

Condensed consolidated financial statements of

**Slate Retail REIT**

For the three and six months ended June 30, 2014

Unaudited

# **Slate Retail REIT**

## **Condensed Consolidated Financial Statements**

### **June 30, 2014**

#### **Table of contents**

Condensed consolidated statements of financial position .....	1
Condensed consolidated statements of comprehensive income .....	2
Condensed consolidated statements of changes in unitholders' equity .....	3
Condensed consolidated statements of cash flows .....	4
Notes to the condensed consolidated financial statements .....	5 - 21

**SLATE RETAIL REIT**

Unaudited condensed consolidated statements of financial position  
Expressed in thousands of United States dollars

	<i>Note</i>	June 30, 2014 <sup>(1)</sup>	December 31, 2013 <sup>(1)</sup>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash		\$13,883	\$10,962
Deposits on investment properties		1,350	540
Prepays		678	695
Accounts receivable	9	4,600	1,230
		<b>20,511</b>	<b>13,427</b>
<b>Non-current assets</b>			
Investment properties	10	438,127	177,050
Interest rate caps	18	8	81
TIF notes receivable	15	4,161	—
Funds held in escrow		401	—
		<b>442,697</b>	<b>177,131</b>
<b>Total assets</b>		<b>\$463,208</b>	<b>\$190,558</b>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$4,547	\$1,771
Distributions payable		963	1,480
		<b>5,510</b>	<b>3,251</b>
<b>Non-current liabilities</b>			
Debt	13, 14	230,626	104,526
TIF notes payable	15	4,142	—
Tenant deposits		850	437
Deferred income taxes	16	29,062	5,757
REIT units	12	160,737	75,944
Exchangeable units of subsidiaries	12	29,401	—
		<b>454,818</b>	<b>186,664</b>
Unitholders' equity		<b>\$2,880</b>	<b>\$643</b>
<b>Total liabilities and unitholders' equity</b>		<b>\$463,208</b>	<b>\$190,558</b>

<sup>(1)</sup> Comparative amounts relate solely to Slate U.S. Opportunity (No. 2) Realty Trust. Amounts for June 30, 2014 relate to the financial position of Slate U.S. Opportunity (No. 2) Realty Trust and the acquisition of Slate U.S. Opportunity (No. 1) Realty Trust and the U.S. Grocery Anchored Retail portfolio on April 15, 2014. See note 5.

**SLATE RETAIL REIT**

Unaudited condensed consolidated statements of comprehensive income  
Expressed in thousands of United States dollars

	Note	Three months ended June 30,		Six months ended June 30,	
		2014 <sup>(1)</sup>	2013 <sup>(1) (2)</sup>	2014 <sup>(1)</sup>	2013 <sup>(1) (2)</sup>
<b>Net property income</b>					
Rental revenue		\$9,885	\$1,829	\$15,549	\$2,851
Property operating expenses		(1,647)	(382)	(5,404)	(991)
Net property income		8,238	1,447	10,145	1,860
<b>Other income (expenses)</b>					
General and administrative	7	(2,211)	(377)	(2,897)	(702)
Interest and other financing charges	11	(10,572)	(3,118)	(11,579)	(5,287)
Property acquisition costs		—	(1,010)	(131)	(1,186)
Fair value change of investment properties	10	21,772	4,598	34,870	8,199
Impairment of goodwill	6	(14,987)	—	(14,987)	—
Net income before taxes		\$2,240	\$1,540	\$15,421	\$2,884
<b>Income taxes</b>					
Current		—	—	—	(68)
Deferred	16	(3,337)	(1,540)	(8,318)	(2,815)
		(3,337)	(1,540)	(8,318)	(2,883)
Net income and comprehensive income		(\$1,097)	\$—	\$7,103	\$1
<b>Allocated to:</b>					
Non-controlling interest		\$—	\$—	\$2,799	\$1
Unitholders		(1,097)	—	4,304	—
		(\$1,097)	\$—	\$7,103	\$1

<sup>(1)</sup> Comparative amounts relate solely to Slate U.S. Opportunity (No.2) Realty Trust. The three months and six months ended June 30, 2014 relate to the full period of earnings of Slate U.S. Opportunity (No. 2) Realty Trust and the acquisition of Slate U.S. Opportunity (No. 1) Realty Trust and the U.S. Grocery Anchored Retail portfolio on April 15, 2014. See note 5.

<sup>(2)</sup> The REIT has retrospectively applied IFRIC 21, *Levies*. See note 3(x).

**SLATE RETAIL REIT**

Unaudited consolidated statements of changes in unitholders' equity  
Expressed in thousands of United States dollars

	<b>Non- controlling interest</b>	<b>Capital reserve</b>	<b>Unitholders' equity</b>	<b>Total</b>
Balance, December 31, 2013	\$643	\$—	\$—	\$643
Net income and comprehensive income	2,799	—	4,304	7,103
Exchange of general partnership interest	(3,442)	(1,424)	—	(4,866)
Balance, June 30, 2014	\$—	(\$1,424)	\$4,304	\$2,880

	<b>Non- controlling interest</b>	<b>Capital reserve</b>	<b>Unitholders' equity</b>	<b>Total</b>
Balance, December 31, 2012	\$—	\$—	\$—	\$—
Net income and comprehensive income	1	—	—	1
Balance, June 30, 2013	\$1	\$—	\$—	\$1

**SLATE RETAIL REIT**

Unaudited condensed consolidated statements of cash flows  
Expressed in thousands of United States dollars

		<b>Six months ended June 30,</b>	
	<i>Note</i>	<b>2014</b>	<b>2013</b>
<b>Cash provided by (used in)</b>			
<b>OPERATING ACTIVITIES</b>			
Net income and comprehensive income		<b>\$7,103</b>	\$1
Deferred income tax expense	16	<b>8,318</b>	2,815
Straight-line rent	10	<b>(101)</b>	(93)
Interest and other financing charges		<b>11,579</b>	5,287
Cash interest paid		<b>(2,651)</b>	(250)
Change in fair value of investment properties	10	<b>(34,870)</b>	(8,199)
Impairment of goodwill		<b>14,987</b>	—
IFRIC 21 adjustment		<b>1,267</b>	210
Changes in non-cash working capital items	22	<b>(1,448)</b>	377
		<b>4,184</b>	148
<b>INVESTING ACTIVITIES</b>			
Acquisitions (net of cash acquired)	6	<b>(427)</b>	(63,350)
Change in funds held in escrow		<b>271</b>	—
Deposits on investment properties		<b>(810)</b>	(22,904)
Capital costs	10	<b>(715)</b>	(139)
Leasing costs	10	<b>(150)</b>	(102)
		<b>(1,831)</b>	(86,495)
<b>FINANCING ACTIVITIES</b>			
Term loan facility advances	13	<b>4,061</b>	59,165
Mortgage repayments		<b>(112)</b>	—
Redemption of REIT units		<b>(332)</b>	—
REIT unit distributions	11	<b>(2,820)</b>	—
Exchangeable units distribution	11	<b>(229)</b>	—
		<b>568</b>	59,165
<b>Increase in cash</b>		<b>2,921</b>	(27,182)
<b>Cash, beginning of period</b>		<b>10,962</b>	40,001
<b>Cash, end of period</b>		<b>\$13,883</b>	\$12,819

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

### 1. Description of the REIT and operations

Slate Retail REIT (the "REIT") (formerly known as, Slate U.S. Opportunity (No. 1) Realty Trust ("SUSO 1")) is an unincorporated, open-ended investment trust under, and governed by, the laws of the Province of Ontario. The REIT focuses on acquiring, owning and leasing a portfolio of diversified revenue-producing commercial real estate properties in the United States with an emphasis on grocery anchored retail properties. As of June 30, 2014, the properties of the REIT (the "Properties") consists of a portfolio of 29 grocery anchored retail commercial properties located in the United States. The units of the REIT trade on the The Toronto Stock Exchange ("TSX") under the symbols SRT.U/SRT.UN. The principal, registered and head office of the REIT is 200 Front Street West, Suite 2400, Toronto, ON, M5V 3K2.

The objectives of the REIT are to: (i) provide Unitholders of the REIT (collectively, "REIT Unitholders" and individually a "REIT Unitholder") with stable cash distributions from a portfolio of diversified revenue-producing commercial real estate properties in the United States with a focus on anchored retail properties; (ii) enhance the value of the REIT's assets and maximize long-term REIT Unitholder value through active management; and (iii) expand the asset base of the REIT and increase the REIT's earnings on a per unit basis, including accretive acquisitions.

### 2. Basis of preparation

#### *i. Statement of compliance*

These condensed consolidated financial statements (the "consolidated financial statements") have been prepared in accordance with International Accounting Standard ("IAS") 34, *Interim Financial Reporting* ("IAS 34") as issued by the International Accounting Standards Board ("IASB").

#### *ii. Approval of the consolidated financial statements*

The consolidated financial statements were approved by the trustees of the REIT and authorized for issue on August 13, 2014.

#### *iii. Basis of measurement*

These consolidated financial statements have been prepared on the historical cost basis except for investment properties and certain financial instruments which are measured at fair value.

The application of the going concern basis of presentation assumes that the REIT will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The REIT expects to continue as a going concern for the foreseeable future, accordingly, these consolidated financial statements have been prepared on a going concern basis.

#### *iv. Functional and presentation currency*

These consolidated financial statements are presented in United States dollars, which is the REIT's functional currency and the functional currency of all of its subsidiaries.

### 3. Significant accounting policies

The consolidated financial statements have been prepared in accordance with the significant accounting policies described below.

#### *i. Basis of consolidation*

The consolidated financial statements include the accounts of the REIT and the other entities that the REIT controls in accordance with IFRS 10, *Consolidated Financial Statements*. Control requires exposure or rights to variable returns and the ability to affect those returns through power over an investee. All intercompany transactions and balances have been eliminated on consolidation.

#### *ii. Investment properties*

The REIT accounts for its investment properties in accordance with IAS 40, *Investment Property* ("IAS 40"). For acquired investment properties that meet the definition of a business, the acquisition is accounted for as a business combination. Acquisitions of investment properties that do not meet the definition of a business are initially measured at cost including directly attributable expenses. Subsequent to acquisition, investment properties are carried at fair value, which is determined based on available market evidence at the statement of financial position date including, among other things, rental revenue from current leases and reasonable and

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases less future cash outflows in respect of capital expenditures. Gains and losses arising from changes in fair value are recognized in net income in the period of change.

The carrying value of investment properties includes the impact of straight-line rental revenue, tenant inducements and deferred leasing costs since these amounts are incorporated in the determination of the fair value of income-producing properties.

When an investment property is disposed of, the gain or loss is determined as the difference between the net disposal proceeds and the carrying amount of the property and is recognized in net income in the period of disposal.

### *iii. Business combinations*

The REIT accounts for investment property acquisitions as a business combination if the particular assets and set of activities acquired can be operated and managed as a business in its current state. The REIT applies the acquisition method to account for business combinations. The consideration transferred for a business combination is the fair value of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the REIT. The total consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired as well as liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

The REIT recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of the acquiree's identifiable net assets.

Acquisition related costs are expensed as incurred.

Any contingent consideration is recognized at fair value at the acquisition date. Subsequent changes to the fair value of contingent consideration is recognized as a liability in accordance with IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39") primarily in net income or, in certain circumstances, as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the identifiable net assets acquired. If the consideration is lower than the fair value of the net assets acquired, the difference is recognized in net income.

### *iv. Revenue recognition*

The REIT has retained substantially all of the risks and benefits of ownership of its investment 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 asset. Generally, this occurs on the lease inception date or, where the REIT is required to make additions to the property in the form of tenant improvements that enhance the value of the property, upon substantial completion of those improvements. 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, which is included in the carrying amount of investment property, is recorded for the difference between the rental revenue recorded and the contractual amount received.

### *v. Expenses*

Property expenses and general and administrative expenses are recognized in income in the period in which they are incurred.

### *vi. Income taxes*

Subsidiaries of the REIT, Slate Retail Investment L.P. ("Investment LP") and GAR (1B) Limited Partnership ("GAR B"), that hold the REIT's investments made an election pursuant to the United States Internal Revenue Code of 1986, as amended, to be classified as corporations for U.S. federal income tax purposes effective on the date of its formation. Consequently, Investment LP and GAR B are each considered a "foreign corporation" for U.S. federal income tax purposes. The REIT measures deferred tax liabilities of these subsidiaries, by applying the appropriate tax rate to temporary differences between the carrying amounts of assets and liabilities, and their respective tax basis. The appropriate tax rate is determined by reference to the rates that are expected to apply to the year and the jurisdiction in which the assets are expected to be realized or the liabilities settled. Deferred tax assets are recorded for all deductible temporary differences, carry forwards of unused tax credits and unused tax losses, to the extent that it is probable that deductions, tax credits and tax losses can be utilized. For the determination of deferred tax assets and liabilities where investment property is measured using the fair value model, the presumption is that the carrying amount of an investment property is recovered through sale, as opposed to presuming that the economic benefits of the investment property will be substantially



## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

consumed through use over time. The REIT qualifies as a "mutual fund trust" under the Income Tax Act (Canada) and plans to distribute or designate all taxable earnings to Unitholders and, under current legislation, the obligation to pay tax rests with each Unitholder. Accordingly, no current or deferred tax provision is recognized on the REIT's income at the REIT level in addition to deferred tax amounts recorded in respect of Investment LP and GAR B on consolidation.

### vii. *Slate Retail Exchangeable Units and GAR B Exchangeable Units*

The Slate Retail Exchangeable Units (as defined below) have been issued from a subsidiary of the REIT and are redeemable for cash or Class U Units (as defined below) of the REIT at the option of the REIT and therefore are classified as financial liabilities under IAS 32 *Financial Instruments: Presentation* ("IAS 32"). The GAR B Exchangeable Units (as defined below) have also been issued from a subsidiary of the REIT and are redeemable for Class U Units at the option of the holder and therefore, are classified as financial liabilities under IAS 32.

The Slate Retail Exchangeable Units and the GAR B Exchangeable Units are designated as FVTPL (as defined below) financial liabilities and are measured at fair value at each reporting period with any changes in fair value recognized in net and comprehensive income. The distributions paid on the Slate Retail Exchangeable Units and the GAR B Exchangeable Units are recorded in interest expense and other financing charges in net and comprehensive income in the period in which they become payable.

### viii. *REIT Units*

The REIT has class A units, class I units and class U units issued and outstanding (collectively, the "REIT Units"). As an open-ended investment trust, Unitholders of each class of units of the REIT are able to require the REIT to redeem at any time or from time to time at the demand of the Unitholder all or any part of the REIT Units held by the Unitholder in an amount equal to redemption price, as specified by the REIT's declaration of trust. This redemption is to be provided in cash, subject to certain limitations. If a redemption is not satisfied in cash, the redemption price is to be paid by notes of the REIT or property of the REIT. Accordingly, as (i) the units of the REIT contain a contractual agreement to deliver cash or another financial liability to the Unitholders of the REIT and (ii) each class of units do not have identical features, the REIT Units have been classified as a liability and measured at fair value and distributions to Unitholders are presented as finance expenses and recognized when declared by the Board of Trustees. Units are presented as a separate component in the statement of financial position. Offering costs are expensed as incurred in the consolidated statements of comprehensive income.

### ix. *Financial instruments*

Financial instruments are classified as one of the following: (i) held-to-maturity, (ii) loans and receivables, (iii) fair value through profit or loss ("FVTPL"), (iv) available-for-sale, or (v) other financial liabilities. Financial assets and liabilities classified as FVTPL are measured at fair value with gains and losses recognized in the consolidated statements of comprehensive income. Financial instruments classified as held-to-maturity, loans and receivables or other financial liabilities are measured at amortized cost, using the effective interest method. Available-for-sale financial instruments are measured at fair value and any unrealized gains and losses will be recognized in other comprehensive income.

The REIT has made the following classifications:

Cash	Loans and receivables
Accounts receivable	Loans and receivables
TIF notes receivable	Loans and receivables
Funds held in escrow	Loans and receivables
Interest rate caps	FVTPL
Exchangeable units of subsidiaries	FVTPL
REIT units	FVTPL
Accounts payable and accrued liabilities	Other financial liabilities
Distributions payable	Other financial liabilities
TIF notes payable	Other financial liabilities
Debt	Other financial liabilities

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

Transaction costs other than those related to financial instruments classified as FVTPL, which are expensed as incurred, are capitalized to the carrying amount of the instrument and amortized using the effective interest method. These costs include interest, amortization of discounts or premiums relating to borrowings, fees and commissions paid to agents, brokers and advisers and transfer taxes and duties that are incurred in connection with the arrangement of borrowings.

### x. *New and future accounting policies*

In these consolidated financial statements the REIT has applied the accounting interpretation described below:

#### IFRIC 21, *Levies*

The REIT has retrospectively adopted IFRIC 21, *Levies* ("IFRIC 21"), in its consolidated financial statements for the period beginning January 1, 2013. The interpretation provides guidance on when to recognize a liability for levies that are accounted for in accordance with the requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and those where the timing and amount of the levy are certain. Levies are outflows from an entity imposed by a government in accordance with legislation. The REIT has assessed property taxes as being within the scope of IFRIC 21, given that property taxes are non-reciprocal charges imposed by a government, in accordance with legislation, and are based on property value. IFRIC 21 confirms that an entity recognizes a liability for a levy when, and only when, the triggering event specified in the legislation occurs. The REIT has determined that the liability to pay property taxes on its properties should be recognized at a point in time, being the start of the fiscal year. This resulted in the REIT recognizing the full property tax liability and expense on its properties as at January 1, 2014 with a retrospective adjustment to January 1, 2013.

The retrospective application of IFRIC 21 resulted in the REIT recording a decrease in operating expenses of \$114 for the three months ended June 30, 2013 and a decrease of \$114 to fair value of investment properties for the three months ended June 30, 2013.

The IASB has issued the following new standards that will be relevant to the REIT in preparing its consolidated financial statements in future periods:

#### IFRS 9, *Financial Instruments*

In October 2010, the IASB issued IFRS 9 *Financial Instruments* ("IFRS 9"). IFRS 9, which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. This new standard is effective for the REIT's annual consolidated financial statements commencing January 1, 2018. The REIT is assessing the impact of this new standard on its consolidated financial statements.

#### IFRS 15, *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers* ("IFRS 15"). The new standard provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standard on leases, insurance contracts and financial instruments. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2017, and is to be applied retrospectively. Early adoption is permitted. The REIT is currently assessing the impact of the new standard on its consolidated financial statements.

## 4. **Combination Transaction**

On April 15, 2014, the REIT completed the unitholder approved combination transaction (the "Combination Transaction"). Pursuant to the Combination Transaction (i) the REIT acquired all of the assets of Slate U.S. Opportunity (No. 2) Realty Trust ("SUSO 2") in consideration for Class U units of the REIT ("Class U units"), (ii) the REIT effectively acquired, directly and indirectly, all of the assets of U.S. Grocery Anchored Retail (1A), (1B) and (1C) Limited Partnerships ("GAR") in consideration for Class U units of the REIT or securities that are economically equivalent to Class U units of the REIT (subject to certain adjustments) and redeemable for cash or Class U units of the REIT and (iii) the Class U units of the REIT were listed on the Toronto Stock Exchange on April 22, 2014 (TSX:SRT.U / SRT.UN).

The following steps occurred in connection with the implementation of the Combination Transaction:

- The SUSO 1 Declaration of Trust was amended to, among other things, change the name of SUSO 1 to Slate Retail REIT and to grant holders of SUSO 1 class A units and SUSO 1 class I units the right to convert all or any portion of their SUSO

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

1 class A units and SUSO 1 class I units (the "Conversion Rights") into SUSO 1 class U units which were listed on the TSX (the "Class U Units").

- The SUSO 2 Declaration of Trust was amended to, among other things, add a right for SUSO 2 to redeem the SUSO 2 Units by delivering Class U Units to SUSO 2 Unitholders.
- SUSO 1 acquired all of the assets of SUSO 2 in consideration for Class U Units. SUSO 2 redeemed all SUSO 2 Units (except for any units acquired by SUSO 1) by delivering Class U Units to SUSO 2 Unitholders.
- In consideration for their units in GAR, the limited partners of GAR A and GAR C received, at their election, either Class U Units or units of Slate Retail Two L.P. ("Slate Retail"), a subsidiary of the REIT. Approximately, 21.0% of GAR A and GAR C units were provided as consideration by the limited partners of GAR A and GAR C for Class U Units. To satisfy U.S. withholding taxes payable in respect of those GAR A limited partners electing to receive Class U Units as consideration for their units in GAR A approximately 25 Class U Units were redeemed for cash.
- In consideration for their units in GAR, the limited partners of GAR B received, at their election either Class U Units or exchangeable limited partnership units of GAR B ("GAR B Exchangeable Units"). Each GAR B Exchangeable Unit is redeemable for one Class U Unit. Limited partners of GAR B were also issued one Special Voting Unit for each GAR B Exchangeable Unit held. Approximately 27.4% of the GAR B limited partnership units were provided as consideration by the limited partners of GAR B for Class U Units and accordingly, the REIT holds an interest in GAR B equal to the interest of the GAR B limited partnership units provided as consideration by the limited partners of GAR B for Class U Units. GAR B is accounted for as a consolidated subsidiary by the REIT.
- The indirect holders of the general partner interests of SUSO 1, SUSO 2 and GAR transferred their interests to Slate Retail, a subsidiary of the REIT, in consideration for Class B units of Slate Retail ("Slate Retail Exchangeable Units"), which are redeemable for cash or Class U Units, determined by the REIT. Collectively, the indirect holders of the general partner interests of SUSO 1, SUSO 2 and GAR, received 952 Slate Retail Exchangeable Units.
- SUSO 1, SUSO 2 and GAR have effected a reorganization to rationalize the resulting structure.
- The REIT and Slate Properties Inc. ("Slate") entered into an amended and restated management agreement.

SUSO 2 and GAR Unitholders received the following consideration:

- Each SUSO 2 class A unit was redeemed for 0.9812 REIT Units;
- Each SUSO 2 class F unit was redeemed for 1.0123 REIT Units;
- Each SUSO 2 class I unit was redeemed for 1.0335 REIT Units;
- Each SUSO 2 class U unit was redeemed for 0.9793 Class U Units.
- Holders of GAR A or GAR C units received, at their election, either Class U Units or Slate Retail Exchangeable Units. Approximately, 21.0% of GAR A and GAR C units were provided as consideration by the limited partners of GAR A and GAR C for Class U Units; and
- Holders of GAR B units received, at their election, either Class U Units or GAR B Exchangeable Units. Holders of GAR B Exchangeable Units were also issued one Special Voting Unit for each GAR B Exchangeable Unit held. Approximately, 27.4% of GAR B units were provided as consideration by the limited partners of GAR B for Class U Units.
- In aggregate, SUSO 2 Unitholders, as a group, received 7,200 Class U Units.

Unitholders of GAR, as a group, received 445 Class U Units (subsequent to the redemption described above related to U.S. withholding taxes), 590 GAR B Exchangeable Units and 928 Slate Retail Exchangeable Units, which on an exchanged basis are equivalent to 1,963 Class U Units.

### 5. Presentation of Consolidated Financial Statements as a result of the Combination Transaction

The Combination Transaction has been accounted for as a business combination in accordance with the REIT's policy as described in Note 3(iii). SUSO 2 has been identified as the acquirer for accounting purposes as the Unitholders of SUSO 2 collectively hold a controlling interest in the REIT immediately following the completion of the Combination Transaction.

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

Accordingly, these consolidated financial statements have been issued under the name of the REIT, the legal acquirer, but reflect a continuation of the business of the accounting acquirer, SUSO 2. As a result, the notes and comparative periods in these consolidated financial statements reflect SUSO 2, with the exception that the presentation of REIT capital has been adjusted retroactively to that of SUSO 1, the legal acquirer.

### 6. Acquisitions

On January 7, 2014 the REIT acquired Oak Hill Village, a grocery-anchored retail investment property located in Jacksonville, Florida for \$6,850.

On April 15, 2014, the closing date of the Combination Transaction, the REIT acquired control of the combined net assets of SUSO 1 and GAR ("Initial Properties"). The Combination Transaction has been accounted for as a business combination in accordance with the REIT's policy as described in Note 3(iii). SUSO 2 has been identified as the acquirer for accounting purposes as the Unitholders of SUSO 2 collectively hold a controlling interest in the REIT immediately following the completion of the Combination Transaction.

The identifiable net assets acquired are as follows:

	Oak Hill	Combination Transaction	Total
Cash	\$—	\$6,423	\$6,423
Prepays	—	702	702
Accounts receivables	—	3,195	3,195
Investment properties	6,850	219,658	226,508
Goodwill	—	14,987	14,987
Funds held in escrow	—	672	672
Interest rate caps	—	2	2
Accounts payable and accrued liabilities	—	(4,790)	(4,790)
Tenant deposits	—	(391)	(391)
Assumed debt, including mark-to market adjustment	—	(121,836)	(121,836)
Deferred income taxes	—	(14,987)	(14,987)
Net assets acquired	\$6,850	\$103,635	\$110,485

The purchase price was satisfied as follows:

	Oak Hill	Combination Transaction	Total
Cash	\$6,850	\$—	\$6,850
REIT Units	—	78,044	78,044
Slate Retail Exchangeable Units	—	18,315	18,315
GAR B Exchangeable Units	—	7,276	7,276
	\$6,850	\$103,635	\$110,485

The acquisition of Oak Hill Village was financed through \$1,712 of cash on hand and \$5,138 of borrowings from the the REIT's credit facility.

As identified above, the REIT acquired 100% of of the combined net assets of SUSO 1 and GAR. Under IFRS, the allocation of the fair value of consideration exchanged to the net assets acquired gave rise to goodwill of \$14,987. The goodwill arises primarily from the difference between how deferred tax is calculated for accounting purposes and the value ascribed to it in negotiations. The former is based on the difference between the values of the assets and liabilities concerned for accounting purposes and those applying for taxation. The latter is based on tax payments likely to be made on the sale of the investment properties. In management's

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

opinion, the carrying amount of this goodwill cannot be justified by reference to future cash flows and the ongoing business plan to operate and own the Initial Properties in the foreseeable future. As a result, it has been determined that the goodwill has been impaired and a impairment charge has been recognized in the consolidated financial statements.

### 7. General and administrative

		Three months ended June 30,		Six months ended June 30,	
	Note	2014	2013	2014	2013
Asset management and service fees	8	\$393	\$271	\$664	\$541
REIT start up costs		1,534	—	1,534	—
Professional fees		255	88	670	155
Other administrative costs		29	—	29	—
Trust Units offering costs		—	18	—	6
General and administrative expense		\$2,211	\$377	\$2,897	\$702

### 8. Related parties

Pursuant to the terms of a management agreement dated April 15, 2014 (the "Management Agreement"), Slate Properties Inc., a Toronto-based real estate asset management company, (the "Manager") provides all management services to the REIT. As such, the Manager meets the definition of "key management personnel" as defined in IAS 24, *Related Party Disclosures*. As described in Note 21, the Manager is paid a monthly asset management fee for its services, and is also paid an acquisition fee for properties purchased. Asset management and acquisition fees incurred and payable to the Manager during the period from January 1, 2014 to June 30, 2014 amounted to \$664 and \$131, respectively, and are included in asset management and service fees and property acquisition costs, respectively on the condensed consolidated statement of comprehensive income. The fees paid to the Manager during the period from January 1, 2014 to June 30, 2014 includes the legacy SUSO 2 asset management and service fees and property acquisitions costs earned from January 1, 2014 to April 15, 2014. On completion of the Combination Transaction, the asset management fee is calculated as described in note 21. These transactions are in the normal course of operations and are measured at the exchange amount which is the consideration established and agreed to by the parties.

### 9. Accounts receivable

The accounts receivable balance is comprised of the following:

	June 30, 2014	December 31, 2013
Rent receivable	\$2,073	\$271
Allowance for doubtful accounts	(46)	(16)
Accrued recovery income	2,573	975
Accounts receivable	\$4,600	\$1,230

Accrued recovery income represents amounts that have not been billed to the tenants and are generally billed and paid in the following year to which they relate.

The following is a reconciliation of the change in allowance for doubtful accounts for the six months ended June 30, 2014 and year ended December 31, 2013:

	June 30, 2014	December 31, 2013
Balance at beginning of the period	\$16	\$—
Provision for allowance	36	16
Bad debt write-offs	(6)	—
Allowance for doubtful accounts	\$46	\$16

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

An allowance is provided when collection is no longer reasonably assured, including bankruptcy, abandonment by tenants and in certain tenant disputes.

The following is an aging analysis of rents receivable past due, net of allowance for doubtful accounts:

	June 30, 2014	December 31, 2013
Current to 30 days	\$491	\$211
31 to 60 days	1,148	29
Greater than 60 days	388	15
	<u>\$2,027</u>	<u>\$255</u>

### 10. Investment properties

Investment properties are comprised of income-producing properties.

As at June 30, 2014, the REIT has wholly-owned interests in 29 income-producing properties for which the results of operations of these properties have been included in these consolidated financial statements from the respective dates of acquisition.

The REIT determines the fair value of investment properties based upon either the overall income capitalization rate method or the discounted cash flow method, or in certain circumstances a combination of both methods. Both methods are generally accepted appraisal methodologies. Under the overall income capitalization method, year one income is stabilized and capitalized at a rate appropriate for each investment property. Capitalization rates and estimates of stabilized income are the most significant assumptions in determining fair values under the overall capitalization method. Under the discounted cash flow method, fair values are primarily determined by discounting the expected future cash flows, generally over a term of 10 years, including a terminal value based on the application of a capitalization rate to estimated year 11 net operating income. The REIT uses leasing history, market reports, tenant profiles and available appraisals, among other things, in determining the most appropriate assumptions. As at June 30, 2014, all valuations were completed by management of the REIT using the overall income capitalization method.

The market capitalization rates at June 30, 2014 ranged from 5.00% to 7.75%. The estimated fair market value of the REIT's investment properties implies a weighted average capitalization rate of 7.00%. Under the fair value hierarchy, the fair value of the REIT's investment properties is determined using the methodology described above and using level 3 inputs. The fair value of investment property would change by approximately \$15.6 million for a 25 basis point change in capitalization rates, and by approximately \$1.4 million for a \$0.1 million change in underlying annual net operating income. Generally, an increase in net positive cash flows will result in an increase in the fair value of investment properties and an increase in capitalization rates will result in a decrease in fair value of investment properties.

Under IFRS, the fair values of investment properties are measured individually without consideration to their aggregate value on a portfolio basis. Accordingly, under IFRS no consideration is given to diversification benefits related to single property tenant risk and geography, the value of assembling a portfolio or to the utilization of a common management platform, amongst other benefits. As a result, the fair value of the REIT's investment properties taken as a whole may differ from that appearing on the REIT's consolidated statements of financial position.

The change in investment properties for the period is as follows:

<b>December 31, 2012, balance</b>	<b>\$28,350</b>
Acquisitions	132,567
Capital costs	615
Leasing costs	565
Straight-line rent receivable	358
Change in fair value	14,595
<b>December 31, 2013, balance</b>	<b>\$177,050</b>

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

<b>December 31, 2013, balance</b>	<b>\$177,050</b>
Acquisitions	226,508
Capital costs	715
Leasing costs	150
Straight-line rent receivable	101
Property tax adjustment under IFRIC 21	(1,267)
Change in fair value	34,870
<b>June 30, 2014, balance</b>	<b>\$438,127</b>

As discussed in Note 5 the December 31, 2013 balance represents the historical balances solely of SUSO 2. Acquisitions represent the acquisition of investment properties of SUSO 1 and GAR as well as the acquisition of Oak Hill Village by SUSO 2, an acquisition completed prior to the Combination Transaction.

### 11. Interest expense and other financing charges

Interest expense and other financing charges is comprised of:

		Three months ended June 30,		Six months ended June 30,	
	Note	2014	2013	2014	2013
Interest on short-term investments		\$2	\$19	\$5	\$40
Interest on term loan	13	(1,875)	(290)	(2,656)	(290)
Amortization of loan costs	13	(232)	—	(428)	—
Amortization of mark to market premium	13	86	—	86	—
Interest on TIF notes receivable	15	75	—	97	—
Interest on TIF notes payable	15	(61)	—	(81)	—
Deferred gain on TIF notes receivable	15	23	—	30	—
Exchangeable units of subsidiaries distributions	12	(382)	—	(382)	—
REIT unit distributions	12	(2,150)	—	(2,150)	—
Fair value change of interest rate caps		(33)	—	(75)	—
Change in measurement of REIT Units	12	(7,081)	(2,847)	(7,081)	(5,037)
Change in measurement of exchangeable units of subsidiaries	12	1,056	—	1,056	—
Total		\$(10,572)	\$(3,118)	\$(11,579)	\$(5,287)

### 12. REIT Units and Exchangeable Units of subsidiaries

As at June 30, 2014 the REIT has the following units:

	Class U	Class A	Class I
Authorized for issue	Unlimited	Unlimited	Unlimited
Issued and Outstanding	12,480	616	383

Each REIT Unit confers the right to one vote at any meetings of REIT Unitholders. The REIT is also authorized to issue an unlimited number of Special Voting Units. Special Voting Units are only issued in tandem with the issuance of securities redeemable for or exchangeable into REIT Units. The Special Voting Units do not have any economic entitlement in the REIT with respect to distributions but provide the holder with the same voting rights in the REIT as a holder of REIT Units. Special Voting Units may only be issued in connection with or in relation to redeemable or exchangeable securities for the purpose of providing voting rights with respect to the REIT to the holders of such securities.



## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

Each REIT Unit entitles the holder to the same rights and obligations as a REIT Unitholder and no REIT Unitholder is entitled to any privilege, priority or preference in relation to any other holder of REIT Units, subject to the proportionate entitlement of the holders of class A units, class I units and Class U Units of the REIT to participate in distributions made by the REIT including distributions of net income, net realized capital gains or other amounts and, in the event of termination or winding-up of the REIT, in the net assets of the REIT remaining after satisfaction of all liabilities, based on their respective conversion ratios for Class U Units. REIT Units will be fully paid and non-assessable when issued and are transferable.

SUSO 1 class A and class I unitholders continue to own their existing units. Class A and class I unitholders will have the right to convert all or any portion of their units into Class U Units. The following conversion rates will apply:

- Each SUSO 1 class A unit is convertible into 1.0078 Class U Units; and
- Each SUSO 1 class I unit is convertible into 1.0554 Class U Units.

The REIT Declaration of Trust grants holders of class A units and class I units of the REIT the right to convert all or any portion of their class A units and class I units of the REIT, at any time (the "Conversion Date"), into Class U Units by giving written notice to the REIT. On the applicable Conversion Date the REIT will deliver to the class A unitholder or class I unitholder the applicable number of Class U Units for each class A unit or class I unit converted by such unitholder.

With certain restrictions, the Unitholders have the right to require the REIT to redeem their Units on demand. Upon receipt of the redemption notice by the REIT, all rights to and under the Units tendered for redemption shall be surrendered and the holder thereof shall be entitled to receive a price per unit as determined by a market formula and shall be paid in accordance with the conditions provided for in the Declaration of Trust.

The GAR B Exchangeable Units are accompanied by an equivalent number of Special Voting Units.

The following is a summary of REIT Units and Exchangeable Units of subsidiaries outstanding during the period and their Class U equivalent amounts if converted basis:

Class / Type	Units of REIT			Exchangeable Units of Subsidiaries		Total (Class U equivalent)
	A	U	I	LP2	GAR B	
Balance, December 31, 2013	3,702	1,298	703	—	—	5,771
Issued for Combination Transaction	—	7,759	—	1,880	590	10,229
Units redeemed	—	(25)	—	—	—	(25)
Exchanges	(3,086)	3,448	(320)	—	—	—
Balance, June 30, 2014	616	12,480	383	1,880	590	15,975
Conversion ratio to Class U Units	1.0078	1.0000	1.0554	1.0000	1.0000	—
Class U Units equivalent	621	12,480	404	1,880	590	15,975

If all of the Exchangeable Units of subsidiaries, class A units of the REIT and class I units of the REIT were redeemed or exchanged for Class U Units, as applicable, there would be in aggregate approximately 15,975 Class U Units outstanding.

The following table shows the change in the carrying amount of Exchangeable Units of subsidiaries and REIT Units during the period:

	Exchangeable Units of subsidiaries	REIT Units	Total
Balance, December 31, 2013	—	75,944	75,944
Issued for Combination Transaction	30,457	78,044	108,501
Units redeemed	—	(332)	(332)
Change in fair value	(1,056)	7,081	6,025
Balance as at June 30, 2014	29,401	160,737	190,138



## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

The REIT Units and the Exchangeable Units are designated as financial liabilities measured at FVTPL and re-measured at the end of each reporting period by reference to the closing market price of the Class U Units into which they are exchangeable. For the three months ended June 30, 2014, the change in fair value of the REIT Units and Exchangeable Units was an increase of \$7,081 and a decrease of \$1,056, respectively.

For the three months ended June 30, 2014, the REIT declared distributions of \$2,150 on the REIT Units and \$382 on the Exchangeable Units which were recorded as other financing charges.

As part of the Combination Transaction, the owner of the general partner interest in a subsidiary of SUSO 2, exchanged its interest in the general partner of the subsidiary of SUSO 2 for 395 LP2 Exchangeable Units. The fair value of the LP2 Exchangeable Units provided was \$4,866. As this transaction represents a transaction between owners, the difference between the amount by which the non-controlling interests were adjusted and the fair value of the consideration provided has been attributed to the unitholders of the REIT and recorded in unitholders' equity as a capital reserve.

### 13. Debt

The following is a summary of the debt held by the REIT as of June 30, 2014:

	Coupon <sup>(1)</sup>	Effective Rate <sup>(2)</sup>	Principal	Carrying Amount
Credit facility 1	L+300 bps	3.16%	\$87,230	\$87,230
Credit facility 2	L+300 bps	2.96%	111,592	109,242
GAR mortgage	5.80%	5.34%	27,743	30,440
Cudahy Centre first mortgage	5.25%	6.17%	3,655	3,755
Cudahy Centre second mortgage	6.00%	3.55%	200	213
Transactions costs (note 14)			(279)	(279)
Amortization of transaction costs (note 14)			25	25
Total			\$230,166	\$230,626

<sup>(1)</sup> "L" means the one-month U.S. London Interbank Offering Rate ("LIBOR") and "bps" means basis points.

<sup>(2)</sup> The effective interest rate for credit facility 2 includes the impact of unamortized financing costs not yet recorded in interest expense under the effective interest method. The remaining debt includes mark-to-market adjustments on assumption of such debt by SUSO 2. Both of the credit facilities have used 1-month LIBOR of = 0.17.

The Cudahy Center first and second mortgages mature on April 1, 2031 and May 1, 2016, respectively. The GAR mortgage is secured by Pinewood Plaza, Springboro Plaza, Field Club Commons, Kennywood Shops and Buckeye Plaza and matures on April 30, 2021. Credit facility 1 matures on September 13, 2015 and has two one-year extension options. Credit facility 2 matures on April 2, 2017 and has a one-year extension option. Both of the credit facilities are closed and can no longer be drawn down.

Debts assumed on the acquisition of the Initial Properties was recorded at their aggregate fair value of \$121,836 on initial recognition resulting in a mark-to-market adjustment of \$2,896 which is amortized using the effective interest method over the remaining terms of the debt assumed. During the six months ended June 30, 2014, the REIT recorded amortization of \$86.

Credit facility 2 balance is comprised of the following:

	June 30, 2014	December 31, 2013
Credit facility 2	\$111,592	\$106,730
Transaction costs	(3,088)	(2,539)
Amortization of transaction costs	738	335
	\$109,242	\$104,526

### 14. Secured revolving facility and senior secured term facility

On closing of the Combination Transaction, a syndicate of U.S. lenders in the United States provided, (i) a \$30 million secured revolving facility (the Secured Revolving Facility), and (ii) a \$45 million senior secured term facility (the Senior Secured Term Facility).

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

The Secured Revolving Facility bears interest at a rate equal to LIBOR plus 300 basis points or the bank's base rate plus 200 basis points. The REIT pays an unused fee of 50 basis points on the unused aggregate revolving commitment, paid quarterly in arrears. The Secured Revolving Facility matures six months after Closing. The REIT has one six month extension option so long as it provides 30 day notice, is not in default or subject to an event of default and upon payment of an extension fee in the amount of 50 basis points. The Secured Revolving Facility may be used by the REIT for the acquisition and maintenance of retail grocery anchored properties, a repurchase of up to \$7.5 million of the securities of the REIT and for other general working capital purposes.

The Senior Secured Term Facility bears interest at a rate equal to LIBOR plus 300 basis points or the bank's base rate plus 200 basis points. The Senior Secured Term Facility is a delayed draw term loan that is to be funded within 12 months of Closing, which was April 15, 2014. Any unused portion of the Senior Secured Term Facility would be terminated at that time. Amounts repaid must not be re-borrowed under the Senior Secured Term Facility.

The Senior Secured Term Facility matures three years after the Closing. The REIT has one 12 month extension option so long as it provides 60 day notice, is not in default or subject to an event of default and upon payment of an extension fee in the amount of 20 basis points. The Senior Secured Term Facility may be used for the acquisition of grocery-anchored retail assets, capital expenditure for grocery-anchored retail assets and general corporate purposes.

The ability of the REIT to borrow under the Senior Secured Term Facility remains subject to the limitations on the ability of the REIT to incur indebtedness contained in the REIT Declaration of Trust. The Senior Secured Term Facility will include conditions precedent, financial and non-financial covenants and events of default customary for a credit facility of this nature.

There have been no drawings made on the Secured Revolving Facility or the Senior Secured Term Facility.

Financing fees of \$279 were incurred to obtain the Secured Revolving Facility and Senior Secured Term Facility and are being amortized into income over the initial term of each facility. As at June 30, 2014, the amortized financing fees totaled \$25.

### 15. Tax increment financing

On March 6, 2014, the REIT acquired tax incremental revenue notes issued by the City of St. Paul (the "Phalen City Note") and by the City of Brainerd (the "Brainerd City Notes", and collectively the "TIF Notes Receivable") in Minnesota, related to the REIT's Phalen and Brainerd properties, respectively. The Phalen City Note and Brainerd City Note obligates each municipality to pay certain tax increments resulting from increases, if any, from a reference amount in the taxable valuation of the respective property to the REIT. The Phalen City Note had an original principal amount of \$3,100 and had a current outstanding balance of \$3,028 at the time of purchase. The Brainerd City Note had an original principal amount of \$2,400 and had a current outstanding balance of \$2,288 consisting of \$1,290 in principal and \$998 in interest at the time of purchase. The outstanding principal of the Brainerd City Note and Phalen City Note each bear interest payable on February 1 and August 1 at a rate of 8% and 6% per annum, respectively. The TIF Notes Receivable mature on February 1, 2029. The effective interest rate of the TIF Notes Receivable are 2.731% and 3.304%, respectively.

Also, on March 6, 2014, the REIT entered into two separate tax increment financing agreements with a third party (the "TIF Notes Payable") whereby the REIT borrowed in aggregate \$4,297. The TIF Notes Payable mature on February 28, 2019 and bear interest at a fixed rate equal to 5.25%. The TIF Notes Payable require annual blended interest and principal payments of \$205. All proceeds from the TIF Notes Receivable are required to be applied against interest and then the principal of the TIF notes payable.

Transaction costs related to the TIF Notes Payable in the amount of \$158 are amortized over the term to initial maturity based on the effective interest rate method. Included in interest on the TIF notes on the consolidated statement of comprehensive income is amortization of transaction costs of \$3.

The REIT acquired the TIF Notes Receivable for \$4,175. However, on acquisition, the REIT estimated the fair value of the TIF Notes Receivable to be \$5,488. Accordingly, the REIT adjusted the measurement amount of the TIF Notes Receivable to defer the difference between the fair value at acquisition and transaction price of \$1,313. The REIT recognizes the difference in income on a straight-line basis over the term of the maturity of the TIF Notes Receivable.

### 16. Income taxes

The REIT qualifies as a mutual fund trust for Canadian income tax purposes. The REIT intends to distribute all of its taxable income to Unitholders and is entitled to deduct such distributions for Canadian income tax purposes. Accordingly, no provision for current income taxes payable is required, except for amounts incurred in Investment LP.

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

Investment LP and GAR B made an election to be classified as a corporation for U.S. federal tax purposes. Investment LP is subject to U.S. federal and state income taxation on its allocable shares in Slate Retail One Limited Partnership ("Limited Partnership 1") a subsidiary of the REIT, and Slate Retail and GAR US Portfolio LP, as the case may be, and any subsidiary limited partnership thereof.

is therefore subject to U.S. federal income taxation on its allocable share of rental income derived directly or indirectly through such subsidiary limited partnerships, on a net basis taking into account allowable deductions. Investment LP is subject to a combined federal and state income tax rate of 38.25%. Current taxes in Investment LP have been reduced to nil. To the extent U.S. taxes are paid by Investment LP such amounts will be creditable against an investor's Canadian federal income tax liability to the extent permitted by Canadian tax law.

A deferred income tax asset or liability arises from temporary differences between the tax and accounting basis of assets and liabilities in Investment LP. At June 30, 2014, the REIT had deferred tax liability of \$29,062 primarily related to the increased fair value of the investment properties located in the United States.

### 17. Capital management

The primary objectives of the REIT's capital management activities is to facilitate the investment in a diversified portfolio of well-located, quality income-producing properties with positive cash flows and to provide quarterly distributions to its unitholders. The REIT is restricted in its use of capital to making investments in real property in the United States. The REIT manages its capital structure and makes adjustments to it, in light of changes to prevailing economic conditions and its results of operations and financing and investing activities. The REIT intends to make distributions if results of operations and cash flows permit in the future.

### 18. Financial Instruments

The REIT measures financial assets and liabilities under the following fair value hierarchy in accordance with IFRS. The different levels have been defined as follows:

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

The carrying amounts and fair values of the REIT's financial instruments as at June 30, 2014 and December 31, 2013 measured at fair value are presented in the table below:

	June 30, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Cash	\$13,883	\$13,883	\$10,962	\$10,962
Accounts receivable	4,600	4,600	1,230	1,230
TIF notes receivable	4,161	5,488	—	—
<b>Financial liabilities</b>				
Accounts payable and accrued liabilities	\$4,547	\$4,547	\$1,771	\$1,771
Credit facility 1	87,230	87,230	—	—
Credit facility 2	109,242	111,592	104,526	106,730
GAR mortgage	30,440	30,440	—	—
Cudahy Centre first mortgage	3,755	3,755	—	—
Cudahy Centre second mortgage	213	213	—	—
REIT units	160,737	160,737	—	—
Exchangeable units of subsidiaries	29,401	29,401	—	—
TIF notes payable	4,142	4,297	—	—

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

The REIT Unit and Exchangeable Units are fair valued based on the market trading price of REIT Units consistent with Level 1. The interest rate cap is valued using an interest rate swap valuation methodology and inputs consistent with Level 2. All other fair value measurements for non-derivative financial instruments are measured using Level 3 inputs. The fair values of derivative instruments are calculated using quoted rates. When such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments.

The following table presents the fair value hierarchy of financial assets and financial liabilities as at June 30, 2014:

	Level 1	Level 2	Level 3	Fair value
<b>Financial assets</b>				
Cash	\$13,883	\$—	\$—	\$13,883
Accounts receivable	—	4,600	—	4,600
TIF notes receivable	—	—	5,488	5,488
<b>Total financial assets</b>	<b>\$13,883</b>	<b>\$4,600</b>	<b>\$5,488</b>	<b>\$23,971</b>
<b>Financial liabilities</b>				
Accounts payable and accrued liabilities	\$—	\$4,547	\$—	\$4,547
Credit facility 1	—	87,230	—	87,230
Credit facility 2	—	111,592	—	111,592
GAR mortgage	—	30,440	—	30,440
Cudahy Centre first mortgage	—	3,755	—	3,755
Cudahy Centre second mortgage	—	213	—	213
REIT units	160,737	—	—	160,737
Exchangeable units of subsidiaries	29,401	—	—	29,401
TIF notes payable	—	4,297	—	4,297
<b>Total financial liabilities</b>	<b>\$190,138</b>	<b>\$242,074</b>	<b>\$—</b>	<b>\$432,212</b>

During the period REIT units were transferred from Level 3 to Level 1 of the fair value hierarchy because of their listing on the TSX and the establishment of an active market for the REIT Units.

### 19. Risk management

The REIT's risk management policies are established to identify, analyze and manage the risks faced by the REIT and to implement appropriate procedures to monitor risks and adherence to established controls. Risk management policies and systems are reviewed periodically in response to the REIT's activities and to ensure applicability.

In the normal course of business, the main risks arising from the REIT's use of financial instruments include credit risk, liquidity risk and market risk. These risks, and the actions taken to manage them, include:

#### *i. Credit risk*

Credit risk is the risk of financial loss to the REIT associated with the failure of a tenant or other party to meet its contractual obligations related to lease agreements, including future lease payments. The risk is mitigated by carrying out appropriate credit checks and related due diligence on the significant tenants.

For the period from January 1, 2014 to June 30, 2014, one individual tenant by location accounted for 4.89% of the REIT's rental revenue.

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

### ii. Liquidity risk

Liquidity risk is the risk that the REIT will not be able to meet its financial obligations as they fall due. The REIT's approach to managing liquidity is to ensure that it will have sufficient financial resources available to meet its liabilities as they become due. This includes monitoring of cash, current receivables and payables and non-current liabilities as they become current.

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relation to the demand for and the perceived desirability of such investments. Such illiquidity may tend to limit the REIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If the REIT were required to liquidate a real property investment, the proceeds to the REIT might be significantly less than the aggregate carrying value of such property.

The REIT has the following contractual commitments:

	Total contractual cash flow	Less than one year	1-6 years
Accounts payable and accrued liabilities	\$4,547	\$4,547	\$—
Credit facility 1	87,230	—	87,230
Credit facility 2	111,592	—	111,592
GAR mortgage	27,743	412	27,331
Cudahy Centre first mortgage	3,655	138	3,517
Cudahy Centre second mortgage	200	—	200
TIF note payable	4,297	308	3,989
TIF note interest payable	931	214	717
Credit facility 1 interest payable <sup>(1)</sup>	4,063	2,766	1,297
Credit facility 2 interest payable <sup>(2)</sup>	12,144	3,539	8,605
REIT units	160,737	400	160,337
Exchangeable units of subsidiaries	29,401	400	29,001
Total contractual commitments	\$446,540	\$12,724	\$433,816

<sup>(1)</sup> Credit facility 1 interest payable is calculated on \$87,230 (balance outstanding) using an estimated "all in" interest rate of 3.17% under the "within one year" column. The long term average interest rate is based on the 30-day LIBOR forward curve plus the specified margin for the LIBOR rate option under the Term Loan Facility and results in an anticipated increase to the "all-in" interest rate to 3.27%. The total Term Loan Facility interest payable is calculated until maturity of the Initial Term.

<sup>(2)</sup> Credit facility 2 interest payable is calculated on \$111,592 (balance outstanding) using an estimated "all in" interest rate of 3.17% under the "within one year" column. The long term average interest rate is based on the 30-day LIBOR forward curve plus the specified margin for the LIBOR rate option under the Term Loan Facility and results in an anticipated increase to the "all-in" interest rate to 3.84%. The total Term Loan Facility interest payable is calculated until maturity of the Initial Term.

### iii. Interest rate risk

Interest rate risk arises from the possibility that the value of, or cash flows related to, a financial instrument will vary as a result of changes in market interest rates. The REIT manages its financial instruments with the objective of mitigating any potential interest rate risks. For the Term Loan Facility, interest rate on the loans will vary depending on changes in base rate and/or LIBOR rate. The REIT is subject to interest rate risks for debt that has variable interest rates.

### iv. Unit price risk

The REIT is exposed to Unit price risk as a result of the issuance of the REIT Units and Exchangeable Units. As described in note 3, the REIT Units and Exchangeable Units have been classified as liabilities and measured at fair value based on market trading prices. The REIT Units and Exchangeable units negatively impact net income when the Unit price rises and positively impact net income when Unit prices decline. An increase of \$1.00 in the underlying price of REIT Units would result in an increase to liabilities and decrease in net income of \$13,505. An increase of \$1.00 in the underlying price of Exchangeable Units would result in an increase to liabilities and a decrease in net income of \$2,470.

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

### v. Currency risk

Currency risk is the risk associated with a fluctuation in the value of the U.S. dollar relative to other foreign currencies. The REIT is exposed to currency risk as certain transactions related to payment of the REIT's expenses are denominated in Canadian dollars.

## 20. Leases

The Company enters into long-term lease contracts with tenants for space in the REIT's properties. Leases generally provide for the tenant to pay base rent, with provisions for contractual increases in base rent over the term of the lease, plus operating cost and realty tax recoveries. Certain leases have limitations or escalation restrictions on the amount of recoveries or cost reimbursements which they are obligated to pay regardless of the actual costs incurred by the REIT to operate and maintain the properties.

The REIT's existing leases have a weighted average outstanding term of 5.4 years and may include clauses to enable periodic upward revisions in rental rates. The future minimum lease payments from the REIT's non-cancellable operating leases as a lessor are as follows:

	June 30, 2014	December 31, 2013
Not later than one year	\$31,668	\$14,392
Later than one year but not later than five years	89,509	43,872
Later than five years	42,350	29,476
	\$163,527	\$87,740

## 21. Acquisition fee and asset management fee

Pursuant to the terms of the Management Agreement, the Manager agreed to provide certain services in connection with the business of the REIT, including: the structuring of the initial public offering, the REIT, the Investment LP and the Holding LP; liaising with legal and tax counsel; identifying Properties for acquisition; maintaining ongoing relationships with the lenders in respect of the mortgage loans for the Properties; conducting continuous analysis of market conditions; and advising the Holding LP with respect to the disposition of the Properties. In return for its service, the Manager receives the following fees:

- An acquisition fee in an amount equal to 0.75% of the gross purchase price of each Property (or interest in a Property), including the price, due diligence costs, closing costs, legal fees, and additional capital costs for all Properties indirectly acquired by the REIT;
- An asset management fee equal to 0.4% of the Gross Book Value of the REIT (payable on a quarterly basis);
- An annual incentive fee, calculated in arrears, in an aggregate amount equal to 15% of the REIT's funds from operation per Class U Unit as derived from the annual financial statements of the REIT in excess of U.S. \$1.28, subject to ordinary course adjustments for certain transactions affecting the Class U Units and increasing annually by 50% of the increase in the United States consumer price index.

## 22. Supplemental cash flow information

The net change in non-cash operating assets and liabilities consists of the following:

	Six months ended June 30,	
	2014	2013
Prepays	\$719	\$109
Accounts receivable	(175)	(588)
Accounts payable and accrued liabilities	(2,014)	634
Tenant deposits	22	222
	(\$1,448)	\$377

## SLATE RETAIL REIT

Notes to the unaudited condensed consolidated financial statements

As at June 30, 2014

Expressed in thousands of United States dollars

### 23. Subsequent events

The REIT declared a monthly distribution for the month ended July 31, 2014 of \$0.06 per Unit.

On July 24, 2014, the REIT completed the acquisition of North Summit Square, a shopping center located in Winston-Salem, North Carolina. North Summit Square was acquired for \$15.8 million. The property is 99% occupied and anchored by Sam's Club.

On July 28, 2014, the REIT announced that it had entered into a binding agreement to purchase East Little Creek, a 100% occupied, grocery-anchored shopping center in Norfolk, Virginia for \$9.85 million. The property is anchored by Farm Fresh, a local brand of SuperValu Inc. The acquisition is expected to be completed in third quarter 2014 and remains subject to customary closing conditions.

On July 29, 2014, the REIT announced that it had entered into a binding agreement to purchase Waterbury Plaza, a 100% occupied, grocery-anchored shopping center in Waterbury, Connecticut for \$27.3 million. The property is anchored by Stop & Shop, a wholly owned subsidiary of the Dutch supermarket operator Ahold. The acquisition is expected to be completed in the third quarter 2014 and remains subject to customary closing conditions.

On August 11, 2014, the REIT announced that it had entered into a binding agreement to purchase Wellington Park, a 91% occupied, grocery-anchored shopping center in Cary, North Carolina for \$15.5 million. The property is anchored by Lowes Foods. The acquisition is expected to be completed in the third quarter 2014 and remains subject to customary closing conditions.