Consolidated Financial Statements of

PARTNERS REAL ESTATE INVESTMENT TRUST

For the year ended December 31, 2012

KPMG LLP
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INDEPENDENT AUDITORS' REPORT

To the Unitholders of Partners Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Partners Real Estate Investment Trust, which comprise the consolidated statements of financial position as at December 31, 2012, the consolidated statements of comprehensive income, changes in 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 Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

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Opinion

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

Other matter

The consolidated financial statements of Partners Real Estate Investment Trust as at and for the year ended December 31, 2011 were audited by another auditor who expressed an unmodified opinion on those statements on March 15, 2012.

KPMG LLP

Chartered Accountants

March 19, 2013
Vancouver, Canada

PARTNERS REAL ESTATE INVESTMENT TRUST
Table of Contents
For the year ended December 31, 2012

	Page
Consolidated Statements of Financial Position	1
Consolidated Statements of Comprehensive Income	2
Consolidated Statements of Changes in Unitholders' Equity	3
Consolidated Statements of Cash Flows	4
Notes to the Consolidated Financial Statements	5-34

PARTNERS REAL ESTATE INVESTMENT TRUST
Consolidated Statements of Financial Position
audited (Cdn $)

As at	**December 31, 2012**	December 31, 2011
ASSETS		
Non-current assets		
Income producing properties (Note 4)	**$ 465,727,634**	$ 258,510,224
	465,727,634	258,510,224
Current assets		
Note receivable (Note 5)	**5,935,813**	-
Other assets (Note 6)	**4,108,577**	4,526,314
Accounts receivable (Note 7)	**1,443,134**	868,733
Cash	**1,853,630**	1,842,769
	13,341,154	7,237,816
	$ 479,068,788	$ 265,748,040
LIABILITIES		
Non-current liabilities		
Mortgages payable (Note 8)	**$ 215,528,319**	$ 152,598,529
Convertible debentures (Note 9)	**60,718,110**	26,889,496
Credit facilities (Note 10)	**-**	18,545,886
	276,246,429	198,033,911
Current liabilities		
Mortgages payable (Note 8)	**10,911,228**	3,920,157
Credit facilities (Note 10)	**7,277,940**	-
Accounts payable and other liabilities	**11,132,105**	4,891,719
Distributions payable	**1,208,437**	425,879
	30,529,710	9,237,755
	306,776,139	207,271,666
Exchangeable LP units (Note 11)	**2,228,125**	2,070,000
	309,004,264	209,341,666
UNITHOLDERS' EQUITY	**170,064,524**	56,406,374
	$ 479,068,788	$ 265,748,040

Subsequent Events (Note 10, 23)

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST
Consolidated Statements of Comprehensive Income
audited (Cdn $)

	Year ended December 31, 2012	2011
Revenues from income producing properties (Note 12)	$ **43,045,555**	$ 24,164,527
Property operating expenses	**(6,143,431)**	(3,779,313)
Realty taxes	**(8,635,043)**	(4,529,163)
Property management fees	**(816,133)**	(545,415)
	27,450,948	15,310,636
Other expenses:		
Financing costs	**13,482,842**	9,577,253
General and administrative expenses	**2,379,995**	1,781,006
Other transaction costs	**448,444**	730,573
	16,311,281	12,088,832
Income before fair value gains	**11,139,667**	3,221,804
Fair value gains (Note 13)	**16,684,311**	4,031,626
Net income and comprehensive income	$ **27,823,978**	$ 7,253,430
EARNINGS PER UNIT (Note 14)		
Basic	$ **1.45**	$ 0.94
Diluted	$ **1.33**	$ 0.87

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Changes in Unitholders' Equity

audited (Cdn $)

	Year ended December 31, 2012	2011
Trust Units (Note 15)		
BALANCE, BEGINNING OF PERIOD	**$ 70,108,603**	$ 69,848,343
Issuance of units under distribution reinvestment plan, net of costs	**657,265**	260,260
Issuance of units under alternate compensation plan (Note 17)	**51,002**	-
Issuance of units under incentive unit option plan (Note 17)	**92,250**	-
Issuance of units under private offering, net of costs	**47,882,820**	-
Issuance of units under public offering, net of costs	**42,653,187**	-
Issuance of units under rights certificates, net of costs	**2,157,826**	-
Issuance of units under warrant exercise, net of costs	**4,789,929**	-
BALANCE, END OF PERIOD	**168,392,882**	70,108,603
Contributed Surplus		
BALANCE, BEGINNING OF PERIOD	**569,830**	569,830
Cost of units issued under incentive unit option plan	**(4,750)**	-
BALANCE, END OF PERIOD	**565,080**	569,830
Accumulated Other Comprehensive Income/Loss		
BALANCE, BEGINNING OF PERIOD	**(14,272,059)**	(16,557,825)
Net income and comprehensive income	**27,823,978**	7,253,430
Distributions to unitholders	**(12,445,357)**	(4,967,664)
BALANCE, END OF PERIOD	**1,106,562**	(14,272,059)
TOTAL UNITHOLDERS' EQUITY	**$ 170,064,524**	$ 56,406,374
DISTRIBUTIONS PER UNIT	**$ 0.64**	$ 0.64

The accompanying notes are an integral part of these consolidated financial statements.

PARTNERS REAL ESTATE INVESTMENT TRUST
Consolidated Statements of Cash Flows
audited (Cdn $)

	Year ended December 31, 2012	2011
OPERATING ACTIVITIES		
Net income	**$ 27,823,978**	$ 7,253,430
Adjusted for non-cash items:		
Fair value gains	**(16,684,311)**	(4,031,626)
Employee options costs	**107,000**	57,000
Alternate compensation plan costs (Note 17)	**51,002**	-
Straight-line rent	**(1,211,125)**	(599,582)
Amortization of tenant incentives and direct leasing costs	**573,340**	228,223
Amortization of deferred financing costs	**919,073**	644,220
Net change in working capital (Note 16)	**4,749,523**	(2,041,727)
Cash flow provided by operating activities	**16,328,480**	1,509,938
FINANCING ACTIVITIES		
Proceeds from mortgages	**82,200,000**	51,050,000
Financing costs of mortgages	**(799,621)**	(701,262)
Principal repayments on mortgages	**(22,847,799)**	(19,771,742)
Proceeds from debenture issuance	**34,500,000**	28,750,000
Cost to issue debentures	**(1,683,496)**	(2,107,652)
Drawdowns on credit facilities	**21,500,000**	19,200,000
Repayments of credit facilities	**(33,200,000)**	-
Financing fees on credit facilities	**(457,822)**	(822,063)
Proceeds from private offering (Note 15)	**40,317,346**	-
Proceeds from public offering (Note 15)	**45,704,571**	-
Cost to issue units	**(5,234,314)**	(6,401)
Proceeds from incentive unit option plan issuance	**87,500**	-
Warrant exercise	**5,031,250**	-
Distributions to unitholders	**(11,769,231)**	(4,687,812)
Cash flow provided by financing activities	**153,348,384**	70,903,068
INVESTING ACTIVITIES		
Acquisitions of income producing properties, net of non-cash transactions	**(169,886,159)**	(75,368,438)
Improvements to income producing properties	**(4,783,058)**	(968,277)
Expenditures on tenant incentives and direct leasing costs	**(1,706,635)**	(1,102,764)
Net proceeds from repayment of note receivable	**2,166,183**	-
Net proceeds from notes receivable dispositions	**4,509,700**	-
Cash from notes receivable principal repayments	**33,966**	-
Cash flow used in investing activities	**(169,666,003)**	(77,439,479)
NET INCREASE (DECREASE) IN CASH DURING THE PERIOD	**10,861**	(5,026,473)
CASH, BEGINNING OF PERIOD	**1,842,769**	6,869,242
CASH, END OF PERIOD	**$ 1,853,630**	$ 1,842,769
Non-cash transactions		
Secured debt assumed with acquisitions of properties	**$ 9,592,708**	$ 17,212,633
Market interest rate adjustment to property acquisition costs	**2,146,882**	1,566,107

Supplemental cash flow information (Note 16)

The accompanying notes are an integral part of these consolidated financial statements.

1. ORGANIZATION OF THE TRUST

Partners Real Estate Investment Trust ("Partners REIT" or the "REIT") is an unincorporated, open-ended real estate investment trust and was formed pursuant to a Declaration of Trust dated March 27, 2007 and as amended and restated on May 11, 2012. The address of its registered office and principal place of business is 710 Redbrick Street, Suite 200, Victoria, British Columbia, V8T 5J3. The principal business activity of Partners REIT is acquiring, developing and operating commercial retail properties. The units of the REIT are listed on the Toronto Stock Exchange as of April 3, 2012 (the "TSX") and trade under the symbol "PAR.UN". Prior to April 3, 2012, the REIT's units were listed on the TSX Venture Exchange under the same symbol.

On February 14, 2012 the REIT completed a 1 for 4 consolidation of units. The unit and per unit information presented in these consolidated financial statements have been prepared on a post-consolidation basis.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies that are used in the preparation of these consolidated financial statements:

(a) Statement of compliance

These financial statements were approved and authorized for issue by the Board of Trustees on March 19, 2013.

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

(b) Basis of presentation

The financial statements have been prepared on a going concern basis and have been presented in Canadian dollars. The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of income producing properties and certain financial instruments at fair value (as discussed in Note 2(d) and Note 2(g)). The accounting policies set out below have been applied consistently in all material respects. Standards and guidelines not effective for the current accounting period are described in Note 3.

(c) Basis of consolidation

Subsidiaries are entities over which the REIT has the power to govern the financial and operating policies generally accompanying an ownership of more than half of the voting rights. The existence and effect of any potential voting rights that are currently exercisable or convertible are considered when assessing whether the REIT controls another subsidiary. Subsidiaries are fully consolidated from the date on which control is obtained by the REIT. They are deconsolidated from the date that control ceases.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate.

All intra-group transactions, balances, income and expenses are eliminated, in full, upon consolidation.

(d) Income producing properties

Income producing properties fall within the definition of investment properties under IAS 40 – *Investment Properties* ("IAS 40") and consist of commercial retail properties held to earn rental income and properties that are being constructed, developed, or redeveloped for future use as income producing properties.

Management must assess whether the acquisition of property through the purchase of a corporate vehicle, or directly, should be accounted for as an asset purchase or a business combination. Where the acquisition contains significant assets, liabilities or activities in addition to property and related mortgage debt, particularly where there is an integrated set of activities and assets, capable of being conducted and managed for the purpose of providing a return, lower costs or other economic benefits, the transaction is accounted for as a business combination. More specifically, consideration is made of the extent to which significant processes are acquired and, in particular, the extent of ancillary services provided. Where there are no such items the transaction is treated as an asset acquisition.

Commercial retail properties, developments and redevelopments are measured initially at cost. Cost includes all amounts relating to the acquisition, including transaction costs (except transaction costs related to a business combination), improvement of the properties and market interest rate adjustments on assumed debt. All costs associated with upgrading and extending the economic life of the existing facilities, other than ordinary repairs and maintenance, are capitalized to income producing properties. Costs that are directly attributable to income producing properties under development or redevelopment are capitalized. These costs include direct development costs, realty taxes and other costs directly attributable to the development.

Subsequent to initial recognition, income producing properties are measured at fair value, determined based on valuations performed by third-party appraisers or available market evidence in accordance with IAS 40. Gains or losses arising from changes in the fair value of income producing properties are included in net income in the period in which they arise.

The carrying value of income producing properties includes straight-line rent receivable, tenant incentives and direct leasing costs, since these amounts are incorporated in the appraised values of real estate properties.

Income producing properties are reclassified to assets held for sale when criteria set out in IFRS 5 - *Non-Current Assets Held for Sale and Discontinued Operations* are met.

An income producing property is derecognized upon disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

(e) Income Taxes

The REIT is a “mutual fund trust” as defined under the Income Tax Act (Canada), (the “Tax Act”) and accordingly is not taxable on income to the extent that taxable income is distributed to Unitholders.

Charter Realty Holdings Ltd. (the “Company”) is the REIT’s wholly-owned incorporated subsidiary and is subject to tax on its taxable income. Current tax payable is based on taxable income for the year, as defined by the Tax Act. Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled. Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available to apply against the temporary differences that can be utilized.

(f) Revenue recognition

The REIT has retained substantially all of the risks and benefits of ownership of its income producing properties and therefore, accounts for leases with its tenants as operating leases. Revenue recognition under a lease commences when the tenant has a right to use the leased assets. Generally, this occurs on the lease inception date or, when the REIT is required to make additions to the property in the form of tenant improvements which enhances the value of the property, when substantially complete. The total amount of contractual rent to be received from operating leases is recognized on a straight-line basis over the term of the lease. A straight-line rent receivable is included in the carrying amount of the income producing property and is recorded for the difference between the rental revenue recorded and the contractual amount received. Deducted from revenues are the amortization of tenant incentives and direct leasing costs.

Rental revenue also includes percentage participating rents and recoveries of operating expenses, including realty taxes. Percentage participating rents are recognized when tenants' specified sales targets have been met. Operating expense recoveries are recognized in the period that recoverable costs are chargeable to tenants.

(g) Financial instruments

Financial assets and financial liabilities are recognized when the REIT becomes a party to the contractual provisions of the instrument.

In accordance with IAS 39 – *Financial Instruments: Recognition and Measurement* ("IAS 39"), financial instruments and derivatives are initially measured at fair value. Financial instruments and derivatives are presented and disclosed in accordance with IFRS 7 – *Financial Instruments: Disclosures* ("IFRS 7") and IAS 32 – *Financial Instruments: Presentation* ("IAS 32"). Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value are recognized immediately in profit or loss.

Financial assets

Financial assets are classified into the following specified categories: financial assets at 'fair value through profit or loss' ("FVTPL"); 'held to maturity' investments; 'available-for-sale' financial assets; and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- on initial recognition, it is part of a portfolio of identified financial instruments that the REIT manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the REIT's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the REIT has the positive intent and ability to hold to maturity. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

Available for sale ("AFS") financial assets

AFS financial assets are non-derivatives that are either designated as AFS or are not classified as: loans and receivables; held-to-maturity investments; or financial assets at FVTPL. AFS financial assets are measured at fair value through profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables (including accounts receivables, cash, and other assets including deposits on potential acquisitions and amounts held in escrow) are measured at amortized cost using the effective interest method, less any impairment.

Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Effective interest method

The effective interest method is a method of calculating the amortized cost of an instrument and allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, (or, where appropriate a shorter period) to the net carrying amount on initial recognition.

Partners REIT's financial assets

The following summarizes the REIT's classification and measurement of its financial assets:

Financial asset	Classification	Measurement
Note receivable	Available for sale	FVTPL
Other assets	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Cash	Loans and receivables	Amortized cost

The REIT derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all of the risks and rewards of ownership of the asset to another entity.

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Generally, the carrying amount of the financial asset is reduced by the impairment loss.

Financial liabilities and equity instruments

Debt and equity instruments issued are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the REIT are recognized at the proceeds received, net of direct issue costs. Repurchase of the REIT's own equity instruments is recognized and deducted directly in contributed surplus. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the REIT's own equity instruments. Distributions paid on the REIT's equity instruments subsequent to, declared prior to, and with a record date at or prior to the reporting date, are recorded as a liability.

Financial liabilities are classified as either financial liabilities at 'FVTPL' or 'other financial liabilities'.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- it has been acquired principally for the purpose of repurchasing it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the REIT manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or

- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the REIT's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any interest paid on the financial liability.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective interest basis.

The effective interest method is a method of calculating the amortized cost of a debt instrument and allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, (or where appropriate a shorter period), to the net carrying amount on initial recognition.

These transaction costs are presented net of the financial liability when there is a balance; otherwise they are presented as a financial asset.

Partners REIT financial liabilities

The following summarizes the REIT's classification and measurement of its financial liabilities:

Financial liability	**Classification**	**Measurement**
Mortgages payable	Other financial liabilities	Amortized cost
Debentures	Other financial liabilities	Amortized cost
Embedded derivatives	FVTPL	Fair value
Accounts payable and other liabilities - Deferred unit-based compensation	FVTPL	Fair value
Credit facilities	Other financial liabilities	Amortized cost
Accounts payable and other liabilities – trade and other payables	Other financial liabilities	Amortized cost
Exchangeable LP units (Note 11)	FVTPL	Fair value
Distributions payable	Other financial liabilities	Amortized cost

The REIT derecognizes a financial liability when, and only when, the REIT's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

Embedded derivatives

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at FVTPL.

(h) Deferred unit-based compensation

Deferred unit-based payments, in the form of options to purchase units at a future date with a fixed price issued to employees, trustees and certain contractors, are measured at the fair value of the option at the grant date, which is calculated using an option valuation model. It is recognized over the vesting period to compensation expense using the graded vesting method.

The fair value of the options is categorized as a liability on the consolidated statements of financial position and remeasured at the end of each reporting period until settlement. Changes to the fair value is recognized in profit or loss such that the cumulative expense reflects the amount amortized to date over the vesting period if the amortized amount was otherwise re-calculated at the end of the reporting period.

(i) Provisions

Provisions are recognized when: the REIT has a present obligation (legal or constructive) as a result of a past event; it is probable that the REIT will be required to settle the obligation; and, a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

(j) Critical judgment in applying accounting policies

i. Income producing properties

The REIT's accounting policy relating to income producing properties is described in Note 2(d) above. In applying this policy, judgment is applied in determining the extent and frequency of utilizing independent, third-party appraisals to measure the fair value of the REIT's investment property. Judgment is also applied in determining whether certain costs are additions to the carrying amount of the property and, for property under development, identifying the point at which practical completion of the property occurs and identifying the directly attributable costs to be included in the carrying value of the development property. In addition, judgment is also applied to assess whether the acquisition of property through the purchase of a corporate vehicle or directly should be accounted for as an asset acquisition or a business combination.

iii. Leases

The REIT's policy for property rental revenue recognition is described in Note 2(f) above. The REIT makes judgments in determining whether certain leases, in particular tenant leases, as well as, leased storage space which are considered leases under IFRS, where the REIT is the lessor, are operating or finance leases. The REIT has determined that all of its leases are operating leases.

iv. Financial instruments

The REIT's accounting policies relating to financial instruments are described in Note 2(g). The critical judgments inherent in these policies relate to applying the criteria set out in IAS 39 to designate financial instruments into categories (FVTPL, etc.) and to determine the identification of embedded derivatives in certain hybrid instruments that are subject to fair value measurement.

(k) *Key accounting estimates and assumptions*

The REIT makes estimates and assumptions that affect carrying amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amount of earnings for the year. Actual results could materially differ from estimates. The estimates and assumptions that are critical to the determination of the amounts reported in the financial statements relate to the following:

i. Income producing properties

The choice of valuation method to determine the fair value of the REIT's income producing properties and the critical estimates and assumptions underlying the fair value determination of its commercial retail properties are set out in Note 4. Significant estimates used in determining the fair value of the REIT's income producing properties includes capitalization rates and net operating income (which is influenced by inflation rates, vacancy rates, standard costs). A change to any one of these inputs could significantly alter the fair value of an income producing property.

ii. Financial liabilities at FVTPL

The fair valuation of embedded derivatives and deferred unit-based compensation employs pricing models. The models require estimates and assumptions to be made with regard to the models' inputs, such as, the underlying asset volatility, risk free rates, employee exit rates and option holder's risk aversion, as applicable. Changes in assumptions about these factors could affect the reported fair value of the financial liability. Fair values are most sensitive to change in asset volatility. The following table demonstrates the change in fair value of the convertible feature of the debenture and deferred unit-based compensation:

	Change in volatility	
As at December 31, 2012	-1%	+1%
Convertible feature of debenture	$ (280,000)	$ 280,000
Deferred unit-based compensation	(14,114)	14,568

3. FUTURE ACCOUNTING POLICIES

From time to time, the International Accounting Standards Board ("IASB") issues new accounting standards and revises existing accounting standards. The following standards, not yet effective as at the date of these consolidated financial statements and accordingly not applied to these consolidated financial statements, may have a future impact:

Financial instruments

IFRS 9 – *Financial Instruments: Classification and measurement* ("IFRS 9") was issued by the IASB in November 2009 and contains requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 – *Financial Instruments: Recognition and Measurement* ("IAS 39") for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains or losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Requirements for financial liabilities were added in October 2010, and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss would generally be recorded in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The REIT is currently evaluating the impact of IFRS 9 on its consolidated financial statements.

Consolidated Financial Statements

IFRS 10 – *Consolidated Financial Statements* (“IFRS 10”) builds on existing principals and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. IFRS 10 is not expected to have any impact on the REIT’s consolidated financial statements.

Joint Arrangements

IFRS 11 – *Joint Arrangements* (“IFRS 11”) establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled. IFRS 11 is effective for annual periods beginning on or after January 1, 2013. IFRS 11 will not have any impact on the REIT’s consolidated financial statements.

Disclosure of Interests in Other Entities

IFRS 12 – *Disclosure of Interests in Other Entities* (“IFRS 12”) provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. IFRS 12 will not have any impact on the REIT’s consolidated financial statements.

Fair Value Measurement

IFRS 13 – *Fair Value Measurement* (“IFRS 13”) defines fair value, requires disclosure of fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. The REIT has not yet evaluated the impact of IFRS 13 on its consolidated financial statements.

Investments in Associates and Joint Ventures

IAS 28 – *Investments in Associates and Joint Ventures* (“IAS 28”) is a revision of the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013. The REIT has not yet evaluated the impact of IAS 28 on its consolidated financial statements.

Presentation of Financial Statements

IAS 1 – *Presentation of Financial Statements* (“IAS 1”) provides guidance on the presentation of items contained in other comprehensive income (“OCI”) and their classification within OCI. Retrospective application is required. IAS 1 is effective for annual periods beginning on or after July 1, 2012. The REIT is currently evaluating the impact to the consolidated financial statements as a result of adopting this standard.

4. INCOME PRODUCING PROPERTIES

As at		**December 31, 2012**		December 31, 2011
Balance, beginning of period	**$**	**258,510,224**	$	155,907,020
Acquisitions of income producing properties		**181,625,751**		96,217,178
Improvements to income producing properties		**4,783,058**		968,277
Expenditures on tenant incentives and direct leasing costs		**1,706,635**		1,102,764
Amortization of tenant incentives and direct leasing costs		**(573,340)**		(228,223)
Recognition of straight-line rent		**1,211,125**		599,582
Fair value gains		**18,464,181**		3,943,626
Balance, end of period	**$**	**465,727,634**	$	258,510,224

Income producing properties, which are classified as investment properties under IFRS, are appraised at fair value by qualified external valuation professionals (“Appraisers”) in accordance with IAS 40 – *Investment Properties*. The Appraisers are independent valuation firms not related to the REIT, who employ valuation professionals who are members of the Appraisal Institute of Canada and the Ordre des évaluateurs agréés du Québec, and who have appropriate qualifications and experience in the valuation of properties in the relevant locations.

External valuations were obtained from the Appraisers for a cross section of properties based on different geographical locations and markets across the REIT’s portfolio, as determined by the REIT’s management.

For the year ended December 31, 2012, external appraisals were obtained for eleven of the REIT’s properties with an aggregate fair value of $130.2 million; representing 28.0% of the fair value of the income producing property portfolio as of that date. The value of the remainder of the REIT’s income producing property portfolio was determined internally by the REIT using the same assumptions and valuation techniques used by the Appraisers.

At December 31, 2011, external appraisals were obtained for four of the REIT’s properties with an aggregate fair value of $44.8 million, representing 17.3% of the fair value of the income producing property portfolio as of that date. The value of the remainder of the REIT’s income producing property portfolio was determined internally by the REIT using the same assumptions and valuation techniques used by the Appraisers.

The external valuation of the income producing properties utilized the “Direct Capitalization” method. This method applies the capitalization rate to stabilized net operating income. The resulting stabilized value is adjusted for factors including lost revenues and recoveries on vacant units; anticipated inducement and leasing commission costs of vacant units; and the present value of capital expenditures. Fair values are most sensitive to change in capitalization rates.

The following table outlines the range and weighted average of the capitalization rates applied to the stabilized net operating income in estimating the fair value for the REIT’s properties:

As at	**December 31, 2012**	December 31, 2011
Capitalization rates		
Maximum	**8.50%**	8.50%
Minimum	**6.25%**	6.75%
Weighted Average	**6.73%**	7.55%

At December 31, 2012, a 0.50% increase in capitalization rates for income producing properties would decrease fair value by $32.2 million (December 31, 2011 - $15.9 million) and a 0.50% decrease in capitalization rates would increase fair value by $37.4 million (December 31, 2011 - $18.1 million).

The aggregate cost of tenant incentives and direct leasing costs included in income producing properties are recognized as a reduction of rental income over the lease term, on a straight-line basis.

As at December 31, 2012, income producing properties included $2.7 million (at December 31, 2011 - $1.4 million) of net straight-line rent receivables arising from the recognition of rental revenue on a straight-line basis over the lease term in accordance with IAS 17 – *Leases*.

2012 acquisitions

- *Centre Village Shopping Centre*

On December 21, 2012, the REIT completed the acquisition of Centre Village Shopping Centre, a 95,000 square foot retail property located in Montreal, Quebec. The REIT paid approximately $20.0 million for the property, utilizing $6.75 million of the REIT's credit facility.

- *Elgar Place*

On December 21, 2012, the REIT completed the acquisition of Elgar Place, a 10,000 square foot retail centre located in Montreal, Quebec. The REIT paid approximately $2.0 million for the property, utilizing $0.75 million of the REIT's credit facility.

- *Timmins West Power Centre*

On December 20, 2012, the REIT completed the acquisition of Timmins West Power Centre, a 43,774 square foot open-air retail centre which includes three separate buildings. The REIT paid approximately $10.0 million for the property, funded by the assumption of a first mortgage for $4.94 million with an effective interest rate of approximately 4%, with the balance in cash. An above market interest rate adjustment of $0.2 million has been included in the determination of the total cost of this acquisition.

- *Washington Park Shopping Centre*

On June 15, 2012, the REIT completed the acquisition of Washington Park Shopping Centre, a two building 32,912 square foot open-air shopping centre located in Courtenay, British Columbia. The REIT paid $11.95 million for the property and was funded by a $7.5 million mortgage with interest at 3.84% over a 5-year term. The balance was paid with cash proceeds from a bought deal equity offering.

- *Grand Bend Towne Centre*

On April 30, 2012, the REIT completed the acquisition of Grand Bend Towne Centre, an existing 41,605 square foot shopping centre located in Grand Bend, Ontario. The REIT paid approximately $7.9 million for the property and was funded by the assumption of an existing mortgage on the property in the amount of $3.2 million, which was further increased by $0.8 million for a total mortgage of $4.0 million. The mortgage matures in July 2017 and has a contractual rate of interest of 5.12% per annum. The balance of the acquisition was paid from the REIT's available funds on hand. An above market interest rate adjustment of $0.2 million has been included in the determination of the total cost of this acquisition.

- *Quinte Crossroads*

On March 29, 2012, the REIT completed the acquisition of Quinte Crossroads, a new development consisting of an 88,319 square foot four building power centre on 14.26 acres, in Belleville, Ontario. The REIT paid approximately $21.3 million for the property with $14.2 million funded through a new ten-year mortgage that bears interest at 4.06% per annum, and the balance was paid with available cash on hand.

- *King George Square*

On February 14, 2012, the REIT completed the acquisition of King George Square, an existing 67,100 square foot open-air centre comprised of three buildings and located on the west side of King George Road which traverses Brantford, Ontario's traditional retail node. The REIT paid approximately $16.4 million for the property. This acquisition and the acquisition of Crossing Bridge Square, as noted below, were satisfied by a new one-year bank credit facility of $14.0 million bearing interest at a rate equal to the Canadian Imperial Bank of Commerce ("CIBC") prime rate plus 1.50% for the initial six months and the CIBC prime rate plus 2.00% for the remainder of the term, with the balance paid from the REIT's available cash on hand.

- *Thunder Centre*

On February 14, 2012, the REIT completed the acquisition of Thunder Centre, an existing 168,000 square foot power centre comprised of two big-box stores and five multi-tenant retail strips located in the primary retail node of Thunder Bay, Ontario. The REIT paid approximately $38.2 million for the property and was funded by the assumption of a first mortgage on the property in the amount of $14.8 million, which was further increased by $4.7 million for a total first mortgage of $19.5 million. The mortgage matures in July 2017 and has a contractual interest rate of 4.78% per annum. The balance of the purchase price was funded from the REIT's available cash on hand. An above market interest rate adjustment of $1.1 million has been included in the determination of the total cost of this acquisition.

- *St Clair Beach Towne Centre*

On February 14, 2012, the REIT completed the acquisition of St. Clair Beach Towne Centre, an existing 40,100 square foot centre comprised of two buildings located in the Windsor, Ontario suburb of Tecumseh. The REIT paid approximately $11.6 million for the property and was funded by the assumption of a first mortgage on the property in the amount of $4.4 million, which was further increased by $1.85 million for a total first mortgage of $6.25 million. The mortgage matures in July 2017 and has a contractual interest rate of 4.60% per annum. The balance of the purchase price was funded from the REIT's available cash on hand. An above market interest rate adjustment of $0.3 million has been included in the determination of the total cost of this acquisition.

- *Crossing Bridge Square*

On February 14, 2012, the REIT completed the acquisition of Crossing Bridge Square, an existing 45,800 square foot open-air centre located in Stittsville, Ontario. The centre consists of a retail strip centre and two free-standing pad sites. The REIT paid approximately $11.2 million for the property. The acquisition was funded as noted above under the acquisition of King George Square.

- *Manning Crossing*

On February 14, 2012, the REIT completed the acquisition of Manning Crossing, an existing 64,500 square foot centre comprised of a retail strip and five restaurant pads located in Edmonton, Alberta. The REIT paid approximately $20.9 million for the property and was funded by the assumption of an existing first mortgage on the property for $4.65 million that matures in August 2014 and has a contractual interest rate of 6.59% per annum; a newly acquired second mortgage on the property for a total of $8.0 million that matures in February 2017 and has a contractual interest rate of 4.02% per annum; with the balance funded from the REIT's available cash on hand. An above market interest rate adjustment of $0.3 million has been included in the determination of the total cost of this acquisition.

- *Plaza des Seigneurs*

On February 1, 2012, the REIT completed the acquisition of Plaza des Seigneurs, an existing 20,833 square foot open-air centre anchored by necessity-based tenants located in Terrebonne, Québec. The REIT paid approximately $4.05 million for the property with $2.25 million funded through a new five-year mortgage that bears interest at 3.5% per annum, with the balance paid from the REIT's available funds on hand.

2011 acquisitions

– 137th Avenue Shoppers Drug Mart and PartSource

On December 19, 2011, the REIT completed the acquisition of an existing Shoppers Drug Mart and PartSource development in Edmonton, Alberta. The REIT paid approximately $4.09 million for the property, which was funded by the assumption of a $1.64 million mortgage bearing interest at 4.23%. The balance of the purchase price was satisfied through the issuance of 1,150,000 exchangeable limited partnership units (287,500 post-consolidation units) with a value of $2.07 million and $380,000 in cash. The Exchangeable LP Unit is exchangeable on a one for one basis into Partners REIT units, upon the vendor's election. An above market interest rate adjustment of $0.1 million has been included in the determination of the total cost of this acquisition.

– Evergreen Shopping Centre

On September 1, 2011, the REIT completed the acquisition of the Evergreen Shopping Centre, a five building 88,200 square foot open-air shopping centre located in Sooke, British Columbia approximately 37 kilometers west of Victoria. The shopping centre was acquired for approximately $15.8 million and was funded by a new $10.5 million five-year mortgage on the property with a contractual interest rate of 3.8%. The balance of the purchase price was effectively paid in cash from the REIT's $4.0 million secondary loan, bearing interest at 7.0%, and its bank credit facility.

– Place Desormeaux

On August 31, 2011, the REIT completed the acquisition of Place Desormeaux, a 250,000 square foot enclosed shopping centre in Longueuil, Québec on the south shore of the Greater Montreal Region. The REIT paid approximately $32.2 million for the property with approximately $3.6 million in additional acquisition and capital improvement costs to be incurred in the future. The purchase was funded by a $23.0 million loan; secured by the property with a three year term and bearing contractual interest at a rate of 4.05%. The balance of the purchase price was funded by a portion of the $13.5 million, three year revolving loan facility, secured against the REIT's portfolio of properties. The revolving loan facility bears a floating interest rate that is the greater of 9.00% or the TD Canada Trust Posted Bank Prime Rate of Interest plus 4.00%. This facility also included a funding fee whereby the lender received warrants to purchase 625,000 units of Partners REIT at $7.20 per unit (refer to Note 10).

– Centuria Urban Village

On May 16, 2011, the REIT completed an acquisition of the majority of the retail units in Centuria Urban Village, a food and drug store anchored mixed-use retail and high-rise residential property located in Kelowna, British Columbia, for a cost of $8.9 million. The purchase has been funded by cash from the proceeds of the REIT's debenture offering and the REIT's bank credit facility.

– Shoppers Drug Mart Properties

On March 17, 2011, the REIT completed the acquisition of five properties in Manitoba and one in Québec aggregating approximately 104,000 square feet of gross leasable area, for a cost of $32.5 million. The properties are fully occupied, primarily by Shoppers Drug Mart. The acquisition was partially funded by the assumption of existing mortgages with contractual values of $17.2 million, with the balance funded by cash from the proceeds of the REIT's debenture offering. An above market interest rate adjustment of $1.5 million has been included in the determination of the total cost of this acquisition.

5. NOTE RECEIVABLE

On February 1, 2012, the REIT acquired eight mortgages receivable as a result of the NorRock Realty Finance Corporation (TSXV: RF.H) ("NorRock") transaction, as detailed in Note 15(c). On March 29, 2012 the REIT sold three of the mortgage assets with a combined carrying value of approximately $3.7 million for proceeds of $3.2 million. The difference reduced the amount owing under the deferred rights obligation.

On June 29, 2012, the REIT sold one of the mortgage assets with a carrying value of $1.5 million for proceeds of $1.5 million. On June 30, 2012, the REIT sold the remaining mortgage assets to a related party, League Holdings Corporation, ("LHC") (refer to Note 22) for $7.9 million based on third party valuations. In exchange for purchasing the mortgage assets, the REIT accepted a full recourse note receivable from LHC, fully guaranteed by League Assets Corp ("LAC"), bearing interest from September 15, 2012 at 12% and having a maturity date that has been extended to May 31, 2013.

During the quarter ended December 31, 2012, principal repayments of $1.9 million were received from LHC on the note. Subsequent to December 31, 2012, LHC made an additional repayment of $4.1 million to the REIT, leaving a remaining balance of $1.9 million.

6. OTHER ASSETS

The major components of other assets are as follows:

As at		**December 31, 2012**		December 31, 2011
Prepaid realty taxes and insurance	**$**	**767,331**	$	583,276
Restricted cash - amounts held in escrow		**1,892,703**		1,429,421
Deposits on acquisitions		**200,000**		1,454,655
Deferred acquisition costs		**404,813**		742,861
Prepaid expenses and other		**843,730**		316,101
	$	**4,108,577**	$	4,526,314

Cash is considered restricted when it is held in escrow and is only available for use for specific purposes. Restricted cash totaled $1.9 million at December 31, 2012 (December 31, 2011 – $1.4 million) and its permitted use is to fund certain future capital expenditures for the REIT's income producing property portfolio.

7. ACCOUNTS RECEIVABLE

As at		**December 31, 2012**		December 31, 2011
Rents receivable	**$**	**457,436**	$	498,426
Unbilled recoveries and rents receivable		**1,041,075**		395,084
		1,498,511		893,510
Allowance for doubtful accounts		**(55,377)**		(24,777)
	$	**1,443,134**	$	868,733

The REIT records an allowance for doubtful accounts on tenant rent receivables on a tenant-by-tenant basis, using specific, known facts and circumstances that exist at the time of the analysis. See Note 21 for the REIT's exposure to credit risk regarding its receivables, and precautions taken to mitigate these risks.

8. MORTGAGES PAYABLE

As at	December 31, 2012	December 31, 2011
Mortgages payable	**$ 224,583,939**	$ 155,639,032
Unamortized above market interest rate adjustments	**3,379,779**	1,994,065
Unamortized commitment and other fees	**(1,524,171)**	(1,114,411)
	$ 226,439,547	$ 156,518,686
Non-current	**$ 215,528,319**	$ 152,598,529
Current	**10,911,228**	3,920,157
	$ 226,439,547	$ 156,518,686

Scheduled repayments of secured debt are as follows:

	Principal instalments	Principal maturing	Total
2013	$ 6,608,760	$ 4,000,000	$ 10,608,760
2014	6,714,802	24,870,435	31,585,237
2015	6,095,699	32,267,407	38,363,106
2016	4,998,831	28,376,013	33,374,844
2017	2,953,665	68,641,804	71,595,469
Thereafter	3,707,581	35,348,942	39,056,523
Contractual obligations	$ 31,079,338	$ 193,504,601	$ 224,583,939

Mortgages payable are secured by the income producing properties to which they relate with some having recourse to the REIT. The mortgages bear interest at effective rates ranging between 3.58% and 8.53% per annum (December 31, 2011 – 3.64% and 8.55%) and contractual rates ranging between 3.40% and 7.00% (December 31, 2011 – 3.42% and 7.00%). The REIT's weighted average effective interest rate is 4.50% per annum (December 31, 2011 – 4.95%). The total carrying value of the properties pledged as security is $399.0 million (December 31, 2011 - $225.4 million).

During the year ended December 31, 2012 the following mortgages were obtained:

In December 2012, upon the acquisition of Timmins Shopping Centre, the REIT assumed a first mortgage on the property in the amount of $4.9 million. The loan matures in September 2018, has a contractual interest rate of 6.00% per annum, and an amortization period of approximately 20 years.

In June 2012, upon the acquisition of Washington Park Shopping Centre, the REIT acquired a mortgage for $7.5 million on the property. The mortgage has a contractual rate of interest at 175 basis points over the five-year Government of Canada Bond rate, which is currently equal to 3.84% per annum, with a five-year term to maturity and a 25-year amortization period.

In April 2012, upon the acquisition of Grand Bend Towne Centre, the REIT assumed a first mortgage on the property in the amount of $3.2 million and increased the existing mortgage by $0.8 million for a total first mortgage of $4.0 million. The loan matures in July 2017, has a contractual interest rate of 5.12% per annum, and an amortization period of 20 years.

In March 2012, upon the acquisition of Quinte Crossroads, the REIT acquired a first mortgage on the property for a total of $14.2 million. The loan matures in April 2022, has a contractual interest rate of 4.06% per annum, and an amortization period of 25 years.

In February 2012, upon the acquisition of Thunder Centre, the REIT assumed a first mortgage on the property in the amount of $14.8 million and increased the existing mortgage by $4.7 million for a total first mortgage of $19.5 million. The loan matures in July 2017, has a contractual interest rate of 4.78% per annum, and an amortization period of 20 years.

In February 2012, upon the acquisition of St. Clair Beach Towne Centre, the REIT assumed a first mortgage on the property in the amount of $4.4 million and increased the existing mortgage by $1.85 million for a total first mortgage of $6.25 million. The loan matures in July 2017, has a contractual interest rate of 4.60% per annum, and an amortization period of 20 years.

In February 2012, upon the acquisition of Manning Crossing, the REIT assumed an existing first mortgage on the property for approximately $4.65 million. The loan matures in August 2014 and has a contractual interest rate of 6.59% per annum. The REIT also acquired a second mortgage on the property for a total of $8.0 million. The loan matures February 2017, has a contractual interest rate of 4.02% per annum, and an amortization period of 25 years.

In February 2012, upon the acquisition of Plaza des Seigneurs, the REIT acquired a first mortgage on the property for a total of $2.25 million. The loan matures in February 2017, has a contractual interest rate of 3.5% per annum, and an amortization period of 20 years.

During the twelve months ended December 31, 2011 the following mortgages were obtained:

In December 2011, upon the acquisition of 137th Avenue, the REIT acquired a first mortgage on the property for a total of $2.55 million. The loan matures in January 2017, has a contractual interest rate of 4.23% per annum, and has an amortization period of 20 years.

In September 2011, upon the acquisition of Evergreen Shopping Centre, the REIT acquired a first mortgage on the property for a total of $10.5 million. The loan matures in October 2016, has a contractual interest rate of 3.80% per annum, and has an amortization period of 25 years.

In August 2011, upon the acquisition of Place Desormeaux, the REIT acquired a first mortgage on the property for a total of $23.0 million. The loan matures in October 2014, has a contractual interest rate of 4.05% per annum, and has an amortization period of 20 years.

In July 2011, the REIT obtained a second mortgage in the amount of $4 million secured on five Shoppers Drug Mart properties located in Manitoba. It is an interest-only loan maturing April 30, 2013 and bears interest at a floating rate of the Royal Bank prime plus 4.00%.

In March 2011, upon the acquisition of the Shoppers Drug Mart properties, the REIT assumed first mortgages on each of the six properties for a total of $17.2 million. The loans mature between 2015 and 2021 and have a weighted average interest rate, adjusted to market, of 3.61% per annum. The mortgages are secured by the properties.

9. CONVERTIBLE DEBENTURES

As at		December 31, 2012		December 31, 2011
8.0% Convertible debenture	**$**	**27,950,000**	$	27,950,000
6.0% Convertible debenture		**33,990,000**		-
Debentures, excluding convertible feature		**61,940,000**		27,950,000
Fair value of convertible features at issuance		**1,310,000**		800,000
		63,250,000		28,750,000
Issue costs		**3,733,260**		2,107,652
Accumulated amortization of issue costs		**(901,370)**		(367,148)
Issue costs, net		**2,831,890**		1,740,504
		60,418,110		27,009,496
Accumulated fair value (gain) loss on convertible feature		**300,000**		(120,000)
	$	**60,718,110**	$	26,889,496

Under IFRS, the embedded derivative is not considered to be an equity instrument, and as such the value of the convertible feature of outstanding debentures is included in liabilities in the consolidated statements of financial position. IAS 39 – *Financial Instruments: Recognition and Measurement ("IAS 39")* requires the liability to be revalued at each reporting period. Change in fair value is recognized in profit or loss.

In March, 2011, the REIT issued $28,750,000 of 8.0% extendible convertible unsecured subordinated debentures (the "8.0% convertible debentures") due March 31, 2016. The 8.0% convertible debentures are convertible into REIT units at $8.80 per unit at the holder's option at any time on or after March 31, 2014. On or after March 31, 2014 and prior to March 31, 2015, the 8.0% convertible debentures may be redeemed by the REIT, in whole or in part, at a price equal to their principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of the REIT's units during the 20 consecutive trading days ending on the fifth trading day preceding the date on which the notice of redemption is given is not less than 125% of the conversion price. On or after March 31, 2015, the 8.0% debentures may be redeemed by the REIT at any time. The fair value of the convertible feature of the 8.0% convertible debentures as at December 31, 2012 is $1,140,000 (December 31, 2011 - $680,000).

On September 5, 2012, the REIT issued $34,500,000 of 6.0% convertible unsecured subordinated debentures (the "6.0% convertible debentures") due September 30, 2017. The 6.0% convertible debentures are convertible into REIT units at $10.35 per unit at the holder's option at any time on or after September 30, 2015. On or after September 30, 2015 and prior to September 30, 2016, the 6.0% convertible debentures may be redeemed by the REIT, in whole or in part, at a price equal to their principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of the REIT's units during the 20 consecutive trading days ending on the fifth trading day preceding the date on which the notice of redemption is given is not less than 125% of the conversion price. On or after September 30, 2016, the 6.0% debentures may be redeemed by the REIT at any time. The fair value of the convertible feature of the 6.0% convertible debentures as at December 31, 2012 is $470,000.

10. CREDIT FACILITIES

As at		**December 31, 2012**		December 31, 2011
Credit facilities, excluding unit purchase warrants	**$**	**7,500,000**	$	19,003,000
Fair value of unit purchase warrants at funding date		**-**		197,000
		7,500,000		19,200,000
Issue costs		**692,775**		1,142,680
Accumulated amortization of issue costs		**(470,715)**		(430,651)
Issue costs, net		**222,060**		712,029
		7,277,940		18,487,971
Accumulated fair value loss on warrants		**-**		36,000
Accumulated fair value accretion of warrants		**-**		21,915
	$	**7,277,940**	$	18,545,886
Non-current	**$**	**-**	$	18,545,886
Current		**7,277,940**		-
	$	**7,277,940**	$	18,545,886

During the year ended December 31, 2012, the REIT secured a revolving credit facility (the “Credit Facility”) from a consortium of Canadian chartered banks of up to a formula-based maximum not to exceed $50.0 million, bearing interest at the bank’s prime rate (3.0% as at December 31, 2012) plus 1.0% per annum or the Banker’s Acceptance stamping fee plus 2.25% per annum. As at December 31, 2012, the facility was secured by the King George Square and Crossing Bridge Square properties with a formula-based amount available under the facility of $15.0 million with $7.5 million in outstanding draws. The facility is renewable annually. The carrying value of properties pledged as security is $28.4 million. Subsequent to the year ended December 31, 2012 the Centre Village Shopping Centre and Elgar Place properties, with a carrying value of $22.1 million, were added as security to the facility, increasing the formula-based amount available under the facility to $28.8 million.

During the year ended December 31, 2012, the REIT repaid its revolving loan facility, leaving a balance of nil outstanding (December 31, 2011 - $13.5 million). All of the underlying warrants were exercised in the fourth quarter of 2012, resulting in net proceeds to the REIT of $4.5 million and the issuance of 625,000 units at $8.05 per unit, for a total issuance of $5.0 million.

The REIT has a revolving operating and acquisition facility (the “Acquisition Facility”) with a Canadian chartered bank. Pursuant to the terms of the Acquisition Facility, the amount permitted to be drawn is calculated based on the value of a property that has been specified under the agreement. The facility bears interest at the bank’s prime rate plus 2.25% per annum or the Banker’s Acceptance stamping fee plus 3.25% per annum. As at December 31, 2012, the Acquisition Facility was secured by the Centuria Urban Village property and the current maximum available under this facility was $5.8 million, with no draws outstanding. The carrying value of properties pledged as security is $10.2 million (December 31, 2011 - $9.4 million).

11. EXCHANGEABLE LP UNITS

Exchangeable LP units represents 287,500 units of 137th Avenue LP, a wholly owned subsidiary, issued to the participating third party vendor in exchange for a property acquired by 137th Avenue LP. The units are exchangeable on a one-for-one basis, at the option of the holder, into Partners REIT units. The exchangeable LP units are presented as a liability under IFRS and are measured at FVTPL. The fair value of the exchangeable LP units as at December 31, 2012 was $2.2 million (December 31, 2011 – $2.1 million). The REIT recorded a fair value loss for the year ended December 31, 2012 of $158,125 (December 31, 2011 – nil). The loss was calculated with reference to the closing price for the REIT’s units as at December 31, 2012.

The holder of the exchangeable LP units of 137th Avenue LP is entitled to receive distributions on a per unit basis equal to the amount that is paid to the holders of REIT units. Under IFRS, these distributions are considered interest expense and are included in financing costs in the consolidated statements of comprehensive income.

12. REVENUES FROM INCOME PRODUCING PROPERTIES

Revenues recognized from income producing properties for the year ended December 31, 2012 were $43.0 million (year ended December 31, 2011 - $24.2 million). The REIT leases commercial retail properties under operating leases generally with lease terms of between one and fifteen years, with options to extend for successive five year periods. Included in revenues from income producing properties are recoveries from tenants for the year ended December 31, 2012 of $12.9 million (year ended December 31, 2011 - $6.8 million), which represents the recovery of common area maintenance costs, realty taxes, insurance, and other permissible recoverable costs. Also included in revenues from income producing properties for the year ended December 31, 2012 is $550,811 of revenues related to 20% of the liquidated value of the notes receivable that exceeded the assets at closing. Deducted from revenues are the amortization of tenant incentives and direct leasing costs.

As at December 31, 2012, the REIT is entitled under its non-cancellable tenant operating leases to the following minimum future receipts:

	Within 12 months	2 to 5 years	Beyond 5 years
Operating lease revenue	$ 31,436,417	$ 95,129,720	$ 76,985,355

13. FAIR VALUE GAINS

The components of fair value gains are as follows:

	Year ended December 31,	
	2012	2011
Income producing properties	**$ 18,464,181**	$ 3,943,626
Financial liabilities designated as FVTPL		
Deferred unit-based compensation	**(55,000)**	4,000
Unit purchase warrants	**(418,546)**	(36,000)
Convertible feature of debentures	**(420,000)**	120,000
Exchangeable LP units	**(158,125)**	-
Note receivable	**(193,977)**	-
Amortization of convertible debenture issuance costs	**(534,222)**	-
Total fair value gains	**16,684,311**	4,031,626

14. PER UNIT CALCULATIONS

Under IAS 33 – *Earnings Per Share*, if the number of ordinary or potential ordinary units decreases as a result of a reverse unit split, the calculation of the basic and diluted earnings per unit for all periods presented must be adjusted retrospectively. On February 14, 2012, the REIT completed a 1 for 4 consolidation of units. The table below presents the net income per unit and weighted average units outstanding calculations, which reflects the REIT's unit consolidation. Only dilutive elements have been included in the calculation of diluted per unit amounts.

The table below presents the net income per unit and weighted average units outstanding calculations.

		Year ended December 31,		
		2012		2011
Numerator				
Net income and comprehensive income - basic	**$**	**27,823,978**	$	7,253,430
Gain/(loss) on fair value adjustment to unexercised deferred units		**578,125**		(120,000)
Interest savings of dilutive convertible debt		**3,145,675**		1,881,076
Net income and comprehensive income - diluted	**$**	**31,547,778**	$	9,014,506
Denominator				
Weighted average units outstanding - basic		**19,164,337**		7,745,519
Dilutive covertible units		**4,620,119**		2,672,452
Weighted average units outstanding - diluted(1)		**23,784,456**		10,417,971

(1) *The calculation of diluted per unit amounts for the years ended December 31, 2012 and 2011 excludes unexercised deferred options as their inclusion is anti-dilutive.*

Earnings per unit - basic	**$**	**1.45**	$	0.94
Earnings per unit - diluted		**1.33**		0.87

15. UNITHOLDERS' EQUITY

(a) Authorized units

The REIT is authorized to issue an unlimited number of units and special voting units. Each unit represents a single vote at any meeting of unitholders and entitles the unitholder to receive a pro rata share of all distributions. Units are redeemable at any time on demand for a price per unit (the "Redemption Price") as determined by a market formula. The Redemption Price will be paid in accordance with the conditions provided for in the Declaration of Trust.

Special voting units may only be issued in connection with or in relation to securities exchangeable, directly or indirectly, for units, in each case for the purpose of providing voting rights with respect to the REIT to the holders of such securities. Each special voting unit will entitle the holder thereof to that number of votes at any meeting of unitholders that is equal to the number of units that may be obtained upon the exchange of the exchangeable security to which it is attached. No special voting units are currently issued and outstanding.

(b) Public offerings

On January 24, 2012, Partners REIT filed a prospectus with Canadian securities regulators to offer 2,688,250 units at $7.44 per unit by way of a public offering. The offering also granted an over-allotment option of up to an additional 403,238 units at $7.44 per unit on the same terms and conditions as the offering. Partners REIT issued a total 3,049,062 units under the offering for total raised capital of $22.7 million and incurred issue costs of $1.6 million

On May 30, 2012, Partners REIT filed a prospectus with Canadian securities regulators to offer 2,705,000 units at $7.40 per unit by way of a public offering. The offering also granted an over-allotment option of up to an additional 405,750 units at $7.40 per unit on the same terms and conditions as the offering. Partners REIT issued a total of 3,110,750 units under the offering for total raised capital of $23.0 million and incurred issue costs of $1.5 million.

(c) *Private offering*

On October 17, 2011 the REIT entered into an acquisition agreement with NorRock whereby the REIT would acquire substantially all of the assets of NorRock. The transaction was approved by the REIT on December 15, 2011 and closed on February 1, 2012. The assets acquired by the REIT consisted of cash, cash equivalents, mortgages and other assets from NorRock in exchange for the issuance of REIT units, certain rights to acquire REIT units and cash (the “NorRock Transaction”).

The REIT issued units for consideration in the amount of $41,742,531 (which includes a credit to NorRock of $1,425,000 on account of expenses) for the cash and cash equivalents held by NorRock. In addition, the REIT issued units for consideration in the amount of $9,422,980 and issued 3,074,160 Rights (the “Rights”) for the non-cash assets of NorRock.

The consideration was settled as follows:

- 7,393,833 units were issued to holders of NorRock preferred shares and Class A shares;
- $344,050 was paid to those holders of NorRock preferred shares that elected to receive partial consideration in cash;
- $217,717 was paid on account of the stub period dividend payment for the NorRock preferred shares to holders of such shares;
- $88,500 was paid to holders of NorRock stock appreciation rights; and
- 3,074,160 Rights were issued to holders of NorRock Class A shares and holders of NorRock stock appreciation rights.

The final value of the Rights was $2,223,244 payable to holders of NorRock Class A shares and holders of NorRock stock appreciation rights. In accordance with the terms of the Rights, a payment was made on September 28, 2012 based on the final value of the Rights. Each right holder received REIT units corresponding to that holder’s pro rata share of the final value of the Rights. The number of REIT units issued was 259,993, calculated based on the five day volume weighted average trading price of the REIT units determined at the time of issue of $8.55.

(d) *Distributions*

The REIT currently makes monthly cash distributions to unitholders in an amount of $0.05333 per unit, representing an annualized distribution of $0.64 per unit. The amount of the REIT’s cash distributions is determined by, or in accordance with, the guidelines established from time to time by the Board of Trustees (the “Trustees”). The REIT’s Trustees have discretion in declaring distributions. Pursuant to the REIT’s Declaration of Trust, it is the intention of the REIT’s Trustees to make distributions not less than the amount necessary to ensure that the REIT will not be liable to pay income taxes under Part I of the Income Tax Act.

(e) *Distribution reinvestment plan*

The REIT has a Distribution Reinvestment and Optional Unit Purchase Plan (“the Plan”) to enable Canadian resident unitholders to acquire additional units of the REIT:

(i) through the reinvestment of regular monthly distributions on all or any part of their units; and

(ii) once enrolled in the Plan, through optional cash payments subject to a minimum of $1,000 per month and a maximum of $12,000 per calendar year.

Units issued in connection with the Plan are issued directly from the treasury of the REIT at a price based on the volume-weighted average of the closing price for the 20 trading days immediately preceding the relevant distribution date. Participants receive “bonus units” in an amount equal in value to 5% (prior to June 16, 2011: 3%) of each cash distribution.

The REIT has reserved for issuance with the TSX 500,000 additional units to accommodate the issuance of units under the Plan.

(f) Outstanding units

As at	**December 31, 2012**		December 31, 2011	
	Units	**Dollars**	Units	Dollars
Units outstanding, beginning of period	**7,765,603**	**$ 70,108,603**	7,727,266	$ 69,848,343
Units issued:				
Distribution reinvestment plan	**87,299**	**676,253**	38,337	266,659
Public offerings	**6,159,812**	**45,704,571**	-	-
Private offering	**7,393,833**	**51,165,326**	-	-
Incentive unit option plan	**12,500**	**92,250**	-	-
Alternate compenation plan	**6,493**	**51,002**	-	-
Deferred rights obligation	**259,993**	**2,222,940**	-	-
Warrant exercise	**625,000**	**5,031,250**	-	-
Unit issue costs	**-**	**(6,659,313)**	-	(6,399)
Units outstanding, end of period	**22,310,533**	**$ 168,392,882**	7,765,603	$ 70,108,603

16. SUPPLEMENTAL CASH FLOW INFORMATION

The following table outlines supplemental cash flow information and the net change in the REIT’s working capital:

	Year ended December 31,	
	2012	2011
Supplemental		
Income taxes paid	**$ -**	$ -
Interest paid	**12,488,163**	8,553,988
Net change in working capital		
Net change in accounts receivable	**$ (574,401)**	$ (600,034)
Net change in other assets	**417,737**	(1,234,329)
Net change in current mortgages payable and credit facilities market interest rate adjustment	**(761,165)**	-
Net change in accounts payable and other liabilities(1)	**4,884,667**	(207,364)
Net change in distributions payable	**782,685**	-
	$ 4,749,523	$ (2,041,727)

(1) The net change in accounts payable and other liabilites between December 31, 2012 and December 31, 2011 does not include non-cash changes relating to the incentive unit option plan and deferred revenues.

17. UNIT-BASED COMPENSATION PLANS

(a) *Incentive unit option plan*

The REIT's incentive unit option plan provides that the maximum number of units which may be reserved and set aside for issue under the incentive unit option plan shall not exceed 10% of the issued and outstanding units at the time that the options were granted (on a non-diluted basis). Options issued by the REIT vest evenly over three years and expire five years after the grant date.

Incentive unit-based compensation is comprised of the following:

	Year ended December 31, 2012		Year ended December 31, 2011	
	Units	**Weighted Average Exercise Price**	Units	Weighted Average Exercise Price
Options outstanding, beginning of period	**237,500**	**$ 7.36**	12,500	$ 13.80
Options granted	**364,500**	**7.30**	255,000	7.00
Options exercised	**(12,500)**	**7.00**	-	-
Options canceled	**(67,500)**	**8.39**	(30,000)	7.00
Options outstanding, end of period	**522,000**	**$ 7.19**	237,500	$ 7.36
Options exercisable, end of period	**62,096**	**$ 7.00**	12,500	$ 13.80

On March 23, 2012, the REIT granted 364,500 options under its unit option plan with an exercise price of $7.30 per unit (February 18, 2011 – 255,000 options granted, exercise price $7.00 per unit). At the grant date, the options each had a weighted average fair value of $0.10.

Under IFRS, the options are not considered to be equity instruments, and as such the unexercised, outstanding options are included in liabilities in the consolidated statements of financial position. IAS 39 requires the liability to be measured at fair value. Changes to the fair value are recognized in profit or loss such that the cumulative expense reflects the amount amortized to date over the vesting period if the amortized amount was otherwise re-calculated at the end of the reporting period.

As at December 31, 2012, the fair value of the incentive unit-based compensation liability is $215,000 (December 31, 2011 – $53,000). During the year ended December 31, 2012 the REIT recorded $107,000 of employee compensation expense (December 31, 2011 – $57,000).

The weighted average remaining contractual life at December 31, 2012 for the exercisable unit options is approximately 3.2 years (December 31, 2011 – approximately 0.7 years).

(b) Alternate compensation plan ("ACP")

Under the ACP, Trustees will have the option to have their fees ("Trustees Fees") paid in units of the REIT. The number of units will be equivalent to the cash value of the Trustees Fees elected by the Trustee to be paid in units. The maximum number of units reserved for issuance under the ACP is 1% of the issued and outstanding units and the maximum number of units reserved under the ACP and all unit-based compensation plans of the REIT shall not exceed 10% of the REIT's issued and outstanding units at any given time.

The issue price of the units under the ACP is the closing price of the units on the market with the largest trading volume of units on the last trading date preceding the date of issuance to the Trustees. If there is no trading on that date, the issue price is the closing price on the next previous day on which trading took place preceding the date of issuance to the Trustees or such other amount as determined by the Board and permitted by the TSX upon which the units are from time to time listed for trading and any other applicable regulatory authority.

The ACP became effective April 13, 2012. As at December 31, 2012, the number of units issued to the Trustees under the ACP is 6,493 units (December 31, 2011 – nil) at a weighted average price of $7.85 per unit (December 31, 2011 – nil).

18. INCOME TAXES

One of the REIT's corporate entities, Charter Realty Holdings Ltd. (the "Company") does not have current taxes payable because it has a sufficient non-capital loss carry-forward balance from previous years to apply against any taxable income in the current year. All of the other corporate entities that consolidate into the REIT are nominee corporations and do not have any taxable income and therefore do not have any current income tax payable. The REIT also has a partnership contained within the structure, 137th Ave LP (the "LP"). For Canadian tax purposes, this entity is a flow-through entity and any income or loss of the partnership is recorded by the partners (in this case, Partners REIT and 137th Avenue GP Inc.). The REIT qualifies as a MFT for Canadian income tax purposes. The REIT expects to distribute all of its taxable income to unitholders and is entitled to deduct such distributions for income tax purposes. Accordingly, no provision for Canadian income tax payable has been made.

19. CAPITAL MANAGEMENT

The REIT actively manages both its debt capital[(1)] and its equity capital with the objectives of ensuring that the REIT can continue to grow and operate its business.

The real estate industry is capital intensive by nature. As a result, debt capital is a very important aspect in managing the business. In addition, financial leverage is used to enhance returns from purchased real estate. Part of the REIT's objectives in securing mortgages for its properties and managing its long-term debt is to stagger the maturities in order to mitigate short-term volatilities in the debt markets. As well, given the importance of debt capital to real estate entities, the REIT monitors its debt-to-gross book value ratio; a ratio that has become a common industry metric reviewed by analysts, unitholders and others within the industry. The REIT does not have a specific debt-to-gross book value threshold imposed on it in its Declaration of Trust; however the REIT's bank credit facility imposes a restriction on the REIT's debt-to-gross book value ratio, at a maximum of 75%.

The debt-to-gross book value ratio is measured as the REIT's total debt, including mortgages payable, corporate secured debt, debentures and bank credit facility, divided by the gross book value of its assets.

At December 31, 2012, the REIT is in compliance with its debt-to-gross book value ratio at 62.4%, (December 31, 2011 – 73.0%), which is calculated as follows:

As at	**December 31, 2012**	December 31, 2011
Debt		
Mortgage principal	**$ 224,583,939**	$ 155,639,032
Debentures, excluding fair value of convertible feature at issuance	**61,940,000**	27,950,000
Credit facilities, excluding fair value of warrants at funding date	**7,500,000**	19,003,000
	$ 294,023,939	$ 202,592,032
Gross Book Value of Assets		
Original cost of income producing properties [(2)]	**$ 453,054,833**	$ 266,725,072
Book value of all other assets	**13,341,154**	7,237,816
Deferred financing fees	**4,578,121**	3,566,944
	$ 470,974,108	$ 277,529,832
Debt-to-Gross Book Value	**62.4%**	73.0%
Debt-to-Gross Book Value Excluding Debentures	**49.3%**	62.9%

(1) debt capital refers to secured debt, debenture and bank credit facility excluding deferred financing costs, the value of the debentures' convertible feature, fair value of embedded derivatives, and unamortized above market interest rate adjustments.

(2) Original cost of income producing properties represents the historical costs incurred to acquire the REIT's properties.

In terms of the REIT's equity capital, the REIT issues equity when it is available and appropriate to replenish cash, for acquisitions, or other uses. The REIT has access to an Acquisition and Credit Facility, which may be used to fund the equity portion of acquisitions, as well as to fund general working capital requirements.

20. FINANCIAL INSTRUMENTS

Fair value is the amount that arm's length parties are willing to exchange a financial instrument based on the current market for instruments with the same risk, principal and remaining maturity. The fair values of the REIT's financial instruments were determined as follows:

(a) *Current assets and liabilities*

The carrying amounts for cash, accounts receivable, other assets, the note receivable, accounts payable and other liabilities, credit facilities and distributions payable approximate their fair values due to the short-term nature of these items.

(b) *Mortgages payable*

The fair value of secured debt is based on discounted future cash flows, using interest rates ranging between 3.40% and 7.00% that reflect current market conditions for instruments of similar term and risk. The fair value of the secured debt is approximately $235.3 million at December 31, 2012 (December 31, 2011 - $178.2 million).

(c) *Debentures*

The debentures, without the convertible feature, are classified as other financial liabilities and measured at amortized cost. The fair value of the debentures are approximately $59.1 million at December 31, 2012 (December 31, 2010 - $26.2 million).

(d) *Embedded derivatives*

The convertible feature of the debentures is an embedded derivative and is classified as a financial liability at FVTPL. The fair value of the embedded derivatives is approximately $1.6 million for the convertible feature of the debentures for the year ended December 31, 2012 (December 31, 2011 – $0.7 million). Refer to Note 9 for the method of determining fair value of the embedded derivatives.

(e) *Deferred unit-based compensation*

The unit option plan is classified as a financial liability at FVTPL. The fair value of the deferred unit-based compensation liability is approximately $0.2 million at December 31, 2012 (December 31, 2011 - $0.1 million).

(f) *Exchangeable LP units*

The exchangeable LP units are classified as a financial liability at FVTPL. The fair value of the exchangeable feature is approximately $0.2 million (December 31, 2011 – nil).

Financial instruments measured at fair value in the statements of financial position are classified based on a three-level hierarchy that reflects the significance of the inputs used when determining the fair value as follows:

- Level 1- determined by reference to quoted prices in active markets for identical assets and liabilities;
- Level 2- determined by using inputs other than the quoted prices that are observable for the asset or liability, either directly or indirectly; and
- Level 3- determined using inputs that are not based on observable market data.

In accordance with the three-level hierarchy of financial instruments measured at fair value on the consolidated statements of financial position, at December 31, 2012 the REIT has included in the Level 2 category the convertible feature related to the debentures of $1.6 million (December 31, 2011 – $0.7 million) and deferred unit-based compensation of $0.2 million (December 31, 2011 – $0.1 million).

The following table shows the contractual cash flows (including principal and interest) on all of the REIT's non-derivative financial liabilities:

	2013	2014	2015	2016	2017	Thereafter
Mortgages payable						
Interest	$ 10,069,045	$ 9,330,932	$ 8,042,538	$ 5,988,605	$ 2,740,635	$ 2,507,991
Principal payments	6,608,760	6,714,802	6,095,699	4,998,831	2,953,665	3,707,582
Balances due on maturity	4,000,000	24,870,435	32,267,407	28,376,013	68,641,804	35,348,941
Debentures						
Interest	4,370,000	4,370,000	4,370,000	2,645,000	1,552,500	-
Balances due on maturity	-	-	-	28,750,000	34,500,000	-
Credit facilties						
Interest	225,000	-	-	-	-	-
Balances due on maturity	7,500,000	-	-	-	-	-
Accounts and distributions payable and other liabilities	12,340,542	-	-	-	-	-
Total	$ 45,113,347	$ 45,286,169	$ 50,775,644	$ 70,758,449	$ 110,388,604	$ 41,564,514

21. RISK MANAGEMENT

In the normal course of business, the REIT is exposed to a number of risks that can materially affect its operating performance.

(a) Interest rate risk

The REIT is exposed to interest rate risk when funds are drawn under the Acquisition Facility and Credit Facility, which both have a floating rate of interest as well as its variable-rate mortgages. An increase in interest rates would increase the interest cost of the REIT's Acquisition Facility and Credit Facility and have an adverse effect on the REIT's comprehensive income and earnings per unit. Based on the outstanding balance of the Acquisition Facility, Credit Facility and variable rate mortgages at December 31, 2012, a 1% increase or decrease in the Bank's prime rate would have an impact of $115,000 on the REIT's annual interest expense (December 31, 2011 – $97,000) for the period then ended.

The REIT structures its fixed rate financing so as to stagger the maturities of its mortgages, thereby minimizing exposure to future interest rate fluctuations.

(b) Credit risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The REIT attempts to mitigate this risk by conducting credit assessments on new lessees, by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant. The maximum credit risk exposure at December 31, 2012, and December 31, 2011 relates to the carrying value of the accounts receivable balance without taking into account any collateral held or other credit enhancements. Collateral held on certain leases are letters of credit or security deposits from the tenants. Refer to Note 7 for details of accounts receivable.

Credit risk also arises from the possibility that the note receivable will not be repaid. The REIT has mitigated this risk by obtaining a guarantee on the full value of the note and by monitoring the ongoing sales of the related assets.

(c) Liquidity risk

Liquidity risk arises from the possibility of not having sufficient debt and equity capital available to the REIT to fund future growth, refinance debts as they mature or meet the REIT's payment obligations as they arise. Furthermore, liquidity risk also arises from the REIT not being able to obtain financing or refinancing on favourable terms.

The REIT's main liquidity requirements arise from ongoing working capital requirements, debt servicing and repayment obligations, capital and leasing expenditures on existing properties, property acquisitions and distributions to unitholders. All of the aforementioned liquidity requirements, except for debt repayment obligations at maturity and property acquisitions, are generally funded from cash flows from operations or from drawing on the REIT's Acquisition or Credit Facility. Debt repayment obligations (see Notes 8 and 9) are generally funded from refinancing the related debt and property acquisitions are generally funded from equity raises as well as obtaining debt financing on the related property. Between capital raises, the REIT may use its Acquisition or Credit Facility to fund the equity portion of property acquisitions.

The REIT's financial condition and results of operations would be adversely affected if it were unable to obtain financing/refinancing or cost-effective financing/refinancing, or if it were unable to meet its other liquidity requirements from ongoing operating cash flows.

The REIT attempts to mitigate its liquidity risk by staggering the maturities of its debt. As well, the REIT's distributions are made at the discretion of the REIT's Trustees. Finally, the REIT doesn't enter into property acquisitions unless it has secured or knows that it can secure the appropriate capital (debt and equity) to fund the particular acquisition.

22. RELATED PARTY TRANSACTIONS

IAS 24 – Related Party Disclosures requires entities to disclose in their financial statements information about transactions with related parties. Generally, two parties are related to each other if one party controls, or significantly influences the other party. Balances and transactions between the REIT and its subsidiaries, which are related parties of the REIT, have been eliminated on consolidation and are not disclosed in this note.

The REIT entered into related party transactions with IGW Public LP ("IGW Public"), and its subsidiary, LAPP Global Asset Management Corp. ("LAPP"), which are the REIT's major unitholder and asset manager, respectively. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

The REIT also entered into a related party transaction with League Holdings Corporation ("LHC"), a subsidiary of League Assets LP. LHC and League Assets LP are related to the REIT by virtue of certain directors and key management personnel of the REIT having a controlling ownership interest in these entities.

(a) Management agreement

Pursuant to the management agreement between LAPP and the REIT, LAPP provides the REIT with strategic, advisory, asset management and administrative services in exchange for an annual management fee equal to: (i) 0.30% of the “adjusted book value” of the REIT’s assets, paid quarterly in arrears, and (ii) 0.25% of the “adjusted book value” of the REIT’s assets, paid quarterly in arrears, if the “adjusted book value” of the REIT’s assets is greater than $1 billion, and an acquisition fee equal to: (i) 0.50% of the “property cost” of such real property if prior to such acquisition the “adjusted book value” of the REIT’s assets is less than or equal to $1 billion; and (ii) 0.40% of the “property cost” of such real property if prior to such acquisition the “adjusted book value” of the REIT’s assets is greater than $1 billion. “Adjusted book value” equals the original property cost of the income producing properties, plus the book value of all other assets, and plus the add-back of accumulated amortization of deferred costs. In addition, the agreement allows for an incentive fee of 15% of funds from operations in excess of $0.70 per unit. The hurdle of funds from operations of $0.70 per unit increases by 1.5% per year.

The initial term of the management agreement is a three-year period, expiring on March 15, 2015. Upon expiry of the initial term, the management agreement renews automatically for successive three-year terms, unless terminated in accordance with its terms. The management agreement may be terminated if the independent trustees make the decision to employ individuals directly by the REIT rather than by LAPP, where the independent trustees determine the cost of doing so would be less on an annual basis than the fees paid to LAPP under the management agreement; or if otherwise determined that it is in the best interest of the REIT to have the management of the REIT performed on a full time basis by individuals employed directly by the REIT. The management agreement provides each party with termination rights, the exercise of which may, in certain situations, require the REIT to pay a termination fee equal to two times the annual management fee paid in respect of the last full calendar year prior to the date of termination.

In accordance with the management agreement, LAPP is providing the services of certain executives, consultants and other employees to the REIT. As the REIT grows, LAPP will provide additional executives to the REIT in order to fulfill its obligations under the management agreement as recommended by the trustees and agreed to by the trustees and LAPP. All costs associated with the executives and personnel shall be borne by LAPP. In accordance with the terms of the management agreement, LAPP is required to consult with the independent trustees with regard to compensation decisions for executives who devote substantially all of their time to the business of the REIT. In the event that any executive providing services to the REIT ceases to do so for any reason, LAPP will replace such individual with another employee with similar qualifications and experience.

Under the terms of the management agreement, the REIT has incurred the following fees:

	Year ended December 31, 2012	2011
Acquisition fees	**$ 880,354**	$ 460,075
Asset management fees	**1,037,466**	898,341
Property management and accounting fees	**451,764**	104,930
Leasing commissions	**237,728**	33,200
	$ 2,607,312	$ 1,496,546

The acquisition fees and leasing commissions were capitalized to income producing properties in the consolidated statements of financial position, in accordance with IAS 40 – *Investment Properties*. The asset management fees were charged to general and administrative expenses and the property management and accounting fees were charged to operating expenses in the consolidated statements of comprehensive income.

In connection with entering into the management agreement, LAPP, League Assets LP and IGW Public (collectively referred to as the "Restricted Parties") entered into a non-competition agreement with the REIT. Pursuant to the non-competition agreement, each of the Restricted Parties agreed that it will not, and will cause its affiliates not to, directly or indirectly: (i) create, manage or provide restricted management services to another person who carries on the primary business of the acquisition, development and/or management of "retail properties" or "mixed-use retail properties" (the retail properties and mixed-use retail properties collectively are referred to as the "Restricted Real Estate Assets"); (ii) purchase any Restricted Real Estate Asset or develop any property that, on completion of development, will be a Restricted Real Estate Asset; or (iii) provide strategic, advisory and asset management services for any Restricted Real Estate Asset the equity interests in which are not all held by the Restricted Parties or their respective affiliates. Exceptions from the foregoing include the purchase of properties or the making of investments that have been first offered to the REIT and which the REIT notified the Restricted Party that it was not interested in pursuing.

The non-competition agreement remains in effect until the earlier of: (i) six months after the termination of the management agreement in certain circumstances; or (ii) the date of termination of the management agreement under other circumstances.

(b) Other related party transactions

Partners REIT entered into an agreement with LHC, which provides that, at any time, the REIT has the option to sell to LHC the remaining non-cash assets it has purchased from NorRock, and that LHC will purchase the remaining non-cash assets at a designated value.

On June 30, 2012, the REIT exercised its option to sell the remaining mortgage assets to LHC for $7.9 million based on third party valuations. In exchange for purchasing the mortgage assets, the REIT accepted a full recourse note receivable from LHC, fully guaranteed by LAC, bearing interest from September 15, 2012 at 12% and having a maturity date that has been extended to May 31, 2013.

Following the sale of the remaining mortgage assets to LHC, partial repayments on the note receivable have been made to the REIT, including on November 27, 2012 a repayment for $1.9 million upon refinancing of one of the underlying mortgage assets.

Subsequent to December 31, 2012, LHC made an additional repayment of $4.1 million to the REIT, leaving a remaining balance of $1.9 million.

(c) Related party balances

Amounts owing to LAPP and other related parties at December 31, 2012 are $36,727 (December 31, 2011 - $50,460). These amounts have been classified in accounts payable and other liabilities, and consist of outstanding reimbursements payable.

Amounts owing to the REIT from other related parties at December 31, 2012 consist of the note receivable and accrued interest on the note receivable totaling $6.0 million (December 31, 2011 – nil).

(d) Compensation of key management and Trustees

The REIT's independent Trustees include: Louis Maroun, Paul Dykeman, Saul Shulman, John van Haastrecht and Tim O'Neill. Key management personnel include: Chief Executive Officer, Adam Gant; President, Patrick Miniutti; Chief Financial Officer, Tony Quo Vadis and Chief Operating Officer, Peter Morris. The remuneration of the REIT's key management personnel was as follows:

	Year ended December 31,		Year ended December 31,	
	2012	2011	**2012**	2011
	Trustees		**Key Management**	
Compensation and benefits	**$ 184,639**	$ 253,387	**$ 671,237**	$ 416,845
Deferred unit-based compensation	**-**	-	**107,000**	57,000
	$ 184,639	$ 253,387	**$ 778,237**	$ 473,845

23. SUBSEQUENT EVENTS

(a) On January 10, 2013 the REIT closed its public offering of 3,363,750 units at a price of $7.70 per unit representing gross proceeds of approximately $25.9 million, on a bought deal basis, to a syndicate of underwriters.

Net proceeds of the offering were used to repay the Credit Facility, fund acquisitions and for general trust purposes.

(b) In January 2013, the REIT announced that it had entered into agreements with separate vendors to acquire four newly-constructed, necessity-based, open-air retail centres and one stabilized retail centre in the Greater Montreal region.

On March 15, 2013 the REIT completed the acquisitions of two of the retail centres. The first property is a 31,136 square foot, three-building retail development located in Sorel-Tracey, Québec. The REIT paid $9.15 million for the property, funded by cash.

The second property is a 62,599 square foot, grocery-anchored retail development located in Saint-Remi, Québec. The REIT paid $17.0 million for the property, funded by cash.

(c) In February 2013, the REIT announced that it had signed an agreement to purchase the Mariner Square Shopping Centre, a six-building 101,000 square foot open-air retail centre. Anchored by necessity-based tenants, the centre is situated in downtown Campbell River on the east coast of Vancouver Island about 260 kilometers north of Victoria. The transaction is expected to close on or before April 15th, 2013. The REIT will pay approximately $25.8 million for the property, funded in part by the assumption of a $14.7 million first mortgage maturing in November 2017 with an effective interest rate of 3.50%.

(d) On March 12, 2013, the REIT closed an offering for $20.0 million of 5.5% extendible convertible unsecured subordinated debentures due March 31, 2018. On March 19, 2013, the REIT issued an additional $3,0 million of the convertible debentures on the exercise of the over-allotment option. The 5.5% debentures are convertible into REIT units at $10.25 per unit at the holder's option at any time. On or after March 31, 2016 and prior to March 31, 2017, the 5.5% convertible debentures may be redeemed by the REIT, in whole or in part, at a price equal to their principal amount plus accrued and unpaid interest, provided that the volume weighted average trading price of the REIT's units during the 20 consecutive trading days ending on the fifth trading day preceding the date on which the notice of redemption is given is not less than 125% of the conversion price. On or after March 31, 2017, the 5.5% debentures may be redeemed by the REIT at any time.