
Total⁽³⁾⁽⁴⁾		\$1,281,967	\$1,294,537	(1.0%)	\$565	\$568	(0.5%)

⁽¹⁾ All store sales and same-store sales have been reported as if Primaris owned 100% of these enclosed shopping centres.

⁽²⁾ Location previously had a Sears store.

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

⁽⁴⁾ Excludes Northland Village which is slated for redevelopment.

NET INCOME, FFO AND AFFO FROM EQUITY ACCOUNTED INVESTMENTS⁽¹⁾

The following table provides a breakdown of H&R's net income from equity accounted investments which is further reconciled to FFO and AFFO from equity accounted investments:

(in thousands of Canadian dollars)	Three Months Ended December 31		Year ended December 31	
	2018	2017	2018	2017
Rentals from investment properties	\$26,937	\$20,642	\$86,533	\$88,458
Property operating costs	(6,772)	(4,576)	(25,594)	(18,413)
Property operating income	20,165	16,066	60,939	70,045
Net income from equity accounted investments	130	81	406	587
Finance cost - operations	(9,104)	(4,332)	(25,511)	(18,807)
Finance income	681	109	1,311	403
Trust expenses	(904)	(565)	(2,894)	(2,291)
Fair value adjustments on financial instruments	(2,037)	3,402	3,236	4,222
Fair value adjustment on real estate assets	139,726	103,834	133,520	114,996
Gain (loss) on sale of real estate assets	271	89	(20)	(677)
Income tax expense	-	(61)	(46)	(185)
Non-controlling interest	(763)	(286)	(1,532)	(886)
Net income from equity accounted investments	148,165	118,337	169,409	167,407
Realty taxes in accordance with IFRIC 21	(1,252)	(1,306)	-	-
Fair value adjustments on real estate assets and financial instruments	(137,689)	(107,236)	(136,756)	(119,218)
Gain (loss) on sale of real estate assets	(271)	(89)	20	677
Incremental leasing costs	48	63	231	203
Notional interest capitalization ⁽²⁾	1,051	3,342	7,827	13,799
FFO from equity accounted investments	10,052	13,111	40,731	62,868
Straight-lining of contractual rent	(181)	(289)	(430)	(1,445)
Capital expenditures	(694)	(3,016)	(2,754)	(11,120)
Leasing expenses and tenant inducements	(1,122)	(1,787)	(2,730)	(2,079)
Incremental leasing costs	(48)	(63)	(231)	(203)
AFFO from equity accounted investments	\$8,007	\$7,956	\$34,586	\$48,021

⁽¹⁾ Each of these line items represent the REIT's proportionate share of equity accounted investments which are reconciled to net income from equity accounted investments per the REIT's Financial Statements, which is further reconciled to FFO and AFFO from equity accounted investments. These are non-GAAP measures defined in the "Non-GAAP Financial Measures" section of this MD&A.

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

Property operating income from equity accounted investments for the three months ended December 31, 2018 compared to the respective 2017 period increased by \$4.1 million primarily due to occupancy commencing in Jackson Park. Property operating income from equity accounted investments for the year ended December 31, 2018 compared to the respective 2017 period decreased by \$9.1 million primarily due to the sale of nine U.S. industrial properties throughout 2017 and ECHO receiving lease termination fees of \$5.5 million at H&R's ownership interest from four tenants who terminated their leases in Q3 2017. This decrease was partially offset by an increase in property operating income from Jackson Park.

Net income from equity accounted investments for the three months and year ended December 31, 2018 compared to the respective 2017 periods increased by \$29.8 million and \$2.0 million, respectively, primarily due to the fair value of Jackson Park increasing by U.S. \$107.7 million at H&R's ownership interest which was supported by an independent third party appraisal. This increase for the year ended December 31, 2018 compared to the respective 2017 period was offset by a decrease in property operating income from equity accounted investments and higher finance costs from Jackson Park.

FFO from equity accounted investments for the three months and year ended December 31, 2018 compared to the respective 2017 periods decreased by \$3.1 million and \$22.1 million, respectively, primarily due to Jackson Park which is in lease-up and the sale of nine U.S. industrial properties in 2017. FFO from equity accounted investments for the year ended December 31, 2018 compared to the respective 2017 period further decreased due to ECHO receiving lease termination payments of \$5.5 million at H&R's ownership interest from four tenants who terminated their leases in Q3 2017.

INCOME AND EXPENSE ITEMS

The income and expense items section of this MD&A provides management's commentary on the Results of Operations per the REIT's Financial Statements.

<i>Finance Costs</i> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Finance costs – operations:						
Contractual interest on mortgages payable	(\$42,271)	(\$43,083)	\$812	(\$165,855)	(\$174,492)	\$8,637
Contractual interest on debentures payable	(14,355)	(16,095)	1,740	(61,213)	(62,565)	1,352
Effective interest rate accretion	(1,073)	(920)	(153)	(3,666)	(1,808)	(1,858)
Bank interest and charges	(5,639)	(3,588)	(2,051)	(20,709)	(11,877)	(8,832)
Exchangeable unit distributions	(5,511)	(5,464)	(47)	(22,050)	(22,254)	204
	(68,849)	(69,150)	301	(273,493)	(272,996)	(497)
Capitalized interest	3,015	147	2,868	6,406	2,638	3,768
	(65,834)	(69,003)	3,169	(267,087)	(270,358)	3,271
Finance income	2,254	1,407	847	8,638	4,999	3,639
Fair value adjustments on financial instruments	(17,332)	9,553	(26,885)	11,197	27,049	(15,852)
	(\$80,912)	(\$58,043)	(\$22,869)	(\$247,252)	(\$238,310)	(\$8,942)

The decrease in contractual interest on mortgages payable of \$0.8 million and \$8.6 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods is primarily due to the repayment of mortgages upon maturity and sale of investment properties.

The decrease in contractual interest on debentures payable of \$1.7 million and \$1.4 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods is primarily due to the repayment of an aggregate of \$657.1 million of senior and convertible debentures since January 2018 as well as a decrease in contractual interest rates. This was offset by the issuance of an aggregate of \$420.0 million of senior debentures since January 2018.

The increase in bank interest and charges of \$2.1 million and \$8.8 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods is primarily due to unsecured term loans and lines of credit increasing to \$782.6 million as at December 31, 2018 compared to \$682.2 million as at December 31, 2017, as well as an increase in interest rates.

The increase in capitalized interest of \$2.9 million and \$3.8 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods is primarily due to the increase in funding for the River Landing development.

The change in fair value adjustments on financial instruments of (\$26.9 million) and (\$15.9 million), respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods is primarily due to the following non-cash items: (i) gain (loss) on fair value of exchangeable units and convertible debentures, which are fair valued at the end of each reporting period based on quoted prices of Units on the TSX and (ii) gain (loss) on derivative instruments which are marked-to-market at the end of each reporting period, both of which result in an unrealized gain or loss recorded in net income. In addition, during the year ended December 31, 2017, H&R realized a one-time gain of \$8.9 million on the sale of an investment previously classified as held for trading.

<i>Trust Expenses</i> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Other expenses	(\$4,369)	(\$3,700)	(\$669)	(\$15,858)	(\$13,242)	(\$2,616)
Unit-based compensation recovery (expense)	(4,279)	(683)	(3,596)	(2,413)	(4,869)	2,456
Trust expenses	(\$8,648)	(\$4,383)	(\$4,265)	(\$18,271)	(\$18,111)	(\$160)

Other expenses are primarily comprised of salaries, professional fees, trustee fees and corporate overhead expenses. Other expenses increased by \$0.7 million and \$2.6 million, respectively, for the three months and year ended December 31, 2018 compared the respective 2017 periods primarily due to higher salaries and corporate expenses from Primaris and Lantower Residential.

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 their fair value as defined by IFRS 2 based on the quoted prices of Units on the TSX. The fair value adjustment to unit-based compensation was (\$3.2 million) and \$0.3 million, respectively, for the three months ended December 31, 2018 and 2017 and \$1.5 million and (\$1.3 million), respectively, for the year ended December 31, 2018 and 2017.

Fair Value Adjustment on Real Estate Assets

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Fair value adjustment on real estate assets	(\$151,884)	\$3,984	(\$155,868)	(\$246,967)	\$1,796	(\$248,763)

H&R records its real estate assets at fair value. Fair value adjustments on real estate assets are determined based on the movement of various parameters, including changes in capitalization rates, discount rates and future cash flow projections. The fair value adjustment on real estate assets for the three months and year ended December 31, 2018 of (\$151.9 million) and (\$247.0 million), respectively, is primarily due to fair value decreases to the Primaris segment in Q1 and Q4 2018 as a result of a changing retail landscape and increased competition in the retail industry. The weighted overall average capitalization rate for the Primaris segment was 6.00% as at December 31, 2018 compared to 5.54% as at December 31, 2017. Changes in fair value can also occur due to the following factors: (i) realty taxes in accordance with IFRIC 21, (ii) capital and tenant expenditures, (iii) redevelopment costs, and (iv) straight-lining of contractual rent and these factors also contributed to the negative fair value adjustment on real estate assets for both the three months and year ended December 31, 2018.

Loss on Sale of Real Estate Assets

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Loss on sale of real estate assets	(\$267)	(\$70)	(\$197)	(\$19,602)	(\$7,729)	(\$11,873)

During the year ended December 31, 2018, H&R sold 64 retail properties, one Primaris property, a 50% ownership interest in four industrial properties, a 75% ownership interest in one industrial property and a 50% ownership interest in one office property and recognized a loss on sale of real estate assets of \$19.6 million (Q4 2018 - loss on sale of \$0.3 million). The loss on sale of real estate assets for the year ended December 31, 2018 of \$19.6 million is primarily due to mortgage prepayment penalties and closing costs relating to the 63 U.S. retail properties sold in June 2018.

During the year ended December 31, 2017, H&R sold three retail properties, a 50% ownership interest in two Primaris properties, a 50% interest in one industrial property, one residential property and an office property and recognized a loss on sale of real estate assets of \$7.7 million (Q4 2017 - \$0.1 million). The loss on sale of real estate assets includes mark-to-market adjustments of \$3.5 million on the purchaser's assumption of a mortgage.

For a list of property dispositions, please refer to page 12 in this MD&A.

Gain (loss) on Foreign Exchange

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Gain (loss) on foreign exchange	\$ -	\$2,263	(\$2,263)	\$6,886	(\$17,903)	\$24,789

The amounts in the table above were recorded by Finance Trust due to the translation of the U.S. Holdco Notes (a note payable previously owing by U.S. Holdco to Finance Trust) into Canadian dollars prior to the termination of Finance Trust on August 31, 2018. The U.S. Holdco Notes were previously eliminated in the Trusts' Financial Statements. However, the related foreign exchange difference was not eliminated on combination as it flowed through net income of Finance Trust and other comprehensive income of the REIT as U.S. Holdco is a subsidiary of the REIT and formed part of its net investment in the United States. U.S. Holdco was not a subsidiary of Finance Trust. The exchange rate as at September 30, 2018 was \$1.29 for each U.S. \$1.00 (December 31, 2017 - \$1.26). The exchange rate as at December 31, 2017 was \$1.26 for each U.S. \$1.00 (September 30, 2017 - \$1.25, December 31, 2016 - \$1.34).

<i>Income Tax Recovery (Expense)</i> (in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Income tax computed at the Canadian statutory rate of nil applicable to H&R for 2018 and 2017	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Current U.S. income taxes	(142)	(376)	234	(760)	(1,538)	778
Deferred income taxes recovery (expense) applicable to U.S. Holdco						
Impact of U.S. Tax Reform	-	87,970	(87,970)	-	87,970	(87,970)
Other	(37,206)	(24,923)	(12,283)	(39,457)	(48,193)	8,736
Income tax recovery (expense) in the determination of net income	(\$37,348)	\$62,671	(\$100,019)	(\$40,217)	\$38,239	(\$78,456)

H&R is generally subject to tax in Canada under the Income Tax Act (Canada) ("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 recovery (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 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 and losses can be realized. Deferred income tax expense increased by \$100.3 million and \$79.2 million for the three months and year ended December 31, 2018 compared to the respective 2017 periods primarily due to the enactment of U.S. Tax Reform in Q4 2017 and a fair value increase to Jackson Park in Q4 2018.

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 are also recognized in equity.

As at December 31, 2018, H&R had net deferred tax liabilities of \$392.2 million (December 31, 2017 - \$325.1 million) primarily related to taxable temporary differences between the tax and accounting bases of U.S. real estate assets.

FUNDS FROM OPERATIONS AND ADJUSTED FUNDS FROM OPERATIONS

The REIT presents its FFO and AFFO calculations in accordance with REALpac's February 2018 *White Paper on Funds From Operations and Adjusted Funds From Operations for IFRS*. FFO, AFFO and payout ratio per Unit as a % of FFO are non-GAAP measures defined in the "Non-GAAP Financial Measures" section of this MD&A.

FFO AND AFFO (in thousands of Canadian dollars except per Unit amounts)	Three Months Ended December 31		Year ended December 31	
	2018	2017	2018	2017
Net income per the REIT's Financial Statements	\$61,115	\$325,213	\$337,918	\$667,870
Realty taxes in accordance with IFRIC 21	(9,914)	(10,697)	-	-
FFO adjustments from equity accounted investments (page 27)	(138,113)	(105,226)	(128,678)	(104,539)
Exchangeable unit distributions	5,511	5,464	22,050	22,254
Fair value adjustments on real estate assets and financial instruments ⁽¹⁾	169,216	(13,537)	235,770	(19,910)
Fair value adjustment to unit-based compensation	3,291	(317)	(1,493)	1,307
Loss on sale of real estate assets	267	70	19,602	7,729
(Gain) loss on foreign exchange	-	(2,263)	(6,886)	17,903
Deferred income taxes applicable to U.S. Holdco	37,206	(63,047)	39,457	(39,777)
Incremental leasing costs	1,891	1,787	7,956	7,253
FFO	\$130,470	\$137,447	\$525,696	\$560,090
Straight-lining of contractual rent	1,356	894	4,113	6,818
Capital expenditures	(23,330)	(14,874)	(57,825)	(51,845)
Leasing expenses and tenant inducements	(9,575)	(9,394)	(32,441)	(28,722)
Incremental leasing costs	(1,891)	(1,787)	(7,956)	(7,253)
AFFO adjustments from equity accounted investments (page 27)	(2,045)	(5,155)	(6,145)	(14,847)
AFFO	\$94,985	\$107,131	\$425,442	\$464,241
Weighted average number of Units (in thousands of basic Units adjusted for conversion of exchangeable Units) ⁽²⁾	301,200	306,629	302,605	304,462
Diluted weighted average number of Units (in thousands of Units) for the calculation of FFO ⁽²⁾⁽³⁾⁽⁴⁾⁽⁵⁾⁽⁶⁾	301,881	311,836	304,131	312,433
Diluted weighted average number of Units (in thousands of Units) for the calculation of AFFO ⁽²⁾⁽³⁾⁽⁴⁾⁽⁶⁾	301,881	307,595	304,131	312,433
FFO per basic Unit (adjusted for conversion of exchangeable units)	\$0.433	\$0.448	\$1.737	\$1.840
FFO per diluted Unit	\$0.432	\$0.445	\$1.732	\$1.821
AFFO per basic Unit (adjusted for conversion of exchangeable units)	\$0.315	\$0.349	\$1.406	\$1.525
AFFO per diluted Unit	\$0.315	\$0.348	\$1.403	\$1.514
Distributions per Unit	\$0.345	\$0.345	\$1.380	\$1.380
Payout ratio per Unit as a % of FFO	79.7%	77.0%	79.4%	75.0%

- (1) During the year ended December 31, 2017, H&R realized a one-time gain of \$8.9 million on the sale of an investment classified as held for trading which has not been added back above.
- (2) For the three months and year ended December 31, 2018, included in the weighted average and diluted weighted average number of Units are exchangeable units of 15,540,024 and 15,544,685, respectively. For the three months and year ended December 31, 2017, included in the weighted average and diluted weighted average number of Units are exchangeable units of 15,546,256 and 15,674,341, respectively.
- (3) For the three months and year ended December 31, 2018, included in the determination of diluted FFO and AFFO with respect to H&R's Unit Option Plan and Incentive Unit Plan are 681,054 Units and 701,032 Units, respectively. For the three months and year ended December 31, 2017, included in the determination of diluted FFO and AFFO with respect to H&R's Unit Option Plan and Incentive Unit Plan are 966,301 Units and 1,555,465 Units, respectively.
- (4) The 2020 convertible debentures are dilutive for the year ended December 31, 2018. Therefore, debenture interest of \$1.1 million is added to FFO and AFFO and 824,855 Units are included in the diluted weighted average number of Units outstanding for this period.
- (5) The 2020 convertible debentures are dilutive for the three months ended December 31, 2017. Therefore, debenture interest of \$1.5 million is added to FFO and 4,240,511 Stapled Units are included in the diluted weighted average number of Stapled Units outstanding for this period.
- (6) The 2018 and 2020 convertible debentures are dilutive for the year ended December 31, 2017. Therefore, debenture interest of \$8.8 million is added to FFO and AFFO and 6,416,361 Units are included in the diluted weighted average number of Units outstanding for this period.

FFO for the three months and year ended December 31, 2018 compared to the respective 2017 periods decreased by \$7.0 million and \$34.4 million, respectively, primarily due to lower property operating income as a result of property dispositions and lower notional interest capitalization due to occupancy commencing at Jackson Park. FFO further decreased for the year ended December 31, 2018 compared to the respective 2017 period due to a one-time gain of \$8.9 million on the sale of an investment classified as held for trading recorded in 2017.

AFFO for the three months and year ended December 31, 2018 compared to the respective 2017 periods decreased by \$12.1 million and \$38.8 million, respectively, primarily due to the following: (i) a decrease in FFO explained above; (ii) higher capital expenditures in Q4 2018 compared to Q4 2017; and (iii) higher leasing expenses and tenant inducements for the year ended December 2018 compared to the respective 2017 period.

Included in FFO at the REIT's proportionate share 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		
	2018	2017	Change	2018	2017	Change
Lease termination fees	\$705	\$4	\$701	\$2,631	\$5,989	(\$3,358)
Mortgage prepayment penalties	(153)	(404)	251	(153)	(952)	799
Jackson Park FFO loss during lease-up	(608)	(708)	100	(4,533)	(708)	(3,825)
Notional interest capitalization (Jackson Park)	835	3,342	(2,507)	7,511	13,799	(6,288)
Adjustment to straight-lining of contractual rent	-	(252)	252	-	(5,892)	5,892
Other income	-	1,040	(1,040)	-	1,040	(1,040)
One-time gain realized on sale of investment	-	-	-	-	8,935	(8,935)
	\$779	\$3,022	(\$2,243)	\$5,456	\$22,211	(\$16,755)

Excluding the above items, FFO would have been \$129.7 million for the three months ended December 31, 2018 (Q4 2017 - \$134.4 million) and \$0.43 per basic Unit (Q4 2017 - \$0.44 per basic Unit). For the year ended December 31, 2018, FFO would have been \$520.2 million (Q4 2017 - \$537.9 million) and \$1.72 per basic Unit (Q4 2017 - \$1.77 per basic Unit).

Included in AFFO at the REIT's proportionate share 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		
	2018	2017	Change	2018	2017	Change
Additional current year capital expenditure recoveries net of capital expenditures	\$1,003	\$632	\$371	\$852	\$2,297	(\$1,445)
Lease termination fees	705	4	701	2,631	5,989	(3,358)
Mortgage prepayment penalties	(153)	(404)	251	(153)	(952)	799
Jackson Park AFFO loss during lease-up	(608)	(708)	100	(4,533)	(708)	(3,825)
Notional interest capitalization (Jackson Park)	835	3,342	(2,507)	7,511	13,799	(6,288)
Other income	-	1,040	(1,040)	-	1,040	(1,040)
One-time gain realized on sale of investment	-	-	-	-	8,935	(8,935)
Capital expenditures	(24,024)	(17,890)	(6,134)	(60,579)	(62,965)	2,386
Leasing expenses and tenant inducements	(10,697)	(11,181)	484	(35,171)	(30,801)	(4,370)
	(\$32,939)	(\$25,165)	(\$7,774)	(\$89,442)	(\$63,366)	(\$26,076)

Excluding the above items, AFFO would have been \$127.9 million for the three months ended December 31, 2018 (Q4 2017 - \$132.3 million) and \$0.42 per basic Unit (Q4 2017 - \$0.43 per basic Unit). For the year ended December 31, 2018, AFFO would have been \$514.9 million (Q4 2017 - \$527.6 million) and \$1.70 per basic Unit (Q4 2017 - \$1.73 per basic Unit).

Capital and Tenant Expenditures

The following is a breakdown of H&R's capital expenditures and tenant expenditures (leasing expenditures and tenant inducements) by operating segment:

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Office:						
Capital expenditures	\$10,207	\$10,307	(\$100)	\$24,855	\$33,675	(\$8,820)
Leasing expenditures and tenant inducements	4,016	5,400	(1,384)	12,439	17,179	(4,740)
Primaris:						
Capital expenditures	9,476	2,924	6,552	22,965	10,264	12,701
Leasing expenditures and tenant inducements	3,292	2,777	515	8,564	8,822	(258)
H&R Retail:						
Capital expenditures	98	-	98	1,037	1,065	(28)
Leasing expenditures and tenant inducements	1,781	705	1,076	3,658	1,170	2,488
ECHO:						
Capital expenditures	694	752	(58)	2,754	2,366	388
Leasing expenditures and tenant inducements	858	914	(56)	2,175	1,206	969
Industrial:						
Capital expenditures	167	2,343	(2,176)	1,619	9,694	(8,075)
Leasing expenditures and tenant inducements	750	1,385	(635)	8,335	2,424	5,911
Lantower Residential:						
Capital expenditures	3,382	1,564	1,818	7,349	5,901	1,448
Leasing expenditures and tenant inducements	-	-	-	-	-	-
Total at the REIT's proportionate share	34,721	29,071	5,650	95,750	93,766	1,984
Less: equity accounted investments	(1,816)	(4,803)	2,987	(5,484)	(13,199)	7,715
Total per the REIT's Financial Statements ⁽¹⁾	\$32,905	\$24,268	\$8,637	\$90,266	\$80,567	\$9,699

(1) Equal to the sum of capital expenditures and leasing expenses and tenant inducements per the REIT's Financial Statements.

During 2017 and 2018, H&R's largest office project was at 160 Elgin St., in Ottawa, ON at which a complete renovation of the lobby and retail space was substantially completed. H&R expects to spend an additional \$4.9 million to complete this project. Total capital and tenant expenditures at 160 Elgin St., in Ottawa, ON during the three months and year ended December 31, 2018 were \$2.0 million and \$8.7 million, respectively, compared to the three months and year ended December 31, 2017 of \$6.7 million and \$27.3 million, respectively. Capital expenditures from the Office segment for the three months and year ended December 31, 2018 also included \$4.7 million and \$4.9 million, respectively, relating to an entrance and lobby renovation, washroom upgrades and electrical upgrades at Atrium in Toronto, ON.

The largest capital expenditures from the Primaris segment for the three months and year ended December 31, 2018 included: (i) a food court re-location at Place d'Orleans in Orleans, ON; (ii) backfilling a former Sobey's location with a new Marshalls/Home Sense store at McAllister Place in Saint John, NB; and (iii) backfilling a former Safeway location with a new Marshalls store at Garden City Square in Winnipeg, MB.

Tenant expenditures from the H&R Retail segment for the three months and year ended December 31, 2018 included a \$1.8 million tenant allowance paid as part of a 15-year lease renewal to a single tenant at an Ontario retail property occupying 118,526 square feet.

Capital expenditures from the Industrial segment for the three months and year ended December 31, 2017 included \$2.6 million and \$9.1 million, respectively, which related to re-paving work being completed at two U.S. industrial properties which were subsequently sold in December 2017. Tenant expenditures from the Industrial segment for the year ended December 31, 2018 included a \$4.6 million tenant allowance paid as part of a 5-year lease renewal to a single tenant at an Ontario industrial property occupying 369,051 square feet, at H&R's ownership interest.

LIQUIDITY AND CAPITAL RESOURCES

Cash Distributions

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

(in thousands of Canadian dollars)	Three months ended December 31, 2018	Year ended December 31, 2018	Year ended December 31, 2017	Year ended December 31, 2016
Cash provided by operations	\$122,239	\$462,123	\$479,239	\$424,196
Net income	61,115	337,918	667,870	388,745
Total distributions ⁽¹⁾	98,404	395,568	397,908	381,106
Excess cash provided by operations over total distributions	23,835	66,555	81,331	43,090
Excess (shortfall) of net income over total distributions	(37,289)	(57,650)	269,962	7,639

⁽¹⁾ Total distributions include cash distributions to unitholders and Unit distributions issued under the DRIP. In February 2018, the Trusts announced the suspension of the DRIP until further notice, commencing with the March 2018 distribution. Following the Reorganization, the DRIP remains suspended until further notice.

Unit distributions issued under the DRIP were nil and \$16.6 million, respectively, for the three months and year ended December 31, 2018 (December 31, 2017 - \$107.4 million, December 31, 2016 - \$106.8 million), which are non-cash distributions. Unit distributions issued under the DRIP previously resulted in an increase in the number of Units outstanding, however, the suspension of the DRIP commencing with the March 2018 distribution, has resulted in increased total cash distributions. Distributions exceeded net income for the three months and year ended December 31, 2018 primarily due to non-cash items. Non-cash items relating to the fair value adjustments on financial instruments and real estate assets, gain (loss) on sale of real estate assets, 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.

Major Cash Flow Components

(in thousands of Canadian dollars)	Three months ended December 31			Year ended December 31		
	2018	2017	Change	2018	2017	Change
Cash and cash equivalents, beginning of period	\$93,492	\$51,727	\$41,765	\$42,284	\$48,021	(\$5,737)
Cash flows from operations	122,239	128,512	(6,273)	462,123	479,239	(17,116)
Cash flows from (used) investing	(232,622)	(425,489)	192,867	175,186	(625,635)	800,821
Cash flows from (used) financing	69,964	287,534	(217,570)	(626,520)	140,659	(767,179)
Cash and cash equivalents, end of year	\$53,073	\$42,284	\$10,789	\$53,073	\$42,284	\$10,789

Cash flows from operations decreased by \$6.3 million and \$17.1 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods primarily due to a decrease in property operating income and an increase in interest paid. The decrease for the three months ended December 31, 2018 compared to the respective 2017 period was partially offset by an increase in non-cash operating working capital.

Cash flows from (used) investing increased by \$192.9 million for the three months ended December 31, 2018 compared to the respective 2017 period primarily due to restricted cash released from escrow as a result of H&R completing Section 1031 property exchanges in Q4 2018 and a greater amount spent on acquisitions in Q4 2017 compared to Q4 2018. Cash flows from (used) investing increased by \$800.8 million for the year ended December 31, 2018 compared to the respective 2017 period, primarily due to net proceeds on dispositions of real estate assets including the sale of nine U.S. industrial joint venture properties sold in 2017 with proceeds being disbursed in Q1 2018. The increase for both the three months and year ended December 31, 2018 compared to the respective 2017 periods was partially offset by additions to properties under development. For a list of property acquisitions and dispositions, see pages 11, 12 and 16 of this MD&A.

Cash flows from (used) financing decreased by \$217.6 million and \$767.2 million, respectively, for the three months and year ended December 31, 2018 compared to the respective 2017 periods primarily due to the repayment of debt. Cash flows from (used) financing further decreased for the year ended December 31, 2018 compared to the respective 2017 period due to the Trusts' purchase and cancellation of Units under their NCIB during 2018 and higher cash distributions to unitholders due to the suspension of the DRIP in March 2018.

Capital Resources

Subject to market conditions, management expects to be able to meet all of the REIT's ongoing contractual obligations through cash on hand of \$53.1 million and amounts available under its lines of credit of \$768.2 million as at December 31, 2018. In addition, the REIT has \$172.8 million available under its secured construction facilities held through equity accounted investments as at December 31, 2018. As at December 31, 2018, the REIT is not in default or arrears on any of its obligations including interest or principal payments on debt and any debt covenant.

As at December 31, 2018, H&R had 91 unencumbered properties, with a fair value of approximately \$3.4 billion. Also, due to H&R's 22-year history and management's conservative strategy of securing long-term financing on individual properties, H&R had numerous other properties with very low loan to value ratios. As at December 31, 2018, H&R had 36 properties valued at approximately \$1.3 billion which are encumbered with mortgages totalling \$248.8 million. In this pool of assets, the average loan to value is 18.9%, the minimum loan to value is 0.3% and the maximum loan to value is 27.1%. The weighted average remaining term to maturity of this pool of mortgages is 3.3 years.

The following is a summary of material contractual obligations including payments due as at December 31, 2018 for the next five years and thereafter:

Contractual Obligations ⁽¹⁾ (in thousands of Canadian dollars)	Payments Due by Period				Total
	2019	2020- 2021	2022- 2023	2024 and thereafter	
Mortgages payable	\$177,182	\$1,439,794	\$1,064,238	\$1,483,616	\$4,164,830
Senior debentures	350,000	345,000	575,000	350,000	1,620,000
Lines of credit	3,514	322,680	5,750	-	331,944
Unsecured term loans	-	200,629	-	250,000	450,629
Total contractual obligations	\$530,696	\$2,308,103	\$1,644,988	\$2,083,616	\$6,567,403

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

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

DBRS has confirmed that H&R has a credit rating of BBB (high) with a Stable trend as at December 31, 2018. This is a rating achieved by only three Canadian REITs (including H&R) and one real estate company as at December 31, 2018. 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, 2018, through cash on hand of \$53.1 million and the total amount available under its lines of credit of \$768.2 million and its unencumbered property pool of approximately \$3.4 billion, H&R has sufficient funds for future commitments.

The following summarizes the estimated loan to value ratios on properties for which mortgages mature over the next five years:

Year	Number of Properties	Mortgage Debt due on Maturity (\$000's)	Weighted Average Interest Rate on Maturity	Fair Value of Investment Properties (\$000's) ⁽¹⁾	Loan to Value
2019	6	\$50,679	3.8%	\$145,298	35%
2020	15	366,368	4.5%	992,225	37%
2021	11	839,231	3.9%	3,567,636	24%
2022	39	539,953	3.9%	3,053,530	18%
2023	10	391,746	3.9%	1,862,380	21%
	81	\$2,187,977	4.0%	\$9,621,069	23%

⁽¹⁾ Converting U.S. dollars to Canadian dollars at an exchange rate of \$1.36 as at December 31, 2018.

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.

RELATED PARTY TRANSACTION

In 2018, H&R paid approximately U.S. \$14.6 million for 20.3 acres of land in Dallas, TX, to be developed into approximately 1,000 residential rental units, from an entity in which the CEO held a 50% ownership interest.

OFF-BALANCE SHEET ITEMS

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, 2018, H&R has outstanding letters of credit totalling \$25.9 million (December 31, 2017 - \$32.9 million), including \$17.3 million (December 31, 2017 - \$15.1 million) which has been pledged as security for certain mortgages payable. The letters of credit are secured by certain investment properties.

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, 2018, such guarantees amounted to \$263.9 million expiring between 2019 and 2029 (December 31, 2017 - \$497.5 million, expiring between 2020 and 2029), and no amount has been provided for in the REIT's 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.

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, 2018, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk is approximately \$44.0 million, which expires in 2020 (December 31, 2017 - \$119.3 million, expiring between 2018 and 2020). There have been no defaults by the primary obligors 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 REIT's Financial Statements.

DERIVATIVE INSTRUMENTS

Where appropriate, H&R, including ECHO and Jackson Park, 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 manages risks related to foreign exchange rates on transactions that will occur in the future.

H&R had the following interest rate swaps outstanding:

		Fair value asset (liability)*		Net gain (loss) on derivative contracts	
		December 31 2018	December 31 2017	December 31 2018	December 31 2017
(in thousands of Canadian dollars)					
Debenture interest rate swap	(1)	\$592	\$2,231	(\$1,639)	\$1,455
Debenture interest rate swap	(2)	(331)	-	(331)	-
Debenture interest rate swap	(3)	-	177	(177)	584
Term loan interest rate swap	(4)	4,853	3,966	887	7,350
Term loan interest rate swap	(5)	(2,370)	-	(2,370)	-
		\$2,744	\$6,374	(\$3,630)	\$9,389

(1) To fix the interest rate at 2.36% per annum for the Series K senior debentures, maturing on March 1, 2019.

(2) To fix the interest rate at 2.88% per annum for the Series P senior debentures, maturing on February 13, 2020.

(3) To fix the interest rate at 2.54% per annum for the Series I senior debentures (settled when these debentures matured on January 23, 2017) and to fix the interest rate at 2.04% per annum for the Series J senior debentures (settled when these debentures matured on February 9, 2018).

(4) To fix the interest rate at 2.56% per annum on U.S. \$130.0 million of term loan, maturing on March 17, 2021.

(5) To fix the interest rate at 3.91% per annum on \$250.0 million term loan, maturing on January 6, 2026.

* 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.

SECTION IV

SELECTED FINANCIAL INFORMATION

Selected Annual information

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

	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
(in thousands of Canadian dollars except per Unit amounts)			
Rentals from investment properties	\$1,176,558	\$1,168,454	\$1,196,011
Net income from equity accounted investments	169,409	167,407	48,341
Finance income	8,638	4,999	4,715
Net income	337,918	667,870	388,745
Total comprehensive income	532,794	536,598	350,378
Total assets	14,691,009	14,558,863	14,155,012
Total liabilities	7,490,909	7,379,100	7,242,362
Cash distributions per Unit	\$1.38	\$1.38	\$1.35

Summary of Quarterly Results

The following tables summarize certain financial information for the quarters indicated below:

	Q4	Q3	Q2	Q1
(in thousands of Canadian dollars)	2018	2018	2018	2018
Rentals from investment properties	\$297,416	\$286,223	\$294,302	\$298,617
Net income from equity accounted investments	148,165	8,143	6,864	6,237
Net income	61,115	105,509	108,194	63,100
Total comprehensive income	200,450	71,065	144,329	116,950

	Q4	Q3	Q2	Q1
	2017	2017	2017	2017
Rentals from investment properties	\$298,042	\$289,568	\$286,987	\$293,857
Net income from equity accounted investments	118,337	3,072	26,280	19,718
Net income	325,213	78,784	153,070	110,803
Total comprehensive income (loss)	335,466	(1,511)	104,181	98,462

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

Rentals from investment properties increased by \$11.2 million in Q4 2018 compared to Q3 2018, primarily due to the following: (i) an increase in rentals from Primaris due to seasonality; (ii) contractual rental escalations from H&R's office properties; and (iii) the lease-up and acquisition of Lantower Residential properties.

Net income from equity accounted investments increased by \$140.0 million in Q4 2018 compared to Q3 2018 primarily due to the fair value adjustment on real estate assets increasing by \$141.6 million mainly due to the fair value of Jackson Park increasing by U.S. \$107.7 million at H&R's ownership interest. An independent third party appraisal was obtained for this property in Q4 2018.

Net income decreased by \$44.4 million in Q4 2018 compared to Q3 2018 primarily due to the following: (i) a decrease in the fair value adjustments on real estate assets and financial instruments and (ii) an increase in deferred income taxes. This was partially offset by an increase in net income from equity accounted investments.

Total comprehensive income (loss) increased by \$129.4 million in Q4 2018 compared to Q3 2018 primarily due to an unrealized gain on translation of U.S. denominated foreign operations of \$139.3 million in Q4 2018 compared to an unrealized loss of \$34.5 million in Q3 2018, partially offset by a decrease in net income explained above.

PORTFOLIO OVERVIEW

The geographic diversification of the portfolio of properties in which the REIT has an interest and the related square footage is disclosed at the REIT's proportionate share as at December 31, 2018 in the tables below:

Number of Properties ⁽¹⁾	Canada				United States	Total
	Ontario	Alberta	Other	Subtotal		
Office	20	4	4	28	7	35
Primaris	6	17	7	30	-	30
H&R Retail	34	2	7	43	16	59
ECHO ⁽²⁾	-	-	-	-	230	230
Industrial	36	19	29	84	6	90
Lantower Residential ⁽³⁾	-	-	-	-	22	22
Total	96	42	47	185	281	466

Square Feet (in thousands) ⁽¹⁾	Canada				United States	Total
	Ontario	Alberta	Other	Subtotal		
Office	6,426	2,607	893	9,926	2,023	11,949
Primaris	2,076	3,821	2,090	7,987	-	7,987
H&R Retail	1,675	240	707	2,622	219	2,841
ECHO ⁽²⁾	-	-	-	-	3,178	3,178
Industrial	4,577	2,030	2,012	8,619	1,068	9,687
Lantower Residential ⁽³⁾	-	-	-	-	6,811	6,811
Total	14,754	8,698	5,702	29,154	13,299	42,453

⁽¹⁾ H&R has nine properties under development which are not included in the tables above.

⁽²⁾ ECHO has 11 properties under development which are not included in the tables above.

⁽³⁾ Lantower Residential's properties contain 7,271 residential rental units.

LEASE MATURITY PROFILE

The following tables disclose H&R's leases expiring in Canada and the United States at the REIT's proportionate share, excluding Lantower Residential.

Canadian Portfolio:

LEASE EXPIRIES	Office		Primaris		H&R Retail		Industrial		Total	
	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
2019	215,720	25.03	972,308	24.91	147,523	9.15	764,485	5.65	2,100,036	16.80
2020	234,603	22.36	1,046,416	21.68	97,284	15.23	708,995	8.55	2,087,298	17.00
2021	483,976	18.34	720,805	27.23	208,947	11.48	276,949	5.83	1,690,677	19.23
2022	623,173	24.58	722,270	24.73	53,879	11.33	1,147,156	6.83	2,546,478	16.35
2023	506,186	21.86	462,898	35.50	49,778	12.68	386,899	6.61	1,405,761	21.83
	2,063,658	22.24	3,924,697	25.69	557,411	11.61	3,284,484	6.82	9,830,250	17.86
Total % of each segment	20.8%		49.1%		21.3%		38.1%		33.7%	

U.S. Portfolio⁽¹⁾:

LEASE EXPIRIES	Office		H&R Retail		ECHO		Industrial		Total	
	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
2019	-	-	13,368	46.44	112,487	11.82	82,896	3.94	208,751	10.91
2020	-	-	57,691	52.38	331,047	8.00	-	-	388,738	14.59
2021	-	-	16,465	47.64	159,619	16.16	-	-	176,084	19.10
2022	563	71.76	56,537	46.21	163,240	16.86	54,654	4.94	274,994	20.64
2023	85,725	5.86	32,126	37.97	147,272	21.86	412,585	3.00	677,708	9.12
	86,288	6.29	176,187	46.88	913,665	13.71	550,135	3.33	1,726,275	13.42
Total % of each segment	4.3%		80.5%		28.7%		51.5%		26.6%	

⁽¹⁾ U.S. dollars.

TOP TWENTY SOURCES OF REVENUE BY TENANT

The following table discloses H&R's top twenty tenants at the REIT's proportionate share:

Tenant	% of rentals from investment properties ⁽¹⁾	Number of locations	H&R owned sq.ft. (in 000's)	Average lease term to maturity (in years) ⁽²⁾	Credit Ratings (S&P)
1. Encana Corporation ⁽³⁾	11.4%	1	1,997	19.4	BBB- Positive
2. Bell Canada	8.2%	23	2,541	6.6	BBB+ Stable
3. Hess Corporation	5.1%	1	845	⁽⁹⁾	BBB- Stable
4. New York City Department of Health	3.6%	1	660	11.9	AA Stable
5. Giant Eagle, Inc.	3.2%	192	1,680	12.2	Not Rated
6. Canadian Tire Corporation ⁽⁴⁾	2.6%	19	2,627	7.0	BBB+ Stable
7. TransCanada Pipelines Limited	1.8%	1	466	12.3	BBB+ Stable
8. Lowe's Companies, Inc. ⁽⁵⁾	1.8%	15	1,750	11.6	BBB+ Stable
9. Canadian Imperial Bank of Commerce	1.7%	9	555	5.5	A+ Stable
10. Corus Entertainment Inc.	1.6%	1	472	14.2	BB Negative
11. Government of Ontario	1.3%	4	359	3.9	A+ Stable
12. Telus Communications	1.2%	17	356	6.3	BBB+ Stable
13. Shell Oil Products	1.2%	17	223	3.5	AA- Stable
14. Public Works and Government Services, Canada	1.0%	5	338	4.1	AAA Stable
15. Toronto-Dominion Bank	0.9%	7	277	8.0	AA- Stable
16. Loblaw Companies Limited ⁽⁶⁾	0.9%	20	287	7.8	BBB Stable
17. Empire Company Limited ⁽⁷⁾	0.9%	15	569	10.8	BB+ Stable
18. Royal Bank of Canada	0.9%	5	247	6.4	AA- Stable
19. The TJX Companies Inc ⁽⁸⁾	0.7%	14	548	6.2	A+ Stable
20. Hudson's Bay Company	0.6%	7	958	6.6	B Stable
Total	50.6%	374	17,755	10.9	

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

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

⁽³⁾ Encana Corporation has sublet 27 floors to Cenovus Energy at The Bow located in Calgary, AB. Encana Corporation's lease obligations expire on May 13, 2038.

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

⁽⁵⁾ Lowe's Companies, Inc. includes Rona.

⁽⁶⁾ Loblaw Companies Limited includes Loblaw, No Frills and Shoppers Drug Mart.

⁽⁷⁾ Empire Company Limited includes Sobeys, Sobey's Liquor, Safeway and Lawtons Drugs.

⁽⁸⁾ The TJX Companies Inc. includes Winners, T.J. Maxx, Marshalls and Home Sense.

⁽⁹⁾ Due to the confidentiality under the tenant's lease, the term is not disclosed.

SECTION V

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Preparation of the REIT's 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 REIT's Financial Statements and reported amounts of revenue and expenses during the reporting period.

For a description of the accounting policies that management believes are subject to greater estimation and judgement, as well as other accounting policies, refer to notes 1 and 2 of the REIT's 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; 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 consolidated 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 in the REIT's Financial Statements and this MD&A. Refer to note 3 of the REIT's 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(r)(i) of the December 31, 2018 REIT's 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, 2018 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.

SIGNIFICANT ACCOUNTING POLICIES

Accounting Standards adopted in 2018:

On January 1, 2018, the REIT adopted IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15") and IFRS 9, *Financial Instruments* ("IFRS 9"), in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The policies were adopted retrospectively without restatement of the prior period. For the comparative year ended December 31, 2017, the policies applied were consistent with the 2017 disclosed policies. The adoption of IFRS 15 and 9 did not have a significant impact.

New standards and interpretations not yet adopted:

The REIT intends to adopt these standards when they become effective.

(i) *Leases ("IFRS 16")*

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

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

Management does not expect the adoption of IFRS 16 to have a material impact on the REIT's Financial Statements.

(ii) *IFRIC Interpretation 23, Uncertainty over Income Tax Treatments ("The Interpretation")*

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

Management does not expect the adoption of IFRIC 23 to have a material impact on the REIT's Financial Statements.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

H&R's CEO and Chief Financial Officer ("CFO") has designed, or caused to be designed under their direct supervision, the applicable 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 REIT, 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) information required to be disclosed in the annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. H&R's CEO and CFO have evaluated, or caused to be evaluated under their supervision, the effectiveness of the REIT's disclosure controls and procedures as at December 31, 2018, and based upon that evaluation have each concluded that such disclosure controls and procedures were appropriately designed and were operating effectively as at December 31, 2018. The REIT's 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.

H&R's management has reviewed its respective internal control over financial reporting on an annual basis. The REIT's management, under the supervision of the CEO and the CFO, has evaluated the effectiveness of internal control over financial reporting as at December 31, 2018 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, the CEO and the CFO have concluded that internal control over financial reporting was effective as of December 31, 2018. No changes were made to H&R's internal control over financial reporting during the three-month period ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the REIT's internal controls over financial reporting.

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

SECTION VI

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, 2018, approximately 26.0% of property operating income at the REIT's proportionate share 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 and such termination rights are generally exercisable at a cost to the tenant only. 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, Bell Canada and Hess Corporation. All of these companies have a public debt rating that is rated with at least a BBB- Stable 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 32.4% 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 REIT's 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. Derivative financial instruments may be utilized by 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

H&R is exposed to foreign exchange fluctuations as a result of ownership of assets in the United States and the rental income earned from these properties. In order to mitigate the risk, 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 U.S. mortgages, Series P senior debentures, U.S. unsecured term loans and U.S. lines of credit 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.

Cyber Security Risk

Cyber security has become an increasingly problematic issue for issuers and businesses in Canada and around the world, including H&R. Cyber attacks against large organizations are increasing in sophistication and are often focused on financial fraud, compromising sensitive data for inappropriate use or disrupting business operations. A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of H&R's

information resources. More specifically, a cyber-incident is an intentional attack or an unintentional event that can include gaining unauthorized access to information systems to disrupt operations, corrupt data or steal confidential information. As H&R's reliance on technology has increased, so have the risks posed to its systems. H&R's primary risks that could directly result from the occurrence of a cyber-incident include operational interruption, damage to its reputation, damage to H&R's business relationships with its tenants, disclosure of confidential information regarding its tenants, employees and third parties with whom H&R interacts, and may result in negative consequences, including remediation costs, loss of revenue, additional regulatory scrutiny and litigation. H&R has implemented processes, procedures and controls to help mitigate these risks, but these measures, as well as its increased awareness of a risk of a cyber-incident, do not guarantee that its financial results will not be negatively impacted by such an incident.

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 or on 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, Units may trade at a premium or a discount to the underlying value of the assets of H&R. See also "Forward-Looking Disclaimer".

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

Availability of Cash for Distributions

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 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 Units may decline significantly if H&R 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 H&R is authorized to issue is unlimited. The trustees have the discretion to issue additional Units in certain circumstances, including under H&R's Unit Option Plan and Incentive Unit Plan. In addition, H&R may issue Units pursuant to the DRIP and Unit Purchase Plan. Any issuance of Units may have a dilutive effect on the investors of Units.

Unitholder Liability

H&R's Declaration of Trust provides that unitholders will have no personal liability for actions of the REIT 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. H&R's Declaration of Trust further provides that this lack of unitholder liability, where possible, must be provided for in certain written instruments signed by the REIT. 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 H&R considers 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 REIT's assets. It is intended that the REIT's 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 entitlement of holders of Units to receive cash upon the redemption of their Units is subject to the limitations that: (i) the total amount payable by H&R in respect of those Units and all other Units tendered for redemption in the same calendar month does not exceed \$50,000 (subject to certain adjustments and provided that the trustees of H&R may waive this limitation at their sole discretion), (ii) at the time such units are tendered for redemption, the outstanding Units shall be listed for trading or quoted on a stock exchange or traded or quoted on another market which the trustees consider, in their sole discretion, provides representative fair market value prices for the Units; and (iii) the normal trading of the Units is not suspended or halted on any stock exchange on which the Units are listed (or, if not so listed, on any market on which the Units are quoted for trading) on the redemption date or for more than five trading days during the ten-day trading period commencing immediately prior to such date. 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. 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 Series F, K, L, M, N, O and P 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. 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 2018. 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.

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 Units. If H&R 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), Units 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 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 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. During 2017 and 2018, H&R made loans to U.S. Holdco (“U.S. Holdco Loans”) to refinance existing loans, including U.S. Holdco Notes, or 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 Loans or H&R's ability to make distributions on its Units.

For taxable years beginning before January 1, 2018, Section 163(j) of the Code (prior to its amendment by U.S. Tax Reform, “Prior Section 163(j)”) applied to limit the deduction of interest paid to a related party, including debt financing provided by H&R to U.S. Holdco (e.g., the U.S. Holdco Loans or by acquiring U.S. Holdco Notes). With respect to the U.S. Holdco Notes, H&R took the position that, due to the treatment of Finance Trust as a grantor trust that was disregarded for U.S. federal tax purposes, the interest paid to Finance Trust was treated as having been paid to the holders of the Finance Trust units and was therefore not subject to Prior Section 163(j). If Prior 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 for years subject to Prior Section 163(j).

As discussed below in “U.S. Tax Reform”, Prior Section 163(j) has been repealed and replaced with a new section 163(j) that is applicable to taxable years beginning after December 31, 2017. New section 163(j) applies to both related and third party debt and there is no debt to equity ratio safe harbor. New section 163(j) limits all interest deductions (related and third party) to 30% of “adjusted taxable income” (defined similarly to earnings before interest, taxes, depreciation and amortization for taxable years beginning before January 1, 2022, and earnings before interest and taxes thereafter). However, there is an exception to the limitation of new section 163(j) for certain “real property trades or businesses” that make an irrevocable election. If such an election is made, the real property trade or business is required to use the alternative depreciation system (ADS) to depreciate certain assets for U.S. federal income tax purposes. As discussed below, it is expected that H&R's U.S. subsidiaries are eligible for the real property trade or business exception and may elect out of section 163(j) if the interest deduction limitation would cause adverse tax results.

U.S. Tax Reform

Overview

U.S. Tax Reform was signed into law by the president on December 22, 2017, and Management has considered the material effects of tax reform on H&R's Financial Statements (if any).

U.S. corporate rate reduction

The U.S. federal corporate income tax rate was reduced to 21% effective January 1, 2018. Therefore, the U.S. federal corporate income tax rate applied to the gross deferred income tax assets or liabilities is 21% (24% including the effect of state taxes) instead of 35% (37.5% including the effect of state taxes).

Section 163(j) carryover

Under the tax reform bill, Prior Section 163(j) was repealed and replaced with a new section 163(j) effective January 1, 2018. H&R has U.S. \$147.3 million of Prior Section 163(j) interest carryover that was recorded as a deferred tax asset under the old regime. Given the initial lack of specific guidance regarding the appropriate treatment of a deferred interest carryover under the old regime, H&R reversed the deferred tax benefit of its Prior Section 163(j) carryover, which resulted in a one-time expense of \$48.1 million in 2017 (after taking into account the reduction in value due to the rate change described above). Management continues to monitor guidance from the IRS to determine the future deductibility, if any, of the deferred interest carryover.

New Section 163(j)

As mentioned above, a new section 163(j) has been enacted. However, a real property trade or business may elect out of this new regime. A real property trade or business is defined as an "any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business". With input from its tax advisors, H&R has taken the view that the U.S. subsidiaries of H&R are engaged in real property trades or businesses and therefore are eligible to elect out of section 163(j) with respect to such businesses. Once an election is made, the election is irrevocable. If such an election is made, the real property trade or business is required to use the alternative depreciation system ("ADS") to depreciate certain assets for U.S. federal income tax purposes.

Risks relating to tax reforms

As the new U.S. Tax Reform continues to move through the implementation process, there is risk that regulatory, administrative or legislative actions could have a materially adverse effect on H&R's deferred income tax assets or liabilities. Management continues to monitor ongoing developments and IRS guidance.

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 Units, any distributions in respect of Units which are treated as "excess distribution" under the applicable rules and any gain on a sale or other disposition of 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 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). Units are treated as a specified foreign financial asset for this purpose.

In addition, with respect to years during which unitholders held interests in Finance Trust, 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 on behalf of 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 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 H&R paid or credited (whether in cash or *in specie*) in respect of such Units, subject to reduction under the U.S. Treaty if applicable. In the case of income paid or credited on Units, the withholding rate applicable to a U.S. unitholder entitled to the benefits of the U.S. Treaty in respect of such income generally would be reduced to 15%. U.S. unitholders may be entitled to a refund of a portion of such withholding tax if the rate applied by H&R 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 the REIT are represented by two classes of Units: Units which are unlimited in number; and special voting Units of which a maximum of 9,500,000 may be issued. Each Unit carries a single vote at any meeting of unitholders of the REIT. Each special voting Unit carries a single vote at any meeting of unitholders of the REIT. As at February 6, 2019, there were 285,677,811 Units issued and outstanding and 9,500,000 special voting Units outstanding.

As at December 31, 2018, 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, 477,764 have expired and 7,075,468 remain to be granted. Of the amount originally granted, 10,138,717 had been exercised or expired and 11,263,579 options to purchase Units remained outstanding. As at February 6, 2019, there were 11,263,579 options to purchase Units outstanding of which 8,867,636 have fully vested.

As at December 31, 2018, the maximum number of incentive units authorized to be granted under H&R's Incentive Unit Plan was 5,000,000. As at December 31, 2018, 935,049 incentive units had been granted, of which 46,308 had expired, 320,864 have been settled for cash and 6,635 had been settled for Units. Accordingly, 4,432,123 may still be granted under the plan and 561,242 incentive units remain outstanding. As at February 6, 2019, there were 564,145 incentive units outstanding.

As at December 31, 2018, there were 15,955,541 exchangeable units outstanding of which 9,500,000 exchangeable units are accompanied by special voting units. As at February 6, 2019, there were 15,955,541 exchangeable units outstanding of which 9,500,000 exchangeable units are accompanied by special voting units.

ADDITIONAL INFORMATION

Additional information relating to H&R, including H&R's Annual Information Form, is available on SEDAR at www.sedar.com

SUBSEQUENT EVENTS

- (a) In January 2019, the REIT sold one U.S. office property which was classified as held for sale as at December 31, 2018, for gross proceeds of U.S. \$69.8 million.
- (b) In February 2019, the REIT secured two new mortgages totalling \$36.6 million, bearing interest at 3.36% per annum for a term of 10 years.

Consolidated Financial Statements of

H&R REAL ESTATE INVESTMENT TRUST

Years ended December 31, 2018 and 2017



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INDEPENDENT AUDITORS' REPORT

To the Unitholders of H&R Real Estate Investment Trust

Opinion

We have audited the consolidated financial statements of H&R Real Estate Investment Trust (the Entity), which comprise:

- the consolidated statement of financial position as at December 31, 2018
- the consolidated statement of comprehensive income for the year then ended
- the consolidated statement of changes in unitholders' equity for the year then ended
- the consolidated statement of cash flows for the year then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies.

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2018 and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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



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Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- the information other than the financial statements and the auditors' report thereon, included in a document entitled "Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions and the information other than the financial statements and the auditors' report thereon, included in a document entitled "Annual Report" as at the date of this auditors' report.

If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.



Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.



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- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

The engagement partner on the audit resulting in this auditors' report is Tony Marino.

Toronto, Canada

February 14, 2019



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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 statement of financial position as at December 31, 2017, the combined statements of comprehensive income, changes in unitholders' equity and cash flows for the year 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 audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the 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 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, 2017, and their combined financial performance and their combined cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

February 14, 2018
Toronto, Canada

H&R REAL ESTATE INVESTMENT TRUST

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

		December 31	December 31
	Note	2018	2017
Assets			
Real estate assets:			
Investment properties	3	\$ 12,683,709	\$ 13,074,123
Properties under development	3	404,814	83,132
		13,088,523	13,157,255
Equity accounted investments	4	1,284,985	1,125,135
Assets classified as held for sale	5	110,940	-
Other assets	6	153,488	234,189
Cash and cash equivalents	7	53,073	42,284
		\$ 14,691,009	\$ 14,558,863
Liabilities and Unitholders' Equity			
Liabilities:			
Debt	8	\$ 6,546,072	\$ 6,493,617
Exchangeable units	9	329,482	341,321
Deferred tax liability	21	392,214	325,131
Accounts payable and accrued liabilities	10	223,141	219,031
		7,490,909	7,379,100
Unitholders' equity		7,200,100	7,179,763
Commitments and contingencies	23		
Subsequent events	25		
		\$ 14,691,009	\$ 14,558,863

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board of Trustees:

"Stephen Sender" Trustee

"Thomas J. Hofstedter" Trustee

H&R REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Comprehensive Income

(In thousands of Canadian dollars)

Years ended December 31, 2018 and 2017

	<i>Note</i>	2018	2017
Property operating income:			
Rentals from investment properties	<i>14</i>	\$ 1,176,558	\$ 1,168,454
Property operating costs		(442,626)	(427,013)
		733,932	741,441
Net income from equity accounted investments	<i>4</i>	169,409	167,407
Other income		-	1,040
Finance cost - operations	<i>15</i>	(267,087)	(270,358)
Finance income	<i>15</i>	8,638	4,999
Trust expenses		(18,271)	(18,111)
Fair value adjustments on financial instruments	<i>15</i>	11,197	27,049
Fair value adjustment on real estate assets	<i>3</i>	(246,967)	1,796
Loss on sale of real estate assets, net of related costs	<i>3</i>	(19,602)	(7,729)
Gain (loss) on foreign exchange		6,886	(17,903)
Net income before income taxes		378,135	629,631
Income tax recovery (expense)	<i>21</i>	(40,217)	38,239
Net income		337,918	667,870
Other comprehensive income (loss):			
Items that are or may be reclassified subsequently to net income	<i>13</i>	194,876	(131,272)
Total comprehensive income attributable to unitholders		\$ 532,794	\$ 536,598

See accompanying notes to the consolidated financial statements.

H&R REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Changes in Unitholders' Equity

(In thousands of Canadian dollars)

Years ended December 31, 2018 and 2017

UNITHOLDERS' EQUITY	<i>Note</i>	Value of Units	Accumulated net income	Accumulated distributions	Accumulated other comprehensive income (note 13)	Total
Unitholders' equity, January 1, 2017		\$ 5,354,930	\$ 4,552,274	\$ (3,302,774)	\$ 308,220	\$ 6,912,650
Proceeds from issuance of Units		144,360	-	-	-	144,360
Net income		-	667,870	-	-	667,870
Distributions to unitholders	<i>12(c)</i>	-	-	(397,908)	-	(397,908)
Conversion of convertible debentures, net	<i>8(b)(iii)</i>	2	-	-	-	2
Units repurchased and cancelled	<i>12(d)</i>	(15,939)	-	-	-	(15,939)
Other comprehensive loss		-	-	-	(131,272)	(131,272)
Unitholders' equity, December 31, 2017		5,483,353	5,220,144	(3,700,682)	176,948	7,179,763
Proceeds from issuance of Units		19,313	-	-	-	19,313
Net income		-	337,918	-	-	337,918
Distributions to unitholders	<i>12(c)</i>	-	-	(395,568)	-	(395,568)
Conversion of convertible debentures	<i>8(b)(iii)</i>	70	-	-	-	70
Units repurchased and cancelled	<i>12(d)</i>	(136,272)	-	-	-	(136,272)
Other comprehensive income		-	-	-	194,876	194,876
Unitholders' equity, December 31, 2018		\$ 5,366,464	\$ 5,558,062	\$ (4,096,250)	\$ 371,824	\$ 7,200,100

See accompanying notes to the consolidated financial statements.

H&R REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

Years ended December 31, 2018 and 2017

	<i>Note</i>	2018	2017
Cash provided by (used in):			
Operations:			
Net income		\$ 337,918	\$ 667,870
Finance cost - operations	<i>15</i>	267,087	270,358
Interest paid		(268,156)	(258,328)
Items not affecting cash:			
Net income from equity accounted investments	<i>4</i>	(169,409)	(167,407)
Rent amortization of tenant inducements	<i>14</i>	1,988	2,354
(Gain) loss on foreign exchange		(6,886)	17,903
Fair value adjustment on real estate assets	<i>3</i>	246,967	(1,796)
Loss on sale of real estate assets, net of related costs	<i>3</i>	19,602	7,729
Fair value adjustments on financial instruments	<i>15</i>	(11,197)	(27,049)
Unit-based compensation	<i>12(b)</i>	2,413	4,869
Deferred income taxes (recovery)	<i>21</i>	39,457	(39,777)
Change in other non-cash operating items	<i>16</i>	2,339	2,513
		462,123	479,239
Investing:			
Properties under development:			
Acquisition	<i>3, 16</i>	(31,876)	(71,260)
Additions	<i>3, 16</i>	(115,491)	(14,479)
Investment properties:			
Net proceeds on disposition of real estate assets		879,347	115,432
Acquisitions	<i>3</i>	(463,299)	(417,428)
Redevelopment	<i>3, 16</i>	(58,121)	(111,986)
Capital expenditures	<i>3</i>	(57,825)	(51,845)
Leasing expenses and tenant inducements	<i>3</i>	(32,441)	(28,722)
Equity accounted investments, net		110,603	6,169
Mortgages receivable		(68,150)	(107,233)
Proceeds from sale of investments		-	56,597
Restricted cash	<i>6</i>	12,439	(880)
		175,186	(625,635)
Financing:			
Unsecured term loans	<i>8(c)</i>	250,000	-
Lines of credit	<i>8(d)</i>	(196,323)	69,704
Mortgages payable:			
New mortgages payable	<i>8(a)</i>	619,788	588,094
Principal repayments	<i>8(a)</i>	(536,908)	(585,659)
Redemption of debentures payable	<i>8(b)(iii)</i>	(657,082)	(249,394)
Proceeds from issuance of debentures payable	<i>8(b)(iii)</i>	409,205	619,299
Proceeds from issuance of Units, net of issue costs		8	5,051
Units repurchased and cancelled	<i>12(d)</i>	(136,272)	(15,939)
Distributions to unitholders	<i>12(c)</i>	(378,936)	(290,497)
		(626,520)	140,659
Increase (decrease) in cash and cash equivalents		10,789	(5,737)
Cash and cash equivalents, beginning of year	<i>7</i>	42,284	48,021
Cash and cash equivalents, end of year	<i>7</i>	\$ 53,073	\$ 42,284

See note on supplemental cash flow information (note 16).

See accompanying notes to the consolidated financial statements.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

H&R Real Estate Investment Trust (the "REIT") is an unincorporated open-ended trust domiciled in Canada and H&R Finance Trust ("Finance Trust") was an unincorporated investment trust domiciled in Canada. The REIT owns, operates and develops commercial and residential properties across Canada and in the United States. The REIT's units ("Units") are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol HR.UN. The principal office and centre of administration of the REIT is located at 3625 Dufferin Street, Suite 500, Toronto, Ontario M3K 1N4. Unitholders of the REIT participate pro rata in distributions of income and, in the event of termination of the REIT, participate pro rata in the net assets remaining after satisfaction of all liabilities.

On August 31, 2018, the REIT and Finance Trust effected a reorganization ("Reorganization") by way of plan of arrangement involving the REIT, Finance Trust and certain of the REIT's subsidiaries resulting in, among other things, (i) Finance Trust transferring debt owed to it by H&R REIT (U.S.) Holdings Inc. ("U.S. Holdco") to the REIT for nil consideration and (ii) unitholders subsequently transferring their Finance Trust units to the REIT for nominal consideration and retaining their Units. Following these transactions, Finance Trust was terminated, resulting in the Units no longer being stapled to units of Finance Trust and unitholders holding only REIT Units.

These consolidated financial statements include the accounts of the REIT and Finance Trust, (together with the REIT, the "Trusts") up to August 31, 2018, the date of termination of Finance Trust. The comparative period ended December 31, 2017 continues to reflect the financial position and results of the REIT and Finance Trust as previously reported on a combined basis, as units of the Trusts were previously stapled ("Stapled Units"). For the periods prior to August 31, 2018, references to Units should be read as referring to Stapled Units.

1. Basis of preparation:

(a) Statement of compliance

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

The consolidated financial statements were approved by the Board of Trustees of the REIT on February 14, 2019.

(b) Functional currency and presentation

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

The REIT presents its consolidated statements of financial position based on the liquidity method, where all assets and liabilities are presented in ascending order of liquidity.

(c) Basis of measurement

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

- (i) Real estate assets;
- (ii) Assets classified as held for sale;
- (iii) Derivative instruments;
- (iv) Liabilities for cash-settled unit-based compensation; and
- (v) Exchangeable units.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

1. Basis of preparation (continued):

(d) Use of estimates and judgements

The preparation of these consolidated 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 3); and
- Deferred tax asset (liability) (note 21).

(ii) Use of judgements

The critical judgements made in applying accounting policies that have the most significant effect on the amounts recognized in these consolidated 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 consolidated 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 consolidated financial statements. Refer to note 3 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.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

1. Basis of preparation (continued):

- 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.

2. Significant accounting policies:

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

(a) *Basis of consolidation:*

These consolidated 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.

(b) *Basis of combination:*

The principles used to prepare the 2017 comparative combined financial statements are similar to those used to prepare consolidated financial statements. The 2017 comparative combined financial statements include the assets, liabilities, unitholders' equity, other comprehensive 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 gain (loss) on foreign exchange recorded in net income as a result of translating Finance Trust's U.S. dollar note receivable from U.S. Holdco was not eliminated on combination as it flows through net income on Finance Trust's books and other comprehensive income (loss) 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 was 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.

(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").

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

2. Significant accounting policies (continued):

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.

(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:*

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.

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 consolidated statement of financial position. These amounts are not offset or presented as a single amount.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

2. Significant accounting policies (continued):

(f) *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.

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 2018 and the 2017 comparative year.

For financial statement reporting purposes, the tax deductibility of the REIT's distributions is treated as an exemption from taxation as the REIT has distributed and is committed to continue distributing all of its taxable income to its unitholders.

(g) *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 12(b). These plans are considered to be a cash-settled liability under IFRS 2, *Share-based Payment* ("IFRS 2") and as a result are measured at each reporting period and at settlement date at their 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.

The REIT adopted amendments to IFRS 2 beginning on January 1, 2018, the mandatory effective date. There was no material impact from the adoption of the amendments to IFRS 2.

(h) *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.

(i) *Restricted cash:*

Restricted cash includes amounts relating to Internal Revenue Code Section 1031 U.S. property exchanges, amounts held in reserve by lenders to fund mortgage payments, repairs and capital expenditures or property tax payments.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

2. Significant accounting policies (continued):

(j) *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 consolidated 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 until there is a reduction in the REIT's net investment in the foreign operations. The U.S. dollar denominated senior debenture, unsecured term loan and line of credit 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.

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 consolidated 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.

(k) *Units:*

Under IAS 32, *Financial Instruments: Presentation* ("IAS 32"), puttable instruments, such as the Units are generally classified as financial liabilities unless the exemption criteria are met for equity classification. 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, the REIT met the exemption criteria under IAS 32 for equity classification. Nevertheless, the Units are not considered ordinary units under IAS 33, *Earnings Per Share*, and therefore an income per unit calculation is not presented.

(l) *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.

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

An associate is an entity over which the REIT 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 REIT accounts for investments in associates using the equity method.

The REIT considers investments in joint arrangements to be joint ventures when the REIT jointly controls one or more investment properties with another party and has 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 REIT's interests in its associates and joint ventures are accounted for using the equity method and are carried on the consolidated statements of financial position at cost, adjusted for the REIT's proportionate share of post-acquisition changes in the net assets, less any identified impairment loss. The REIT's share of profits and losses is recognized in the share of net income from the associate or joint venture investments in the consolidated statements of comprehensive income and the REIT's other comprehensive income includes its share of the associate or joint ventures' other comprehensive income.

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

2. Significant accounting policies (continued):

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 associate or joint venture and that event has a negative impact on the future cash flows of the associate or joint venture that can be reliably estimated.

(n) *Joint Operations:*

The REIT considers investments in joint arrangements to be joint operations when the REIT makes 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 REIT will include its share of the underlying assets, liabilities, revenue and expenses in its financial results.

(o) *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 consolidated 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.

(p) *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.

(q) *Subsidiaries*

Subsidiaries are entities controlled by the REIT. The REIT controls an entity when it is exposed to, or has rights to, variable returns from its 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 consolidated financial statements from the date on which control commences until the date on which control ceases.

(r) *Accounting standards adopted in 2018:*

On January 1, 2018, the REIT adopted IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15") and IFRS 9, *Financial Instruments* ("IFRS 9"), in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. These policies were adopted retrospectively without restatement of the prior period. For the comparative year ended December 31, 2017, the policies applied were consistent with the 2017 disclosed policies. The adoption of IFRS 15 and 9 did not have a significant impact.

The new accounting policies and the impact from the adoption of IFRS 15 and IFRS 9 are described below:

(i) *Revenue from contracts with customers:*

IFRS 15 replaces all existing guidance in IFRS related to revenue, including (but not limited to) IAS 11 *Construction Contracts*, IAS 18 *Revenue* and IFRIC 15 *Agreements for the Construction of Real Estate*.

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

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2. Significant accounting policies (continued):

The REIT adopted IFRS 15 on January 1, 2018, using the cumulative effect method, which means that the REIT did not apply the requirements of IFRS 15 to the 2017 comparative period presented. The effect of initially applying this standard would have been recognized at January 1, 2018, however, the adoption of IFRS 15 did not have an impact on the timing of recognition or measurement of revenue.

The REIT earns revenue from its tenants from various sources consisting of base rent for the use of space leased, recoveries of property tax and property insurance, and service revenue from utilities, cleaning and property maintenance costs.

Revenue from lease components is recognized on a straight-line basis over the lease term and includes the recovery of property taxes and insurance. Revenue recognition commences when a tenant has the right to use the premises and is recognized pursuant to the terms of the lease agreement.

Revenue related to the services component of the REIT's leases is accounted for in accordance with IFRS 15. These services consist primarily of utilities, cleaning and property maintenance costs for which the revenue is recognized over time, typically as the costs are incurred, which is when the services are provided.

(ii) *Financial instruments:*

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). The adoption of IFRS 9 was generally applied retrospectively, without restatement of comparative information. There was no material impact from the adoption of IFRS 9.

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

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated at fair value through profit or loss ("FVTPL"):

- It is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All financial assets not classified as measured at amortized cost as described above are measured at FVTPL.

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

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2. Significant accounting policies (continued):

The following table summarizes the classification impacts upon adoption of IFRS 9.

Asset/Liability	Classification under IAS 39	Classification under IFRS 9
Mortgages receivable	Loans and receivables	Amortized cost or fair value through profit or loss
Accounts receivable	Loans and receivables	Amortized cost
Cash and cash equivalents	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Mortgages payable	Other liabilities at amortized cost	Amortized cost
Senior debentures payable	Other liabilities at amortized cost	Amortized cost
Convertible debentures payable	Fair value through profit or loss	Fair value through profit or loss
Exchangeable units	Fair value through profit or loss	Fair value through profit or loss
Lines of credit	Other liabilities at amortized cost	Amortized cost
Accounts payable and accrued liabilities	Other liabilities at amortized cost	Amortized cost
Derivative instruments	Fair value through profit and loss	Fair value through profit and loss

For impairment of financial assets, IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' ("ECL") model. The new impairment model applies to financial assets except for investments in equity instruments, and to contract assets, lease receivables, loan commitments and financial guarantee contracts.

The REIT adopted the practical expedient to determine ECL on accounts receivable using a provision matrix based on historical credit loss experiences adjusted for current and forecasted future economic conditions to estimate lifetime ECL. The other ECL models applied to other financial assets also require judgment, assumptions and estimations on changes in credit risks, forecasts of future economic conditions and historical information on the credit quality of the financial asset.

Impairment losses are recorded in finance cost - operations in the consolidated statement of comprehensive income with the carrying amount of the financial asset or group of financial assets reduced through the use of impairment allowance accounts.

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. The U.S. dollar denominated senior debenture, unsecured term loan and line of credit are designated as a hedge of the REIT's investment in self-sustaining operations.

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

(i) *Leases ("IFRS 16")*

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

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

Management does not expect the adoption of IFRS 16 to have a material impact on the consolidated financial statements.

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2. Significant accounting policies (continued):

(ii) IFRIC Interpretation 23, Uncertainty over Income Tax Treatments ("The Interpretation")

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

Management does not expect the adoption of IFRIC 23 to have a material impact on the consolidated financial statements.

3. Real estate assets:

	December 31, 2018		December 31, 2017		
	Note	Investment Properties	Properties Under Development	Investment Properties	Properties Under Development
Opening balance, beginning of year		\$ 13,074,123	\$ 83,132	\$ 12,564,144	\$ 118,268
Acquisitions, including transaction costs		463,299	196,754	430,537	71,260
Dispositions		(933,403)	-	(70,062)	-
Transfer from equity accounted investment		-	-	62,500	-
Transfer of investment properties to assets classified as held for sale	5	(110,940)	-	-	-
Operating capital:					
Capital expenditures		57,825	-	51,845	-
Leasing expenses and tenant inducements		32,441	-	28,722	-
Development capital:					
Redevelopment (including capitalized interest)		60,892	-	113,212	-
Additions to properties under development (including capitalized interest)		-	119,117	-	15,555
Amortization of tenant inducements, straight-lining of contractual rents and blend and extend rents included in revenue		3,088	-	(1,478)	-
Transfer of properties under development that have reached substantial completion to investment properties		-	-	116,525	(116,525)
Fair value adjustment on real estate assets		(246,967)	-	3,038	(1,242)
Change in foreign exchange		283,351	5,811	(224,860)	(4,184)
Closing balance, end of year		\$ 12,683,709	\$ 404,814	\$ 13,074,123	\$ 83,132

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. 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, 2018, the REIT acquired five residential properties, partial ownership in two industrial properties and three residential properties under development (year ended December 31, 2017 - five residential properties and one residential property under development which was transferred to investment properties upon substantial completion). The results of operations for these acquisitions are included in these consolidated financial statements from the date of acquisition.

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3. Real estate assets (continued):

The following table summarizes the purchase price plus transaction costs of the assets as at the respective dates of acquisition:

	December 31 2018	December 31 2017
Assets		
Investment properties	\$ 462,961	\$ 430,516
Properties under development	196,754	71,260
	\$ 659,715	\$ 501,776

During the year ended December 31, 2018, the REIT incurred additional costs of \$338 (year ended December 31, 2017 - \$21) in respect of prior acquisitions which are not included in the above table.

Asset dispositions:

During the year ended December 31, 2018, the REIT sold 64 retail properties, one Primaris property, a 50% ownership interest in four industrial properties, a 75% ownership interest in one industrial property and a 50% ownership interest in one office property and recognized a loss on sale of real estate assets of \$19,602.

During the year ended December 31, 2017, the REIT sold three retail properties, a 50% ownership interest in two Primaris properties, a 50% interest in one industrial property, one residential property and one office property and recognized a loss on sale of real estate assets of \$7,729. The loss on sale of real estate assets includes mark-to-market adjustments of \$3,544 on the purchaser's assumption of a mortgage.

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) Discounted cash flow analyses which are 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 calculates fair value by applying a capitalization rate to stabilized net operating income; and
- (iv) External independent appraisals. During the year ended December 31, 2018, certain properties were valued by professional external independent appraisers. These properties represent 25.4% of the fair value of investment properties as at December 31, 2018 (year ended December 31, 2017 - 32.3%). The remainder of the portfolio was valued by the REIT's internal valuation team. The properties that were externally appraised are 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 for mortgage financing purposes.

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

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3. Real estate assets (continued):

The following table highlights the significant assumptions used in determining the fair value of the REIT's investment properties:

	Overall Capitalization Rates			Discount Rates			Terminal Capitalization Rates		
	Canada	United States	Total	Canada	United States	Total	Canada	United States	Total
December 31, 2018	5.73%	5.39%	5.64%	6.48%	6.29%	6.43%	5.92%	5.72%	5.86%
December 31, 2017	5.63%	5.78%	5.67%	6.46%	6.60%	6.50%	5.88%	6.08%	5.94%

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 overall capitalization rate applied as at December 31, 2018:

Capitalization Rate Sensitivity Increase (Decrease)	Overall Capitalization Rate	Fair Value of Investment Properties	Fair Value Variance	% Change
(0.75%)	4.89%	\$ 14,629,063	\$ 1,945,354	15.34%
(0.50%)	5.14%	\$ 13,917,533	\$ 1,233,824	9.73%
(0.25%)	5.39%	\$ 13,272,007	\$ 588,298	4.64%
December 31, 2018	5.64%	\$ 12,683,709	\$ -	0.00%
0.25%	5.89%	\$ 12,145,351	\$ (538,358)	(4.24%)
0.50%	6.14%	\$ 11,650,834	\$ (1,032,875)	(8.14%)
0.75%	6.39%	\$ 11,195,011	\$ (1,488,698)	(11.74%)

4. Equity accounted investments:

The REIT has entered into a number of arrangements with other parties for the purpose of jointly developing, 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 joint control over the operations of such properties. The REIT's arrangements fall into three categories: a) joint operations, where the REIT has joint control over the operations and the REIT has rights to the assets and obligations for the liabilities of the properties; b) joint ventures, where the REIT has joint control over the operations, where each investment is structured as a separate vehicle and the REIT has rights to the net assets of the entities; and (c) investments in associates, where the REIT has significant influence over the investment but does not have joint control over the operations. Joint operations are accounted for on a proportionately consolidated basis. Joint ventures and investments in associates are accounted for using the equity method.

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4. Equity accounted investments (continued):

During the year ended December 31, 2018, the REIT: (i) acquired a 33.3% interest in Esterra Park Development Partners LP ("Esterra Park"), a joint venture, for \$3,799; and (ii) acquired a 30.9% interest in Shoreline Developments Partners LP ("Shoreline"), a joint venture, for \$5,973.

During the year ended December 31, 2017, the REIT: (i) acquired a 33.3% net interest in the Koenig Lane Development LP ("The Pearl"), a joint venture, for \$6,413; and (ii) disposed of nine industrial properties.

	Location	Principal activity	Ownership interest	
			December 31 2018	December 31 2017
Investments in joint ventures: ⁽¹⁾				
6 industrial properties	United States	Own and operate investment property	50.5%	50.5%
Hercules Project	United States	Develop, own and operate investment property	31.7%	31.7%
The Pearl	United States	Develop, own and operate investment property	33.3%	33.3%
Esterra Park	United States	Develop, own and operate investment property	33.3%	-
Shoreline	United States	Develop, own and operate investment property	30.9%	-
Investments in associates: ⁽²⁾				
ECHO Realty LP ("ECHO")	United States	Own and operate investment properties	33.6%	33.6%
LIC Operator Co., L.P. ("Jackson Park")	United States	Develop, own and operate investment property	50.0%	50.0%

(1) 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.

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

The following tables summarize the total amounts of the financial information of the equity accounted investments 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, 2018			December 31, 2017		
	Investments in joint ventures	Investments in associates	Total	Investments in joint ventures	Investments in associates	Total
Equity accounted investments:						
Investment properties	\$ 119,340	\$ 2,565,646	\$ 2,684,986	\$ 112,896	\$ 2,328,749	\$ 2,441,645
Properties under development	176,493	2,188,350	2,364,843	68,222	1,596,490	1,664,712
Other assets	538	75,905	76,443	103,056	76,940	179,996
Cash and cash equivalents	11,192	86,096	97,288	107,205	30,383	137,588
Debt	(56,907)	(1,878,428)	(1,935,335)	(36,232)	(1,530,339)	(1,566,571)
Deferred tax liability	(335)	-	(335)	(310)	-	(310)
Accounts payable and accrued liabilities	(14,679)	(123,477)	(138,156)	(4,393)	(99,794)	(104,187)
Non-controlling interest	-	(78,640)	(78,640)	-	(74,428)	(74,428)
Net assets	235,642	2,835,452	3,071,094	350,444	2,328,001	2,678,445
REIT's share of net assets	\$ 91,565	\$ 1,193,420	\$ 1,284,985	\$ 163,907	\$ 961,228	\$ 1,125,135

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, 2018 and November 30, 2017, respectively.

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4. Equity accounted investments (continued):

Net income (loss) from equity accounted investments:	Year ended December 31, 2018			Year ended December 31, 2017		
	Investments in joint ventures	Investments in associates	Total	Investments in joint ventures	Investment in associates	Total
Rentals from investment properties	\$ 11,137	\$ 228,522	\$ 239,659	\$ 31,506	\$ 216,095	\$ 247,601
Property operating costs	(1,235)	(64,421)	(65,656)	(4,855)	(46,852)	(51,707)
Net income from equity accounted investments	-	1,208	1,208	-	1,750	1,750
Finance income	254	2,638	2,892	87	1,071	1,158
Finance cost - operations	(2,033)	(65,043)	(67,076)	(5,431)	(47,874)	(53,305)
Trust expenses	(277)	(8,200)	(8,477)	(293)	(6,387)	(6,680)
Fair value adjustments on financial instruments	-	7,664	7,664	-	9,213	9,213
Fair value adjustment on real estate assets	(3,599)	266,086	262,487	(30,517)	262,840	232,323
Gain (loss) on sale of real estate assets	(628)	868	240	(1,993)	802	(1,191)
Income taxes	(54)	(56)	(110)	(236)	(197)	(433)
Net income (loss)	3,565	369,266	372,831	(11,732)	390,461	378,729
Net income attributable to non-controlling interest	-	(4,559)	(4,559)	-	(2,640)	(2,640)
Net income (loss) attributable to owners	3,565	364,707	368,272	(11,732)	387,821	376,089
REIT's share of net income (loss) attributable to unitholders	\$ 1,771	\$ 167,638	\$ 169,409	\$ (5,854)	\$ 173,261	\$ 167,407

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, 2017 to November 30, 2018 and December 1, 2016 to November 30, 2017, respectively.

5. Assets classified as held for sale:

As at December 31, 2018, the REIT had a 50% interest in one industrial property and a 100% interest in one U.S. office property (December 31, 2017 - no properties) classified as held for sale.

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

	December 31 2018	December 31 2017
Assets		
Investment properties	\$ 110,940	\$ -
	\$ 110,940	\$ -

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6. Other assets:

	<i>Note</i>	December 31 2018	December 31 2017
Mortgages receivable ⁽¹⁾		\$ 96,909	\$ 153,211
Prepaid expenses and sundry assets		25,861	33,554
Restricted cash		12,872	25,311
Accounts receivable		12,401	15,739
Derivative instruments	11	5,445	6,374
		\$ 153,488	\$ 234,189

⁽¹⁾ As at December 31, 2018, mortgages receivable bear interest at effective rates between 3.25% and 9.00% per annum (December 31, 2017 - between 3.25% and 9.00% per annum) with a weighted average effective rate of 6.49% per annum (December 31, 2017 - 7.42%), and mature between 2019 and 2026 (December 31, 2017 - mature between 2018 and 2026).

Future repayments are as follows:

	December 31 2018
Years ending December 31:	
2019	\$ 4,533
2020	-
2021	44,731
2022	34,100
2023	2,297
Thereafter	11,248
	\$ 96,909

7. Cash and cash equivalents:

Cash and cash equivalents at December 31, 2018 includes cash on hand of \$52,807 (December 31, 2017 - \$42,022) and bank term deposits of \$266 (December 31, 2017 - \$262) at a rate of interest of 1.58% (December 31, 2017 - 0.85%).

8. Debt:

The REIT's debt consists of the following items:

	<i>Note</i>	December 31 2018	December 31 2017
Mortgages payable	8(a)	\$ 4,150,459	\$ 3,958,631
Debentures payable	8(b)	1,613,040	1,852,790
Unsecured term loans	8(c)	450,629	186,629
Lines of credit	8(d)	331,944	495,567
		\$ 6,546,072	\$ 6,493,617

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8. Debt (continued):

(a) 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 4.17% (December 31, 2017 - 4.26%) per annum and mature between 2019 and 2032 (December 31, 2017 - maturing between 2018 and 2033). Included in mortgages payable at December 31, 2018 are U.S. dollar denominated mortgages of U.S. \$1,368,241 (December 31, 2017 - U.S. \$1,189,793). The Canadian equivalent of these amounts is \$1,860,808 (December 31, 2017 - \$1,499,139).

Mortgages payable related to certain properties are 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:

	December 31
	2018
Years ending December 31:	
2019	\$ 177,182
2020	491,197
2021	948,597
2022	611,056
2023	453,182
Thereafter	1,483,616
	4,164,830
Financing costs and mark-to-market adjustment arising on acquisitions	(14,371)
	\$ 4,150,459

The following table provides a continuity of mortgages payable for the year ended December 31, 2018:

	December 31
	2018
Opening balance, beginning of year	\$ 3,958,631
Principal repayments:	
Scheduled amortization on mortgages	(129,145)
Mortgage repayments	(407,763)
New mortgages	619,788
Effective interest rate accretion on mortgages	382
Change in foreign exchange	108,566
Closing balance, end of year	\$ 4,150,459

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8. Debt (continued):

(b) 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 2018	December 31 2017
	Maturity	Contractual interest rate	Effective interest rate	Conversion price	Principal amount	Carrying value
Convertible Debentures (i)						
2020 Convertible Debentures (HR.DB.D)		5.90%	5.90%	\$ 23.50	\$ -	\$ -
Senior Debentures (ii)						
Series E Senior Debentures		4.90%	5.22%	-	-	99,971
Series J Senior Debentures		2.04%	(1)	-	-	157,480
Series G Senior Debentures		3.34%	3.54%	-	-	174,847
Series C Senior Debentures		5.00%	5.30%	-	-	124,690
Series K Senior Debentures	March 1, 2019	2.36%	(2)	-	200,000	199,943
Series M Senior Debentures	July 23, 2019	3.06%	(3)	-	150,000	149,902
Series P Senior Debentures	February 13, 2020	3.00%	(4)	-	170,000	169,667
Series F Senior Debentures	March 2, 2020	4.45%	4.58%	-	175,000	174,731
Series L Senior Debentures	May 6, 2022	2.92%	3.11%	-	325,000	321,996
Series O Senior Debentures	January 23, 2023	3.42%	3.44%	-	250,000	248,782
Series N Senior Debentures	January 30, 2024	3.37%	3.45%	-	350,000	348,019
		3.21%	3.29%		1,620,000	1,613,040
		3.21%	3.29%		\$ 1,620,000	\$ 1,613,040
						1,749,650
						\$ 1,852,790

(1) Denominated as \$125,000 U.S. dollars and bore 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 11). In February 2018, the REIT repaid all of its Series J senior debentures upon maturity for a cash payment of \$125,000 U.S. dollars.

(2) 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 11).

(3) Bears interest at a rate equal to 3-month Canadian Dealer Offered Rate plus 123 basis points. The average interest rate for the year ended December 31, 2018 was 3.06%.

(4) Denominated as \$125,000 U.S. dollar and bears interest at a rate equal to 3-month London Interbank Offered Rate plus 79 basis points. The average interest rate for the year ended December 31, 2018 was 3.00%. In December 2018, the REIT entered into an interest rate swap on the Series P senior debentures to fix the interest rate at 2.88% per annum (note 11).

(i) Convertible Debentures:

The Convertible Debentures were measured at fair value, with fair value determined using the quoted price on the TSX on December 31, 2017. In March 2018, the REIT redeemed all of the outstanding 2020 Convertible Debentures for a cash payment of \$99,582.

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Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

8. Debt (continued):

(ii) Senior Debentures:

In January 2018, the REIT issued \$250,000 Series O unsecured senior debentures (the "Series O Senior Debentures"). On issuance, the REIT recorded a liability of \$248,525, net of issue costs of \$1,475.

In February 2018, the REIT issued U.S. \$125,000 Series P floating rate unsecured senior debentures (the "Series P Senior Debentures"). On issuance, the REIT recorded a liability of U.S. \$124,553, net of issue costs of U.S. \$447.

At its option, the REIT may redeem any of the fixed rate Senior Debentures, in whole at any time, or in part from time to time (i) in the case of the Series N and Series O senior debentures, prior to the specified par call date; and (ii) in the case of any other fixed rate senior debentures, 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. Between the specified par call date and maturity, the applicable Senior Debentures may be redeemed on payment of a redemption price equal to par. The REIT will give notice of any redemption at least 30 days but not more than 60 days before the date fixed for redemption. Where less than all of any Senior Debentures are to be redeemed pursuant to their terms, the Senior Debentures to be so redeemed will be redeemed on a pro rata basis according to the principal amount of Senior Debentures registered in the respective name of each holder of Senior Debentures or in such other manner as the indenture trustee may consider equitable.

The Series F, K, L, M, N, O and P unsecured senior debentures (collectively, the "Senior Debentures") pay interest semi-annually or quarterly as noted below:

Senior Debentures	Interest Payment Dates
Series F	March 2 and September 2
Series K	March 1, June 1, September 1 and December 1
Series L	May 6 and November 6
Series M	January 23, April 23, July 23 and October 23
Series N	January 30 and July 30
Series O	January 23 and July 23
Series P	February 13, May 13, August 13 and November 13

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8. Debt (continued):

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

	December 31 2018	December 31 2017
Convertible Debentures		
Carrying value, beginning of year	\$ 103,140	\$ 178,898
Conversion - 2020 Convertible Debentures (HR.DB.D)	(70)	(2)
Redemption - 2020 Convertible Debentures (HR.DB.D) ⁽¹⁾	(99,582)	-
Redemption - 2018 Convertible Debentures (HR.DB.H) ⁽¹⁾	-	(74,394)
Gain on change in fair value	(3,488)	(1,362)
Carrying value, end of year	-	103,140
Senior Debentures		
Carrying value, beginning of year	1,749,650	1,312,693
Redemption - Series E Senior Debentures ⁽¹⁾	(100,000)	-
Redemption - Series J Senior Debentures ⁽¹⁾	(157,500)	-
Redemption - Series G Senior Debentures ⁽¹⁾	(175,000)	-
Redemption - Series C Senior Debentures ⁽¹⁾	(125,000)	-
Redemption - Series I Senior Debentures ⁽¹⁾	-	(60,000)
Redemption - Series B Senior Debentures ⁽¹⁾	-	(115,000)
Issuance - Series M Senior Debentures ⁽²⁾	-	149,461
Issuance - Series N Senior Debentures ⁽²⁾	-	347,393
Issuance - Series L Senior Debentures ⁽²⁾	-	122,445
Issuance - Series O Senior Debentures ⁽²⁾	248,525	-
Issuance - Series P Senior Debentures ⁽²⁾	160,680	-
Change in foreign exchange	8,737	(10,000)
Accretion adjustment	2,948	2,658
Carrying value, end of year	1,613,040	1,749,650
	\$ 1,613,040	\$ 1,852,790

⁽¹⁾ During the year ended December 31, 2018, the REIT redeemed debentures payable of \$657,082 (2017 - \$249,394).

⁽²⁾ During the year ended December 31, 2018, the REIT issued debentures payable of \$409,205 (2017 - \$619,299).

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

8. Debt (continued):

(c) Unsecured term loans:

The REIT has the following unsecured term loans:

	Maturity Date	December 31 2018	December 31 2017
H&R REIT unsecured term loan #1 ⁽¹⁾	March 17, 2021	\$ 200,629	\$ 186,629
H&R REIT unsecured term loan #2 ⁽²⁾	January 6, 2026	250,000	-
		\$ 450,629	\$ 186,629

⁽¹⁾ The total facility as at December 31, 2018 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 rate swap 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, maturing on March 17, 2021 (note 11).

⁽²⁾ The REIT entered into an interest rate swap to fix the interest rate at 3.91% per annum, maturing on January 6, 2026 (note 11).

Included in unsecured term loans at December 31, 2018, are U.S. denominated amounts of \$140,000 (December 31, 2017 - U.S. \$140,000). The Canadian equivalent of these amounts is \$190,400 (December 31, 2017 - \$176,400).

(d) Lines of credit:

The REIT has the following lines of credit:

	Maturity Date	Total Facility	Amount Drawn	Outstanding Letters of Credit	Available Balance
Revolving unsecured operating lines of credit:					
H&R REIT revolving unsecured line of credit #1	September 20, 2022	\$ 150,000	\$ -	\$ -	\$ 150,000
H&R REIT revolving unsecured line of credit #2	January 31, 2023	200,000	-	-	200,000
H&R REIT revolving unsecured line of credit #3	September 20, 2023	350,000	(5,750)	(2,330)	341,920
H&R REIT revolving unsecured letter of credit facility		60,000	-	(23,439)	36,561
Sub-total		760,000	(5,750)	(25,769)	728,481
Revolving secured operating lines of credit⁽¹⁾:					
H&R REIT co-ownership revolving secured line of credit	September 30, 2019	3,514	(3,514)	-	-
H&R REIT and CrestPSP revolving secured line of credit	April 30, 2020	62,500	(49,000)	(105)	13,395
Primaris revolving secured line of credit	July 1, 2020	300,000	(273,680)	-	26,320
Sub-total		366,014	(326,194)	(105)	39,715
December 31, 2018		\$ 1,126,014	\$ (331,944)	\$ (25,874)	\$ 768,196

⁽¹⁾ Secured by certain investment properties.

As at December 31, 2017, the total facility was \$828,514 less the amount drawn and outstanding letters of credit of \$495,567 and \$32,924, respectively, resulting in an available balance of \$300,023.

The lines of credit and can be drawn in either Canadian or U.S. dollars and bear interest at a rate approximating the prime rate of a Canadian chartered bank.

Included in lines of credit at December 31, 2018 are U.S. dollar denominated amounts of \$13,000 (December 31, 2017 - U.S. \$327,000). The Canadian equivalent of these amounts is \$17,680 (December 31, 2017 - \$412,020).

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Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

8. Debt (continued):

The following table provides a continuity of unsecured term loans and lines of credit for the year ended December 31, 2018:

	Unsecured Term Loans	Lines of Credit
Opening balance, beginning of year	\$ 186,629	\$ 495,567
Net advances (repayments)	250,000	(196,323)
Change in foreign exchange	14,000	32,700
Closing balance, end of year	\$ 450,629	\$ 331,944

9. Exchangeable units:

Certain of the REIT's subsidiaries have in aggregate 15,955,541 (December 31, 2017 - 15,979,430) exchangeable units outstanding which are puttable instruments where, upon redemption, the REIT has a contractual obligation to issue Units. A subsidiary of the REIT also holds 433,174 (December 31, 2017 - 433,174) Units to mirror these exchangeable units. Therefore, when such exchangeable units are exchanged for Units, the number of outstanding 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 Unit amount provided to holders of Units. These puttable instruments are classified as a liability under IFRS and are measured at fair value through profit or loss. Fair value is determined by using the quoted prices for the Units as the exchangeable units are exchangeable into Units at the option of the holder. The quoted price as at December 31, 2018 was \$20.65 (December 31, 2017 - \$21.36) per Unit.

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

	December 31 2018	December 31 2017
Carrying value, beginning of year	\$ 341,321	\$ 370,533
Exchanged for Units	(500)	(13,324)
Gain on fair value of exchangeable units	(11,339)	(15,888)
Carrying value, end of year	\$ 329,482	\$ 341,321

The REIT has entered into various exchange agreements that provide, among other things, the mechanics whereby exchangeable units may be exchanged for Units.

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Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

10. Accounts payable and accrued liabilities:

	<i>Note</i>	December 31 2018	December 31 2017
Current:			
Other accounts payable and accrued liabilities		\$ 148,106	\$ 149,282
Mortgage interest payable		9,885	9,376
Prepaid rent		24,030	23,059
Debenture interest payable		14,869	13,295
Derivative instruments	11	2,701	-
Unit-based compensation payable:			
Options	12(b)	1,834	2,249
Incentive units	12(b)	1,688	3,156
Non-current:			
Security deposits		6,051	5,752
Unit-based compensation payable:			
Options	12(b)	9,045	10,297
Incentive units	12(b)	4,932	2,565
		\$ 223,141	\$ 219,031

11. Derivative instruments:

		Fair value asset (liability)*		Net gain (loss) on derivative contracts	
		December 31 2018	December 31 2017	December 31 2018	December 31 2017
Debenture interest rate swap	(1)	\$ 592	\$ 2,231	\$ (1,639)	\$ 1,455
Debenture interest rate swap	(2)	(331)	-	(331)	-
Debenture interest rate swap	(3)	-	177	(177)	584
Term loan interest rate swap	(4)	4,853	3,966	887	7,350
Term loan interest rate swap	(5)	(2,370)	-	(2,370)	-
		\$ 2,744	\$ 6,374	\$ (3,630)	\$ 9,389

The REIT entered into interest rate swaps as follows:

- (1) To fix the interest rate at 2.36% per annum for the Series K senior debentures, maturing on March 1, 2019.
- (2) To fix the interest rate at 2.88% per annum for the Series P senior debentures, maturing on February 13, 2020.
- (3) To fix the interest rate at 2.54% per annum for the Series I senior debentures (settled when these debentures matured on January 23, 2017) and to fix the interest rate at 2.04% per annum for the Series J senior debentures (settled when these debentures matured on February 9, 2018).
- (4) To fix the interest rate at 2.56% per annum on U.S. \$130,000 term loan, maturing on March 17, 2021.
- (5) To fix the interest rate at 3.91% per annum on \$250,000 term loan, maturing on January 6, 2026.

* 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 (note 6) and derivative instruments in a liability position are recorded in accounts payable and accrued liabilities (note 10).

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Years ended December 31, 2018 and 2017

12. 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 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. The aggregate number of Units which the REIT may issue is unlimited and the aggregate number of special voting units which the REIT may issue is 9,500,000. Units carry the right to participate pro rata in any distributions. As at December 31, 2018, 9,500,000 (December 31, 2017- 9,500,000) special voting units are issued and outstanding.

Units are listed and posted for trading on the TSX under the symbol HR.UN.

Units are freely transferable and the trustees shall not impose any restriction on the transfer of Units.

Unitholders have the right to require the REIT to redeem their Units on demand. 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 Declaration of Trust.

Upon valid tender for redemption of each Unit, the unitholder is entitled to receive a price per Unit as determined by a formula based on the market price of a Unit. 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) and *in specie* distribution of notes of H&R Portfolio LP Trust (a subsidiary of the REIT).

Changes in the issued and outstanding number of Units during the years ended December 31, 2018 and 2017 are as follows:

	<i>Note</i>	
As at January 1, 2017		285,279,707
Issuance of Units:		
Issued under the Dividend Reinvestment Plan and Unit Purchase Plan ("DRIP")		5,557,815
Options exercised		652,291
Incentive Units settled in Units		1,354
Exchangeable units exchanged into Units		584,386
Conversion of convertible debentures		85
Units repurchased and cancelled	<i>12(d)</i>	(755,420)
As at December 31, 2017		291,320,218
Issuance of Units:		
Issued under the DRIP ⁽¹⁾		933,594
Options exercised		1,271
Incentive Units settled in Units		5,281
Exchangeable units exchanged into Units		23,889
Conversion of convertible debentures		2,978
Units repurchased and cancelled	<i>12(d)</i>	(6,609,420)
As at December 31, 2018		285,677,811

⁽¹⁾ In February 2018, the Trusts announced the suspension of their DRIP and Unit Purchase Plan until further notice. Commencing with the March 2018 distribution, unitholders who elected to participate in the DRIP received the full cash distributions on their Units. Following the Reorganization, the REIT's DRIP and Unit Purchase Plan remain suspended until further notice and unitholders who elected to participate in the DRIP will receive the full cash distributions on their Units.

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Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

12. Unitholders' equity (continued):

The weighted average number of basic Units for the year ended December 31, 2018 is 287,060,425 (December 31, 2017 - 288,787,282).

(b) 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, 2018, a maximum of 28,000,000 (December 31, 2017 - 28,000,000) options to purchase Units were authorized to be issued, of which 21,402,296 (December 31, 2017 - 21,402,296) options have been granted, 477,764 (December 31, 2017 - 452,170) options have expired and 7,075,468 (December 31, 2017 - 7,049,874) options remain to be granted. The exercise price of each option approximates the quoted price of the Units on the date of grant. 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.

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

	December 31, 2018		December 31, 2017	
	Units	Weighted average exercise price	Units	Weighted average exercise price
Outstanding, beginning of year	11,310,383	\$ 20.51	13,820,539	\$ 20.26
Granted	-	-	-	-
Exercised	(21,210)	(18.98)	(2,401,408)	(19.15)
Expired	(25,594)	(20.71)	(108,748)	(19.65)
Outstanding, end of year	11,263,579	\$ 20.51	11,310,383	\$ 20.51
Options exercisable, end of year	8,867,636	\$ 20.93	6,008,045	\$ 21.62

The options outstanding at December 31, 2018 are exercisable at varying prices ranging from \$15.42 to \$23.18 (December 31, 2017 - \$15.42 to \$23.18) with a weighted average remaining life of 5.8 years (December 31, 2017 - 6.8 years). The vested options are exercisable at varying prices ranging from \$15.42 to \$23.18 (December 31, 2017 - \$15.42 to \$23.18) with a weighted average remaining life of 5.4 years (December 31, 2017 - 5.7 years).

(ii) Incentive unit plan:

As at December 31, 2018, a maximum of 5,000,000 (December 31, 2017 - 5,000,000) incentive units exchangeable into Units were authorized to be issued under the incentive unit plan. Of this amount, 935,049 (December 31, 2017 - 651,026) incentive units have been granted, of which 46,308 (December 31, 2017 - 39,731) incentive units have expired, 320,864 incentive units have been settled for cash (December 31, 2017 - 178,408) and 6,635 (December 31, 2017 - 1,354) incentive units have been settled for Units. 4,432,123 (December 31, 2017 - 4,567,113) incentive units may still be granted under the plan and 561,242 (December 31, 2017 - 431,533) incentive units remain outstanding.

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 Units issued from treasury, with the result that the awards are classified as cash-settled unit-based payments and presented as liabilities. 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.

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12. Unitholders' equity (continued):

The REIT grants restricted units under the incentive unit plan. 100% of the restricted 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 restricted units are, subject to the holder's election, cash settled upon vesting.

The REIT grants performance units under the incentive unit plan with a three-year performance period for certain senior executives. The performance units are and will be subject to both internal and external measures consisting of both absolute and relative performance over a three-year period and, subject to the holder's election, cash settled upon vesting.

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

	December 31 2018	December 31 2017
	Units	Units
Outstanding, beginning of year	431,533	407,360
Granted	284,023	232,001
Settled	(147,737)	(179,762)
Expired	(6,577)	(28,066)
Outstanding, end of year	561,242	431,533

The fair values of the unit options and incentive units, included in accounts payable and accrued liabilities, are as follows:

	December 31 2018	December 31 2017
Options	\$ 10,879	\$ 12,546
Incentive units	6,620	5,721
	\$ 17,499	\$ 18,267

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

	2018	2017
Options	\$ (1,642)	\$ 2,127
Incentive units	4,055	2,742
	\$ 2,413	\$ 4,869

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12. Unitholders' equity (continued):

(c) Distributions:

Under the REIT's Declaration of Trust, the total amount of income of the REIT to be distributed to unitholders for each calendar month shall be subject to the discretion of the trustees however, the total income distributed shall not be less than the amount necessary to ensure that the REIT will not be liable to pay income tax under Part I of the Tax Act for any year. The method of payment is at the discretion of the trustees.

For the year ended December 31, 2018, the REIT declared distributions per Unit of \$1.38 (December 31, 2017 - \$1.38).

The details of the distributions are as follows:

	2018	2017
Cash distributions to unitholders	\$ 378,936	\$ 290,497
Unit distributions (issued under the DRIP) ⁽¹⁾	16,632	107,411
	\$ 395,568	\$ 397,908

⁽¹⁾ In February 2018, the Trusts announced the suspension of their DRIP and Unit Purchase Plan until further notice. Commencing with the March 2018 distribution, unitholders who elected to participate in the DRIP received the full cash distributions on their Units. Following the Reorganization, the REIT's DRIP and Unit Purchase Plan remain suspended until further notice and unitholders who elected to participate in the DRIP will receive the full cash distributions on their Units.

(d) Normal course issuer bid:

On December 14, 2018, the REIT received approval from the TSX for the renewal of its normal course issuer bid ("NCIB"), allowing the REIT to purchase for cancellation up to a maximum of 15,000,000 Units on the open market until the earlier of December 16, 2019 or the date on which the REIT purchased the maximum number of Units permitted under the NCIB. During the year ended December 31, 2018, under a previous NCIB, the Trusts purchased and cancelled 6,609,420 Units at a weighted average price of \$20.62 per Unit, for a total cost of \$136,272. During the year ended December 31, 2017, under a previous NCIB, the Trusts purchased and cancelled 755,420 Units at a weighted average price of \$21.10 per Unit, for a total cost of \$15,939.

13. Accumulated other comprehensive income:

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

	December 31, 2018			December 31 2017
	Cash flow hedges	Foreign operations	Total	Total
Opening balance, beginning of year	\$ (282)	\$ 177,230	\$ 176,948	\$ 308,220
Transfer of realized loss on cash flow hedges to net income	30	-	30	30
Unrealized gain (loss) on translation of U.S. denominated foreign operations	-	139,409	139,409	(86,022)
Net gain (loss) on hedges of net investments in foreign operations	-	55,437	55,437	(45,280)
	30	194,846	194,876	(131,272)
Closing balance, end of year	\$ (252)	\$ 372,076	\$ 371,824	\$ 176,948

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Years ended December 31, 2018 and 2017

14. Rentals from investment properties:

	2018	2017
Rental income	\$ 962,429	\$ 1,177,626
Revenue from services	220,230	(1)
Straight-lining of contractual rent	(4,113)	(6,818)
Rent amortization of tenant inducements	(1,988)	(2,354)
	\$ 1,176,558	\$ 1,168,454

(1) The REIT did not apply the requirements of IFRS 15 to the comparative year (as described in note 2).

Operating Leases:

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

	2018	2017
Less than 1 year	\$ 686,133	\$ 725,151
Between 1 and 5 years	2,150,004	2,323,815
More than 5 years	3,182,837	3,615,459
	\$ 6,018,974	\$ 6,664,425

15. Finance costs:

	2018	2017
Finance cost - operations		
Contractual interest on mortgages payable	\$ 165,855	\$ 174,492
Contractual interest on debentures payable	61,213	62,565
Effective interest rate accretion	3,666	1,808
Bank interest and charges	20,709	11,877
Exchangeable unit distributions	22,050	22,254
	273,493	272,996
Capitalized interest ⁽¹⁾	(6,406)	(2,638)
	267,087	270,358
Finance income	(8,638)	(4,999)
Fair value adjustments on financial instruments ⁽²⁾	(11,197)	(27,049)
	\$ 247,252	\$ 238,310

(1) The weighted average rate of borrowings for the capitalized interest is 3.91% (December 31, 2017 - 4.0%).

(2) During the year ended December 31, 2018, the REIT did not realize any gains on sale of investment previously classified as held for trading (December 31, 2017 - U.S. \$6,718).

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16. Supplemental cash flow information:

	2018	2017
Accrued rents receivable	\$ (5,077)	\$ (876)
Prepaid expenses and sundry assets	7,693	8
Accounts receivable	3,338	(2,728)
Accounts payable and accrued liabilities	(3,615)	6,109
	\$ 2,339	\$ 2,513

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

	<i>Note</i>	2018	2017
Non-cash items:			
Non-cash distributions to unitholders in the form of DRIP Units	<i>12(c)</i>	\$ 16,632	\$ 107,411
Non-cash conversion of convertible debentures	<i>8(b)(iii)</i>	70	2
Non-cash distributions to exchangeable unitholders in the form of DRIP Units		2,033	11,051
Non-cash adjustment to proceeds from issuance of Units		140	7,523
Non-cash assumption of mortgage payable on disposition of investment properties		-	(126,567)
Mortgages receivable from the sale of investment properties		34,100	4,200
Mortgage receivable used for the acquisition of property under development		(164,878)	-
Restricted cash from the disposition of investment properties		-	26,265
Restricted cash used for the acquisition of investment properties		-	(13,109)
Exchangeable units exchanged for Units	<i>9</i>	500	13,324
Other items:			
Decrease in accounts payable on redevelopment		9	336
(Increase) decrease in accounts payable included in finance cost - operations		362	(1,809)
Capitalized interest on redevelopment	<i>15</i>	(2,780)	(1,562)
Capitalized interest on properties under development	<i>15</i>	(3,626)	(1,076)

17. 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:

	December 31 2018	December 31 2017
Debt	\$ 6,546,072	\$ 6,493,617
Exchangeable units	329,482	341,321
Unitholders' equity	7,200,100	7,179,763
	\$ 14,075,654	\$ 14,014,701

H&R REAL ESTATE INVESTMENT TRUST

Notes to Consolidated Financial Statements

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

Years ended December 31, 2018 and 2017

17. Capital risk management (continued):

As long as the REIT complies with its investment and debt restrictions set out in its Declaration of Trust, it is free to determine the appropriate level of capital in context with its cash flow requirements, overall business risks and potential business opportunities. As a result of this, the REIT will make adjustments to its capital based on its investment strategies and changes in economic conditions.

The REIT's level of indebtedness is subject to the limitations set out in its Declaration of Trust. The REIT is limited to a total indebtedness to 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, 2018, this ratio was 44.6% (December 31, 2017 - 43.9%). Management uses this ratio as a key indicator in managing the REIT's capital.

In addition to the above key ratio, the REIT's debt has various covenants calculated as defined within these agreements. The REIT monitors these covenants and was in compliance as at December 31, 2018 and December 31, 2017.

18. 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-positive rating by a recognized rating agency.

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

	Note	December 31 2018	December 31 2017
Mortgages receivable	6	\$ 96,909	\$ 153,211
Accounts receivable	6	12,401	15,739
		\$ 109,310	\$ 168,950

(b) Liquidity risk:

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

The REIT manages liquidity risk by:

- Ensuring appropriate unsecured term loans and lines of credit available are available. As at December 31, 2018 the consolidated amount available under its lines of credit was \$768,196 (note 8(d));
- Maintaining a large unencumbered asset pool. As at December 31, 2018, there were 91 unencumbered properties with a fair value of \$3,438,151; and
- Structuring its financing so as to stagger the maturities of its debt, thereby minimizing exposure to liquidity risk in any one year (note 8).

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

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18. Risk management (continued):

Management monitors the REIT's liquidity risk through review of financial covenants contained in bank credit facility agreements, debt agreements and compliance with the REIT's Declaration of Trust.

The REIT's obligations are as follows:

	Note	2019	Thereafter	Total
Debt ⁽¹⁾	8	\$ 530,696	\$ 6,036,707	\$ 6,567,403
Accounts payable and accrued liabilities ⁽²⁾	10	201,279	10,983	212,262
		\$ 731,975	\$ 6,047,690	\$ 6,779,665

⁽¹⁾ Amounts in the above table only include principal repayments.

⁽²⁾ Excludes options payable.

(c) Market risk:

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

(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 U.S. denominated debt of \$278,000 (2017 - U.S. \$592,000) consisting of the Series P Senior Debentures, U.S. unsecured term loans and U.S. lines of credit (2017 - Series J Senior Debentures, U.S. unsecured term loans and U.S. lines of credit) as a hedge of its net investment in foreign operations of approximately U.S. \$1,492,000 (2017 - U.S. \$1,404,000).

A \$0.10 weakening of the U.S. dollar against the average Canadian dollar exchange rate of \$1.30 for the year ended December 31, 2018 (December 31, 2017 - \$1.30) as well as the Canadian dollar exchange rate as at December 31, 2018 of \$1.36 (December 31, 2017 - \$1.26) would have decreased other comprehensive income (loss) by approximately \$177,000 (December 31, 2017 - \$146,900) and decreased net income by approximately \$14,600 (December 31, 2017 - \$21,600). This analysis assumes that all other variables, in particular interest rates, remain constant (a \$0.10 strengthening of the U.S. dollar against the average Canadian dollar would have had the equal but opposite effect).

(ii) Interest rate risk:

The REIT is exposed to interest rate risk on its borrowings. It minimizes this risk by obtaining long-term fixed interest rate debt. At December 31, 2018, the percentage of fixed rate debt to total debt was 91.6% (December 31, 2017 - 88.2%). Therefore, a change in interest rates at the reporting date would not have a material impact on net income as the majority of the REIT's borrowings are through fixed rate instruments.

As at December 31, 2018, unsecured term loans and lines of credit of \$355,773 are subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2018 would have decreased net income by approximately \$3,600 (December 31, 2017 - \$2,200). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

The floating rate Series K and Series P senior debentures are subject to variable rates, however the REIT entered into interest rate swaps to reduce exposure to fluctuations in interest rates. In 2018, the floating rate Series M senior debentures were subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2018 would have decreased net income by approximately \$1,500 (December 31, 2017 - \$1,300). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

H&R REAL ESTATE INVESTMENT TRUST

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18. Risk management (continued):

As at December 31, 2018, a mortgage payable of \$45,519 is subject to variable interest rates. An increase in interest rates of 100 basis points for the year ended December 31, 2018 would have decreased net income by approximately \$460 (December 31, 2017 - \$1,300). This analysis assumes that all other variables, in particular foreign exchange rates, remain constant.

(d) Fair value measurement:

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

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

The fair value of certain mortgages receivable, mortgages payable, senior debentures, unsecured term loans and lines of credit have been determined by discounting the cash flows of these financial obligations using market rates for debt of similar terms and credit risks.

(ii) Assets and Liabilities carried at fair value:

Assets and liabilities measured at fair value in the consolidated 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).

December 31, 2018	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets measured at fair value						
Investment properties	3	\$ -	\$ -	\$ 12,683,709	\$ 12,683,709	\$ 12,683,709
Properties under development	3	-	-	404,814	404,814	404,814
Assets classified as held for sale	5	-	-	110,940	110,940	110,940
Derivative instruments	6	-	5,445	-	5,445	5,445
Mortgage receivable	6	-	-	44,731	44,731	44,731
Assets for which fair values are disclosed						
Mortgages receivable	6	-	52,306	-	52,306	52,178
		-	57,751	13,244,194	13,301,945	13,301,817
Liabilities measured at fair value						
Exchangeable units	9	(329,482)	-	-	(329,482)	(329,482)
Derivative instruments	10	-	(2,701)	-	(2,701)	(2,701)
Liabilities for which fair values are disclosed						
Mortgages payable	8(a)	-	(4,226,404)	-	(4,226,404)	(4,150,459)
Senior debentures	8(b)	-	(1,611,734)	-	(1,611,734)	(1,613,040)
Unsecured term loans	8(c)	-	(452,143)	-	(452,143)	(450,629)
Lines of credit	8(d)	-	(332,739)	-	(332,739)	(331,944)
		(329,482)	(6,625,721)	-	(6,955,203)	(6,878,255)
		\$ (329,482)	\$ (6,567,970)	\$ 13,244,194	\$ 6,346,742	\$ 6,423,562

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

Years ended December 31, 2018 and 2017

18. Risk management (continued):

December 31, 2017	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value
Assets measured at fair value						
Investment properties	3	\$ -	\$ -	\$ 13,074,123	\$ 13,074,123	\$ 13,074,123
Properties under development	3	-	-	83,132	83,132	83,132
Derivative instruments	6	-	6,374	-	6,374	6,374
Assets for which fair values are disclosed						
Mortgages receivable	6	-	155,656	-	155,656	153,211
		-	162,030	13,157,255	13,319,285	13,316,840
Liabilities measured at fair value						
Convertible debentures	8(b)	(103,140)	-	-	(103,140)	(103,140)
Exchangeable units	9	(341,321)	-	-	(341,321)	(341,321)
Liabilities for which fair values are disclosed						
Mortgages payable	8(a)	-	(4,067,657)	-	(4,067,657)	(3,958,631)
Senior debentures	8(b)	-	(1,779,043)	-	(1,779,043)	(1,749,650)
Unsecured term loans	8(c)	-	(184,293)	-	(184,293)	(186,629)
Lines of credit	8(d)	-	(495,802)	-	(495,802)	(495,567)
		(444,461)	(6,526,795)	-	(6,971,256)	(6,834,938)
		\$ (444,461)	\$ (6,364,765)	\$ 13,157,255	\$ 6,348,029	\$ 6,481,902

19. Compensation of key management personnel:

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

	2018	2017
Salaries and short-term employee benefits	\$ 6,259	\$ 3,794
Unit-based compensation	1,888	3,353
	\$ 8,147	\$ 7,147

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Notes to Consolidated Financial Statements

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

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20. Segmented disclosures:

(i) Operating segments:

The REIT has six reportable operating segments (Office, which also includes the REIT's head office, 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 REIT. The CEO measures and evaluates the performance of the REIT based on property operating income on a proportionately consolidated basis for the REIT's equity accounted investments. The accounting policies of the segments presented here are consistent with the REIT's accounting policies as described in note 2.

Real estate assets by reportable segment as at December 31, 2018 and December 31, 2017 are as follows:

December 31, 2018	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Number of investment properties	35	30	59	230	90	22	466
Real estate assets:							
Investment properties	\$ 6,752,450	\$ 2,733,296	\$ 570,357	\$ 870,033	\$ 1,043,220	\$ 1,755,592	\$ 13,724,948
Properties under development	-	-	-	12,444	85,567	1,451,821	1,549,832
	6,752,450	2,733,296	570,357	882,477	1,128,787	3,207,413	15,274,780
Less: assets classified as held for sale	(93,840)	-	-	-	(17,100)	-	(110,940)
Less: REIT's proportionate share of real estate assets relating to equity accounted investments	-	-	-	(882,477)	(60,267)	(1,132,573)	(2,075,317)
	\$ 6,658,610	\$ 2,733,296	\$ 570,357	\$ -	\$ 1,051,420	\$ 2,074,840	\$ 13,088,523

December 31, 2017	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Total
Number of investment properties	36	31	123	227	93	17	527
Real estate assets:							
Investment properties	\$ 6,562,552	\$ 2,945,800	\$ 1,399,672	\$ 789,419	\$ 1,035,920	\$ 1,187,191	\$ 13,920,554
Properties under development	-	-	-	10,345	83,132	805,127	898,604
	6,562,552	2,945,800	1,399,672	799,764	1,119,052	1,992,318	14,819,158
Less: REIT's proportionate share of real estate assets relating to equity accounted investments	-	-	-	(799,764)	(57,012)	(805,127)	(1,661,903)
	\$ 6,562,552	\$ 2,945,800	\$ 1,399,672	\$ -	\$ 1,062,040	\$ 1,187,191	\$ 13,157,255

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20. Segmented disclosures (continued):

Property operating income by reportable segment for the years ended December 31, 2018 and December 31, 2017 is as follows:

	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Sub-total	Less: Equity Accounted Investments	December 31 2018
Rentals from investment properties	\$ 598,914	\$ 284,505	\$ 86,197	\$ 68,237	\$ 87,496	\$ 137,742	\$ 1,263,091	\$ (86,533)	\$ 1,176,558
Property operating costs	(209,058)	(125,855)	(20,093)	(14,849)	(24,612)	(73,753)	(468,220)	25,594	(442,626)
Property operating income	\$ 389,856	\$ 158,650	\$ 66,104	\$ 53,388	\$ 62,884	\$ 63,989	\$ 794,871	\$ (60,939)	\$ 733,932

	Office	Primaris	H&R Retail	ECHO	Industrial	Lantower Residential	Sub-total	Less: Equity Accounted Investments	December 31 2017
Rentals from investment properties	\$ 600,792	\$ 281,086	\$ 125,194	\$ 72,548	\$ 96,838	\$ 80,454	\$ 1,256,912	\$ (88,458)	\$ 1,168,454
Property operating costs	(211,645)	(123,822)	(28,610)	(15,254)	(25,584)	(40,511)	(445,426)	18,413	(427,013)
Property operating income	\$ 389,147	\$ 157,264	\$ 96,584	\$ 57,294	\$ 71,254	\$ 39,943	\$ 811,486	\$ (70,045)	\$ 741,441

(ii) Geographical locations:

The REIT operates 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 2018	December 31 2017
Real estate assets:		
Canada	\$ 9,186,352	\$ 9,344,350
United States	6,088,428	5,475,050
	15,274,780	14,819,400
Less: assets classified as held for sale	(110,940)	-
Less: REIT's proportionate share of real estate assets relating to equity accounted investments	(2,075,317)	(1,662,145)
	\$ 13,088,523	\$ 13,157,255

	2018	2017
Rentals from investment properties:		
Canada	\$ 875,418	\$ 871,955
United States	387,673	384,957
	1,263,091	1,256,912
Less: REIT's proportionate share of rentals relating to equity accounted investments	(86,533)	(88,458)
	\$ 1,176,558	\$ 1,168,454

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21. Income tax expense (recovery):

	2018	2017
Income tax computed at the Canadian statutory rate of nil applicable to the REIT for 2018 and 2017	\$ -	\$ -
Current U.S. income taxes	760	1,538
Deferred income taxes (recovery) applicable to U.S. Holdco:		
Impact of U.S. Tax Reform	-	(87,970)
Other	39,457	48,193
	39,457	(39,777)
Income tax expense (recovery) in the determination of net income	\$ 40,217	\$ (38,239)

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 combined federal and state tax rate of approximately 24% in 2018 (2017 - 37.5%). As a result of U.S. legislation enacted on December 22, 2017, commonly referred to as the Tax Cuts and Jobs Act of 2017 ("U.S. Tax Reform"), deferred income taxes have been measured based upon a 21% federal income tax rate. The income tax recovery for the year ended December 31, 2017 reflects the impact of U.S. Tax Reform resulting from the reduction in the federal tax rate from 35% to 21% effective in 2018 (24% including state tax) and a reduction in certain deferred tax assets related to deferred interest deductions.

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 2018	December 31 2017
Deferred tax assets:		
Net operating losses	\$ 22,551	\$ 6,924
Accounts payable and accrued liabilities	585	1,387
Other assets	1,463	2,257
	24,599	10,568
Deferred tax liabilities:		
Investment properties	284,006	256,507
Equity accounted investments	132,807	79,192
	416,813	335,699
Deferred tax liability	\$ (392,214)	\$ (325,131)

The change in deferred tax liability is the result of deferred income tax expense (recovery) of \$39,457 (2017 - (\$39,777)) and change in foreign exchange of \$27,626 (2017 - (\$21,867)) recognized in other comprehensive income.

H&R REAL ESTATE INVESTMENT TRUST

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21. Income tax expense (recovery) (continued):

As at December 31, 2018, U.S. Holdco had accumulated net operating losses available for carryforward for U.S. income tax purposes of \$92,805 (December 31, 2017 - \$28,879), the benefit of which has been recognized and deferred interest deductions of \$200,324 (December 31, 2017 - \$194,489), the benefit of which has not been recognized as a result of U.S. Tax Reform. Certain aspects of U.S. Tax Reform may be subject to clarifications or varying interpretations including the treatment of deferred interest deductions. Certain of the net operating losses will expire between 2031 and 2032. Net operating losses arising after December 31, 2017 do not generally expire under current tax legislation. The deductible temporary differences do not generally expire under current tax legislation.

22. Related party transaction:

In 2018, the REIT paid approximately U.S. \$14,600 for 20.3 acres of land in Dallas, TX, to be developed into approximately 1,000 multi-family units, from an entity in which the CEO held a 50% ownership interest.

23. 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, 2018, the REIT has outstanding letters of credit totalling \$25,874 (December 31, 2017 - \$32,924), including \$17,340 (December 31, 2017 - \$15,120) which has been pledged as security for certain mortgages payable. The letters of credit are secured by certain investment properties.
- (b) The REIT provides guarantees on behalf of third parties, including co-owners. As at December 31, 2018, the REIT issued guarantees amounting to \$263,853 (December 31, 2017 - \$497,539), which expire between 2019 and 2029 (December 31, 2017 - expire between 2020 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, 2018, the estimated amount of debt subject to such guarantees, and therefore the maximum exposure to credit risk, is \$43,963 (December 31, 2017 - \$119,279) which expires in 2020 (December 31, 2017 - expires between 2018 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 consolidated 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 material adverse effect on the consolidated financial statements.

24. Subsidiaries:

Significant subsidiaries of the REIT are as follows:

Name of Entity	Place of Business	Ownership interest	
		December 31 2018	December 31 2017
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%

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25. Subsequent events:

- (a) In January 2019, the REIT sold one U.S. office property which was classified as held for sale as at December 31, 2018, for gross proceeds of U.S. \$69,800.
- (b) In February 2019, the REIT secured two new mortgages totalling \$36,550, bearing interest at 3.36% per annum for a term of 10 years.

Corporate Information

H&R REIT Board of Trustees

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

Officers

Thomas J. Hofstedter, President and Chief Executive Officer
Larry Froom, Chief Financial Officer
Robyn Kestenberg, Executive Vice-President, Corporate Development
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)

(1) Investment Committee

(2) Audit Committee

(3) Compensation, Governance and Nominating Committee

Auditors: KPMG LLP

Legal Counsel: Blake, Cassels & Graydon LLP

Taxability of Distributions: 33.3% of 2018 distributions (including those from H&R Finance Trust) will be treated as a return of capital and 1.7% will be designated as taxable capital gains. For taxable Canadian unitholders, 35.0% (2017 - 39.7%) of the distributions will not be subject to current income taxes.

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

Stock Exchange Listing: Units and debentures of H&R are listed on the Toronto Stock Exchange under the trading symbols HR.UN.

Registrar and Transfer Agent: AST Trust Company (Canada), P.O. Box 4229, Station A, Toronto, Ontario, Canada M5W 0G1, Telephone: 1-800-387-0825 (or for callers outside North America 416-682-3860), Fax: 1-888-488-1416, E-mail: inquiries@canstockta.com, Website: www.canstockta.com.

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



H&R Real Estate Investment Trust



Modera Westshore, Tampa



Dufferin Mall, Toronto



Corus Quay, Toronto