



**NORTHWEST HEALTHCARE PROPERTIES  
REAL ESTATE INVESTMENT TRUST**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION  
FOR THE THREE AND NINE MONTHS ENDED  
SEPTEMBER 30, 2014**

**November 6, 2014**

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After a relatively stable and uneventful summer with respect to the global economy and investment sentiment, toward the end of the quarter the North American stock markets, including the Canadian REIT market, experienced some volatility. Recent 'hold the course' commentary from the Bank of Canada regarding interest rates has, however, assisted with stabilizing market sentiment. While still not back to the activity levels of the past years in terms of both number and size of deals, select REITs were active raising equity and debt.

#### Operations

Our operating results for the third quarter were generally as expected, and relatively flat quarter over quarter, with FFO and AFFO per unit for the quarter at \$0.25 and \$0.21, respectively. The AFFO payout ratio for the quarter was 97%.

Occupancy was 91.8%, a slight decrease from the previous quarter.

Year to date we have achieved 49% of our annual budget for new leasing, and 97% of our budgeted renewals for the year. Rental rates for new leasing were in line with expectations, but the leasing was in some of the REIT's more challenged markets, resulting in the average rent being lower than the portfolio average. Renewal rents were also generally in line with expectations, although one significant longer term renewal resulted in a negative spread of 6.2% for the portfolio for the quarter; positive 1.2% if not for this one transaction.

We expect to meet our renewal targets for the year in terms of space renewed, but we expect to fall short of our new leasing projections, primarily as a result of delays in leasing at a small number of specific properties, mostly in Ontario, outside of the GTA. We continue to make physical improvements to a number of these properties in support of our leasing efforts. Further, we continue to believe that the additional leasing and marketing resources recently introduced in Ontario will in due course result in improved performance.

During the quarter the REIT progressed on a number of value-enhancing projects, including the on-going rezoning of certain properties to increase density. This includes the addition of rentable space where market demand exists, primarily in Western Canada, as well as the pursuit of municipal approvals at our proposed redevelopment project in Dorion, just outside of Montreal. Also, as part of our potential strategy to provide 'turnkey' managed clinic opportunities for physicians in certain assets across our portfolio, we opened a 'turnkey' clinic in one of our Atlantic Canada assets this quarter and, to date, we have been pleased with the market reaction, as the clinic has secured a number of physicians already. Based upon this initial success, we anticipate the launch of a similar clinic in one of our southwestern Ontario assets in the first half of next year, with the expectation that this will be a catalyst for the healthcare synergies necessary to reposition such asset into a leading medical office building in its market.

#### Acquisitions & Dispositions

While continuing to review various acquisition opportunities, during the quarter we did not complete or announce any new acquisitions. We did complete the disposition of a small non-core asset, continuing to progress on our plan to recycle capital and focus our efforts upon core properties.

#### Liquidity

During the quarter we refinanced two properties with mortgages totaling approximately \$22.3 million in order to extend mortgage terms, reduce borrowing rates, and improve the REIT's liquidity position.

#### Outlook

The focus for the remainder of 2014 is the continuation of initiatives to maximize the operational performance of the REIT, together with the progression of the previously mentioned asset management and managed clinic initiatives, as well as the disposition of certain non-core assets.

Sincerely,  
(signed) Peter Riggan  
Chief Executive Officer

This Management's Discussion and Analysis ("MD&A") sets out NorthWest Healthcare Properties Real Estate Investment Trust's (the "REIT") operating strategies, risk profile considerations, business outlook and analysis of its financial performance and financial condition for the three and nine months ended September 30, 2014.

This MD&A is based on the REIT's condensed consolidated interim financial statements for the three and nine months ended September 30, 2014, prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts are in thousands of Canadian dollars, except where otherwise stated. Per unit amounts are presented in Canadian dollars, on a diluted basis including Class B Exchangeable Units, except where otherwise stated.

This MD&A should be read in conjunction with the REIT's condensed consolidated interim financial statements and accompanying notes for the three and nine months ended September 30, 2014, prepared in accordance with IFRS. Additional information about the REIT, including the REIT's annual information form dated March 12, 2014 (the "Annual Information Form"), can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

Throughout this MD&A the following terms have the meanings set forth below, unless otherwise indicated. Words importing the singular include the plural and vice versa:

- "Convertible Debenture" means 5.25% convertible unsecured subordinated debentures of the REIT;
- "Class B Exchangeable Unit" means a Class B limited partnership unit of NHP Holdings Limited Partnership ("NHP LP"), exchangeable for Units;
- "Special Voting Unit" means a special voting unit of the REIT attached to a Class B Exchangeable Unit;
- "Unit" or "REIT Unit" means a unit of the REIT; and
- "Unitholder" means a holder of Units and any reference to a Unitholder in the context of such Unitholder's right to vote at a meeting of Unitholders also includes reference to a holder of Special Voting Units.

## **PART I**

### **FORWARD-LOOKING INFORMATION**

This MD&A contains forward-looking statements which reflect management's expectations regarding objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities of the REIT. The words "plans", "expects", "does not expect", "scheduled", "estimates", "intends", "anticipates", "does not anticipate", "projects", "believes" or variations of such words and phrases or statements to the effect that certain actions, events or results "may", "will", "could", "would", "might", "occur", "be achieved" or "continue" and similar expressions identify forward-looking statements. Some of the specific forward-looking statements in this MD&A include, but are not limited to, statements with respect to the following:

- the intention of the REIT to pay stable and growing distributions;
- the ability of the REIT to execute its growth strategies;
- any projections of financial performance of the REIT for the periods set out herein;
- the expected tax treatment of the REIT's distributions to Unitholders;
- the ability of the REIT to qualify for the REIT Exception (as defined herein);
- the access of the REIT to debt markets; and
- the expected healthcare industry and demographic trends.

Forward-looking statements are necessarily based on a number of estimates and assumptions that, while considered reasonable by management of the REIT as of the date of this MD&A, are inherently subject to significant business, economic and competitive uncertainties and contingencies. The REIT's estimates, beliefs and assumptions, which may prove to be incorrect, include the various assumptions set forth herein, including, but not limited to, the REIT's future growth potential, results of operations, future prospects and opportunities, the demographic and industry trends remaining unchanged, future levels of indebtedness, the tax laws as currently in effect remaining unchanged, and the current economic conditions remaining unchanged.

When relying on forward-looking statements to make decisions, the REIT cautions readers not to place undue reliance on these statements, as forward-looking statements involve significant risks and uncertainties and should not be read as

guarantees of future performance or results, and will not necessarily be accurate indications of whether or not, and the times at or by which, such performance or results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under “Risks and Uncertainties”. These forward-looking statements are made as of the date of this MD&A and, except as expressly required by applicable law, the REIT assumes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

## **NON-IFRS FINANCIAL MEASURES**

Certain terms used such as “**Funds from Operations**” (“**FFO**”), “**Adjusted Funds from Operations**” (“**AFFO**”), “**Net Operating Income**” (“**NOI**”), “**Gross Book Value**” (“**GBV**”), “**Payout Ratio**”, “**Interest Coverage**”, “**EBITDA**” and any related per Unit amounts used by management to measure, compare and explain the operating results and financial performance of the REIT are not recognized terms under IFRS, and therefore should not be construed as alternatives to net income or cash flow from operating activities calculated in accordance with IFRS. Management believes that these terms are relevant measures in comparing the REIT’s performance to industry data and the REIT’s ability to earn and distribute cash returns to holders of the REIT Units. These terms are defined in this MD&A and reconciled to the condensed consolidated interim financial statements of the REIT for the three and nine months ended September 30, 2014. Such terms do not have a standardized meaning prescribed by IFRS and may not be comparable to similarly titled measures presented by other publicly traded entities.

## **PART II**

### **BUSINESS OVERVIEW AND STRATEGIC DIRECTION**

The REIT is an unincorporated, open-ended real estate investment trust established pursuant to its Declaration of Trust dated January 1, 2010 and as amended on March 25, 2010, under the laws of the Province of Ontario (the “Declaration of Trust”). The REIT completed its initial public offering (“IPO”) on March 25, 2010. The REIT Units are listed and publicly traded on the Toronto Stock Exchange (“TSX”) under the symbol NWH.UN.

The REIT is the largest non-government owner of medical office buildings and healthcare focused real estate (collectively, “Healthcare Real Estate”) in Canada, and is focused on leasing space to a wide variety of medical and healthcare professionals, institutional healthcare organizations, as well as related healthcare service providers such as pharmacies, laboratories and diagnostic imaging clinics. The REIT employs a full service, fully integrated national management platform with regional offices in four core markets of Calgary, Toronto, Montreal and Halifax.

Management believes that Healthcare Real Estate represents a growing yet defensive market position, owing to necessity-based tenancies that are not typically impacted by recessions or economic slowdowns. The REIT and its property portfolio are well positioned to benefit from strong demographic and industry trends, such as a growing and aging population, increased demand for healthcare, and a shift of administration, diagnostic services and other non-acute services out of hospitals and into nearby Healthcare Real Estate owing to space shortages, pressure for cost savings and a desire by the hospitals to focus their activities on acute care.

The objectives of the REIT are to: (i) provide Unitholders with stable and growing cash distributions from investments focused on income-producing commercial real estate located primarily in Canada, including Healthcare Real Estate, on a tax efficient basis; (ii) enhance the value of the REIT’s assets and maximize long-term Unit value through active management; and (iii) expand the asset base of the REIT and increase the REIT’s AFFO per Unit, including through accretive acquisitions.

## **DECLARATION OF TRUST**

The investment guidelines of the REIT are outlined in the REIT's Declaration of Trust, a copy of which is filed on SEDAR and is also available to all Unitholders upon request. Further information regarding the Declaration of Trust can also be located in the REIT's Annual Information Form under the heading "Declaration of Trust". Some of the main investment guidelines and operating policies in the Declaration of Trust include the following:

### **Investment Guidelines**

1. Acquire and operate income-producing commercial real estate located primarily in Canada;
2. Investments in joint ventures regarding real estate permitted; and
3. Investments in mortgages and mortgage bonds regarding real estate permitted.

### **Operating Policies**

1. Maximum portfolio debt capacity not to exceed 65% of Gross Book Value;
2. No guaranteeing of third-party debt outside its existing structure and potential joint venture partner structures, except under certain specific conditions and meeting certain defined criteria;
3. Limitations meeting certain defined criteria restricting leasing to non – institutional tenants; and
4. Third party environmental surveys are required prior to the acquisition of any property.

At September 30, 2014, the REIT was in compliance with all investment guidelines and operating policies stipulated in the Declaration of Trust.

## FINANCIAL AND OPERATIONAL HIGHLIGHTS

Expressed in thousands of dollars, except per unit amounts	<u>As at September 30, 2014</u>	<u>As at December 31, 2013</u>
<b>Operational information</b>	(Unaudited)	(Unaudited)
Number of properties	74	78
Gross Leasable Area ("GLA")	4,562,195	4,695,333
Occupancy %	91.8%	91.3%
Average lease term to maturity	4.6 years	4.8 years
Weighted average in place net rental rate (\$psf)	\$16.39	\$16.37
<b>Summary of Financial information</b>	(Unaudited)	(Unaudited)
Gross Book Value	\$1,255,827	\$1,314,992
Debt <sup>(1)</sup>	\$692,295	\$698,629
Debt to Gross Book Value <sup>(2)</sup>	55.1%	53.1%
Weighted average mortgage interest rate <sup>(3)</sup>	4.63%	4.80%
Weighted average mortgage term	4.8 years	5.0 years
Adjusted units outstanding – period-end <sup>(4)</sup> :		
Basic	46,558,572	46,334,949
Diluted <sup>(5)</sup>	49,767,171	49,459,335
	<b>For the three months ended</b>	<b>For the three months ended</b>
	<b>September 30, 2014</b>	<b>September 30, 2013 <sup>(12)</sup></b>
<b>Summary of Financial information</b>	(Unaudited)	(Unaudited)
Revenue	\$37,103	\$37,683
NOI <sup>(6)</sup>	\$19,994	\$20,729
FFO <sup>(6)</sup>	\$11,655	\$12,329
FFO per unit (Adjusted basic)	\$0.25	\$0.27
FFO per unit (Adjusted fully diluted)	\$0.25	\$0.26
AFFO <sup>(6) (7)</sup>	\$9,574	\$9,945
AFFO per unit (Adjusted basic)	\$0.21	\$0.22
AFFO per unit (Adjusted fully diluted)	\$0.20	\$0.21
Distributions per Unit	\$0.20	\$0.20
AFFO Payout ratio	97%	93%
AFFO Payout ratio (fully diluted)	98%	94%
Interest coverage <sup>(8)</sup>	2.42x	2.49x
Net debt/EBITDA <sup>(9)</sup>	9.0x	8.8x
Adjusted weighted average units outstanding for the period <sup>(10)</sup> :		
Basic	46,512,943	46,242,692
Diluted <sup>(11)</sup>	49,724,187	47,094,002

### Notes:

- (1) Debt includes Convertible Debentures but excludes Class B Exchangeable Units and is presented net of a Mark- to-Market premium of \$2,548 (December 31, 2013 - \$1,916) and unamortized financing costs of \$1,833 (December 31, 2013 - \$1,727).
- (2) Defined as total debt including Convertible Debentures but excluding Class B Exchangeable Units, divided by total assets.
- (3) Current market weighted average mortgage interest rate = approximately 3.6%.
- (4) Under IFRS the REIT's Class B Exchangeable Units are treated as a financial liability rather than equity. As is permitted under IFRS the REIT has chosen to present an adjusted basic and diluted per unit measure that includes the Class B Exchangeable Units in basic and diluted units outstanding. There were 7,551,546 outstanding Class B Exchangeable Units outstanding as at September 30, 2014 (December 31, 2013 – 7,551,546).
- (5) Adjusted diluted units outstanding includes 2,834,507 REIT Units issuable on the conversion of Convertible Debentures (December 31, 2013 – 2,834,507).
- (6) NOI, FFO and AFFO are not measures recognized under IFRS and do not have standardized meanings prescribed by IFRS. NOI, FFO and AFFO as computed by the REIT may differ from similar computations as reported by other real estate investment trusts and, accordingly, may not be comparable to NOI, FFO and AFFO as reported by other such issuers. These terms are defined in this MD&A and reconciled to the consolidated financial statements of the REIT.
- (7) AFFO amounts are calculated utilizing a stabilized reserve for growth capital expenditures, leasing costs and tenant improvements of 6.0% of revenue from investment properties.
- (8) Defined as net income before fair value adjustment of investment properties, loss on disposal of investment properties, plus finance costs divided by finance costs excluding amounts related to Class B Exchangeable Units, Convertible Debenture issuance costs and fair value adjustments of financial liabilities.
- (9) Defined as debt less cash and cash equivalents divided by annualized net income before fair value adjustment of investment properties, loss on disposal of investment properties plus finance costs.
- (10) Adjusted basic and diluted weighted average units outstanding include 7,551,546 outstanding Class B Exchangeable Units for the three months ended September 30, 2014 and 7,551,546 outstanding Class B Exchangeable Units for the three months ended September 30, 2013.
- (11) Adjusted diluted weighted average units outstanding includes 2,834,507 REIT Units issuable on the conversion of Convertible Debentures for the three months ended September 30, 2014 and 584,048 REIT Units issuable on the conversion of Convertible Debentures for the three months ended September 30, 2013.
- (12) FFO and AFFO for the three months ended September 30, 2013 have been restated to conform with current year presentation.

## SUMMARY OF SIGNIFICANT EVENTS

- AFFO per unit for the quarter was \$0.21, consistent with that of the previous quarter.
- FFO per unit for the quarter was \$0.25, consistent with that of the previous quarter.
- Occupancy was 91.8%, a slight decrease from that of the previous quarter at 92.1%.
- During the quarter the REIT completed the financing of its Mira Health Centre with a \$15,000 fixed rate mortgage, at 3.22% for a 5 year term. The previous mortgage of \$10,495 at 5.76% was early repaid in the second quarter of 2014.
- During the quarter, the REIT early refinanced its New Glasgow Medical Centre with a fixed rate mortgage of \$7,300 at 3.90% (previous rate at 5.07%) for 10 year terms, resulting in net proceeds to the REIT of approximately \$720.
- The REIT paid distributions of \$0.06667 per Unit on July 15, 2014, August 15, 2014 and September 15, 2014 consistent with its annualized target of \$0.80 cents per Unit.



## OUTLOOK AND CURRENT BUSINESS ENVIRONMENT

The REIT believes that its portfolio of primarily necessity-based tenancies is typically not materially impacted by economic slowdowns and is well-positioned to capitalize upon longer term demographic and healthcare industry trends of increasing demand for healthcare from an aging population, as well as increasing pressure on governments and healthcare institutions to contain costs, which will likely result in additional opportunities for non-government providers of Healthcare Real Estate. Although the REIT's healthcare-oriented portfolio operates somewhat differently from that of a general office portfolio, the REIT's portfolio is affected by market conditions for current commercial leasing markets, and recently these have come under pressure from increased supply and/or limited tenant demand in many markets across Canada.

The REIT continues to focus its leasing efforts on increasing the healthcare tenancies within each building, when appropriate and wherever possible, which means aggressively pursuing new healthcare tenancies for vacant space and renewing healthcare tenancies, but only selectively renewing non-healthcare tenancies. This is important in order to create the positive synergies that result from an agglomeration of healthcare users in one property, which over the long term, positions the property for increased rents from support service tenants such as pharmacies, laboratories, diagnostic imaging clinics and other retail-oriented businesses that benefit from such synergies. It also assists in driving maximum traffic to the property which translates into increased miscellaneous revenue, especially parking revenue, if applicable. As a result, the REIT actively renews healthcare tenancies, but only selectively renews non-healthcare tenancies upon lease expiry. It also aggressively pursues strategies to attract new healthcare tenancies to occupy vacant space. In this regard, at select properties where the demand for such an offering is evident, the REIT has recently introduced the concept of a REIT-operated, multi-practitioner managed clinic, wherein medical practitioners operate out of a 'turnkey' clinic, versus a physician-owned, sole practice rented from the landlord, and pay to the clinic owner a fixed portion of their billings. This provides medical practitioners with fewer operating distractions and greater flexibility, which is especially relevant for new and semi-retiring practitioners while providing the REIT with enhanced building synergy, as described above.

The REIT believes, through accretive acquisitions that leverage its existing asset and property management platform, there are significant opportunities to grow the portfolio by being a consolidator within a sector that is characterized by relatively fragmented ownership. Further, portfolio growth often enhances the REIT's relationships with the healthcare communities within which it operates, which over the longer term, will also contribute to improved performance. Acquisitions are also evaluated on their impact on portfolio quality in terms of building attributes such as age, size and condition, tenancy (especially percentage healthcare), market dynamics such as population and population growth, and property location (preferably in close proximity to healthcare infrastructure such as hospitals or large clinical facilities). However, the REIT believes that portfolio improvement can also be achieved through the active asset management of existing properties. Increased a property's value can be obtained through a number of initiatives, including active re-positioning of the site's uses to achieve its highest and best use, maximizing the allowable building density on the property and/or improving the property's quality to garner higher rents. In certain instances, the decision will be made to dispose of a property when market conditions warrant or when the property or its market has been deemed non-core.

## PART III

### RESULTS OF OPERATIONS

The REIT's results of operations for the three and nine months ended September 30, 2014 are summarized below:

Expressed in thousands of dollars	Three months ended September 30, 2014	Three months ended September 30, 2013	Variance	Nine months ended September 30, 2014	Nine months ended September 30, 2013	Variance
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Revenue from operations</b>						
Base rent	\$17,572	\$18,018	(\$446)	\$53,804	\$53,257	\$547
Operating cost recoveries	15,032	14,858	174	46,194	44,491	1,703
Parking revenue	3,780	3,755	25	11,821	11,377	444
Other revenue	686	648	38	1,775	1,898	(123)
Revenue from investment properties	37,070	37,279	(209)	113,594	111,023	2,571
Management fee revenue	33	404	(371)	110	662	(552)
Revenue from operations	37,103	37,683	(580)	113,704	111,685	2,019
Property operating expenses	17,109	16,954	(155)	53,018	50,905	(2,113)
Operating income	19,994	20,729	(735)	60,686	60,780	(94)
Finance cost	7,965	10,124	2,159	24,507	25,815	1,308
Interest income	(210)	(200)	10	(656)	(620)	36
Trust expenses	932	930	(2)	3,050	2,819	(231)
Income before undernoted items	11,307	9,875	1,432	33,785	32,766	1,019
Finance cost:						
Class B Exchangeable Units distributions	(1,510)	(1,511)	1	(4,531)	(4,540)	9
Fair value adjustment of Class B Exchangeable Units	1,888	2,341	(453)	5,211	9,944	(4,733)
Fair value adjustment of Convertible Debentures	(865)	805	(1,670)	(1,268)	805	(2,073)
Fair value adjustment of other financial instruments	(110)	194	(304)	(1,880)	2,609	(4,489)
Fair value adjustment of investment properties	(3,207)	(217)	(2,990)	(52,816)	(5,749)	(47,067)
Net loss on disposal of investment properties	(36)	-	(36)	(1,023)	(73)	(950)
<b>Net income / (loss)</b>	<b>\$7,467</b>	<b>\$11,487</b>	<b>(\$4,020)</b>	<b>(\$22,522)</b>	<b>\$35,762</b>	<b>(\$58,284)</b>

#### Revenue from Operations

Revenue from operations for the three months ended September 30, 2014 is \$580 lower than the actual for the three months ended September 30, 2013, primarily as a result of reduced revenue of \$805 following the sale of four properties. A reduction in management fee revenue of \$371, partially offset by the revenue generated from acquired properties of \$243 and same property revenue increases of \$353, primarily due to operating cost recovery increases driven by same property operating costs increases. Included in Revenue from operations is \$134 of lease termination revenue (three months ended September 30, 2013 - \$21).

Revenue from operations for the nine months ended September 30, 2014 is \$2,019 greater than the actual for the nine months ended September 30, 2013, as a result of a same property revenue increase of \$2,353 driven by parking revenue and operating costs recovery increases, two properties acquired subsequent to December 31, 2012 that increased revenue \$1,841 over the actual for the nine months ended September 30, 2013, partially offset by reduction in revenue previously generated from disposed properties of \$1,623 and a management fee income decrease of \$552.

### **Property Operating Expenses**

Property operating expenses are comprised of amounts recoverable from tenants (including property taxes, repairs and maintenance, utilities and insurance) and non-recoverable expenses including certain property management costs.

Operating expenses for the three months ended September 30, 2014 were \$155 greater than the three months ended September 30, 2013, primarily due to same property operating cost increase of \$518. Acquisitions added \$125 to operating expenses, which was offset by the reduction in operating expenses from disposed properties of \$488.

Operating expenses for the nine months ended September 30, 2014 were \$2,113 greater than the nine months ended September 30, 2013, primarily due to same property operating cost increase of \$2,332. Acquisitions completed subsequent to December 31, 2012 added \$602 of operating expenses offset by the reduction in operating expenses from disposed properties of \$821.

### **Finance Cost**

Interest expense for the three months ended September 30, 2014 is \$2,159 lower than the actual results for the three months ended September 30, 2013, primarily as a result of \$2,092 issuance costs incurred in the third quarter of 2013 related to the Convertible Debenture.

Interest expense for the nine months ended September 30, 2014 is \$1,308 lower than the actual results for the nine months ended September 30, 2013, primarily as a result of \$2,092 issuance costs incurred in the third quarter of 2013 related to the Convertible Debenture and reduced interest expense on fixed and variable rate debt of \$537 and \$766, respectively, offset by increased in debt prepayment cost of \$230, decrease in debt premium amortization of \$475 and interest on the Convertible Debenture of \$1,474.

### **Interest Income**

Interest income for the three and nine months ended September 30, 2014 and 2013, primarily reflects interest earned on an \$8 million loan secured by a medical office building in Owen Sound, Ontario, over which the REIT has a right of first offer to acquire. Interest income also included interest earned on outstanding accounts receivable due from a related party.

### **Trust Expenses**

Trust expense for the three months ended September 30, 2014 was consistent with that of the three months ended September 30, 2013. The increase in trust expense for the nine months ended September 30, 2014 over the nine months ended September 30, 2013 was primarily related to increased deferred unit compensation costs.

### **Finance Cost – Class B Exchangeable Unit distributions**

Under IFRS the Class B Exchangeable Unit distributions are treated as a finance cost. During the three and nine months ended September 30, 2014 the REIT declared distributions of \$1,510 and \$4,531, respectively, (2013 -\$1,511 and \$4,540) on the Class B Exchangeable Units. This represents \$0.06667 per unit, equivalent to REIT Units, for each month of the three and nine month period ended September 30, 2014 and 2013, respectively.

### **Fair Value Adjustment of Class B Exchangeable Units**

Under IFRS the Class B Exchangeable Units are carried at fair value with any change in value recognized in the statement of income. During the three month period ended September 30, 2014 the value of the Class B Exchangeable Units decreased to \$9.75 from \$10.00 resulting in a decrease of the Class B Exchangeable Units liability and an associated gain of \$1,888. During the three month period ended September 30, 2013 the value of the Class B Exchangeable Units decreased to \$11.16 from \$11.47 resulting in a decrease of the Class B Exchangeable Units liability and an associated gain of \$2,341.

During the nine month period ended September 30, 2014 the value of the Class B Exchangeable Units decreased from \$10.44 to \$9.75 resulting in a decrease of the Class B Exchangeable Unit liability and an associated gain of \$5,211. During the nine month period ended September 30, 2013 the value of the Class B Exchangeable Units decreased from \$12.48 to \$11.16 resulting in a decrease of the Class B Exchangeable Unit liability and an associated gain of \$9,944.

**Finance Cost – Fair Value Adjustment of Convertible Debentures**

During the year ended December 31, 2013 the REIT issued \$40,250 of Convertible Debentures. The debentures were designated by the REIT on initial recognition as fair value through profit and loss and are therefore carried at fair value with any change in value recognized in the statement of income. During the three month period ended September 30, 2014 the trading price of the Convertible Debenture increased to \$103.50 from \$101.00 resulting in an increase of the Convertible Debenture liability and an associated loss of \$865.

During the nine month period ended September 30, 2014 the value of the Convertible Debenture increased from \$100.00 to \$103.50 resulting in an increase of the Convertible Debenture liability and an associated loss of \$1,268.

During the three and nine month periods ended September 30, 2013 the trading price of the Convertible Debenture decreased to \$98.00 from \$100.00 resulting in a decrease of the Convertible Debenture liability and an associated gain of \$805.

**Finance Cost – Fair value adjustments of other financial instruments**

During the three and nine months ended September 30, 2014 the REIT recognized a fair value loss of \$110 and \$1,880, respectively, (2013 - \$194 gain and \$2,609 gain, respectively) on interest rate swap contracts used to fix the interest rate on certain variable rate mortgages. The interest rate swap contracts have not been designated by the REIT as hedges and as a result fair value movements on the derivatives are recognized in statement of income rather than other comprehensive income. The fair value movements are non-cash in nature and are expected to reverse over the life of the contracts.

**Fair Value Adjustment of Investment Properties**

Under IFRS the REIT has elected to use the fair value model to account for its investment properties. The REIT's primary valuation methodology is discounted cash flow analysis. Under the fair value model, investment properties are carried on the consolidated balance sheet at fair value. The properties are not depreciated and changes in the fair value of the properties are recognized in income in the period in which they occur. During the three and nine months ended September 30, 2014 the value of the REIT's investment properties decreased by \$3,207 and \$52,816, respectively. See Part III – Investment Properties for additional information on the fair value changes to the REIT's investment properties.

**Net Loss on Disposal of Investment Properties**

During the three months ended September 30, 2014 the REIT sold one non-core investment property for gross proceeds of \$275. The loss on disposal of \$36 represents transaction costs associated with the sale.

During the nine months ended September 30, 2014 the REIT sold four non-core investment properties for gross proceeds of \$18,372. The loss on disposal of \$1,023 represents transaction costs associated with the sales.

## NET OPERATING INCOME

NOI is a non-IFRS measure of a REIT's operating performance, defined as property and property related revenue less operating expenses, inclusive of property management recovery fees and amortization of straight line rent. The REIT uses NOI to assess its property operating performance on an unleveraged basis. Same property NOI for the three months ended September 30, 2014 represents income from currently owned investment properties acquired prior to July 1, 2013. Same property NOI for the nine months ended September 30, 2014 represents income from currently owned investment properties acquired prior to January 1, 2013. The REIT's NOI for the three and nine months ended September 30, 2014 is summarized below:

Expressed in thousands of dollars	Three months ended	Three months ended	Variance	Nine months ended	Nine months ended	Variance
	September 30, 2014	September 30, 2013		September 30, 2014	September 30, 2013	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Same property revenue from operations</b>						
Base rent	\$17,235	\$17,478	(\$243)	\$51,757	\$51,697	\$60
Operating cost recoveries	14,862	14,399	463	44,993	43,116	1,877
Parking revenue	3,704	3,613	91	11,362	10,974	388
Other revenue	682	640	42	1,744	1,716	28
Revenue from investment properties	36,483	36,130	353	109,856	107,503	2,353
Same property operating expenses	16,904	16,386	(518)	51,500	49,168	(2,332)
<b>Same property NOI</b>	<b>19,579</b>	<b>19,744</b>	<b>(165)</b>	<b>58,356</b>	<b>58,335</b>	<b>21</b>
Management fee revenue	33	404	(371)	110	662	(552)
Acquisitions NOI	387	269	118	1,866	627	1,239
Dispositions NOI	(5)	312	(317)	354	1,156	(802)
<b>NOI</b>	<b>\$19,994</b>	<b>\$20,729</b>	<b>(\$735)</b>	<b>\$60,686</b>	<b>\$60,780</b>	<b>(\$94)</b>

### Revenue from Investment Properties

Same property revenue from investment properties for the three months ended September 30, 2014 is \$353 greater than actual results for the three months ended September 30, 2013 primarily due to increase in operating cost recovery of \$463, partially offset by lower base rent of \$243. Same property revenue from investment properties for the nine months ended September 30, 2014 is \$2,353 greater than actual results for the nine months ended September 30, 2013 primarily due to increase in operating cost recovery and parking revenue of \$1,877 and \$388, respectively.

Same property base rent for the three months ended September 30, 2014 is \$243 lower than that of the three months ended September 30, 2013 mainly due to lower occupancy in certain properties in Ontario and Quebec. Same property base rent for the nine months ended September 30, 2013 was consistent with that of the prior year.

Same property operating cost recovery revenue for the quarter increased \$463 over the comparable prior year period driven by higher operating costs. Net operating cost recoveries decreased by \$55 compared to the comparable prior year quarter due to startup costs associated with the managed clinic business and provisions for doubtful accounts.

Same property operating cost recovery revenue for the nine months ended September 30, 2014 increased \$1,877 over the comparable prior year period as a direct result of higher property operating expenses. Net operating cost recoveries decreased \$455 over the comparable prior year nine month period primarily due to gross leases in Quebec, occupancy weakness at certain Ontario properties, startup costs associated with the managed clinic business and provisions for doubtful accounts.

Same property parking revenue increased \$91 over the three months ended September 30, 2013 due to improved transient parking revenue at certain properties in the West region. Same property parking revenue increased \$388 over

the nine months ended September 30, 2013 due to improved transient parking revenue at certain properties in the West.

Other same property revenue was comparable to the three and nine months ended September 30, 2013 and included income from the managed clinic business.

#### **Property Operating Expenses**

Property operating expenses are comprised of amounts recoverable from tenants (including property taxes, repairs and maintenance, utilities and insurance) and non-recoverable expenses including certain property management costs.

Same property operating expenses for the three months ended September 30, 2014 increased by \$518 over the three months ended September 30, 2013 due to higher property taxes, additional marketing resources, startup costs associated with the managed clinic business and provisions for doubtful accounts. Same property operating expenses for the nine months ended September 30, 2014 is \$2,332 over the nine months ended September 30, 2013 primarily due to higher utility costs, repairs and maintenance costs, additional marketing resources, startup costs associated with the managed clinic business and provisions for doubtful accounts.

#### **Management Fee Revenue**

Management fee revenue for the three and nine months ended September 30, 2014 decreased \$371 and \$552 from the comparable prior year periods, respectively, partially due to the termination of a Management and Cost Sharing Agreement with a related party that was terminated in the fourth quarter of 2013 by the related party, following sale of the property subject to the agreement. In the third quarter of 2013 the REIT also earned a non-recurring leasing and construction supervision fee of \$200 pursuant to a lease termination by a related party (see Part V – Related Party Transactions).

### **PORTFOLIO PROFILE**

As of September 30, 2014, the REIT's portfolio consisted of 74 Healthcare Real Estate properties, located in seven provinces. The properties had a total GLA of approximately 4.6 million square feet encompassing approximately 1,500 individual tenancies.

#### **Geographic Diversification**

The properties are well diversified throughout Canada, with 77% of annualized NOI derived from the six major markets of Toronto (27%), Calgary (21%), Edmonton (13%), Montreal (8%), Quebec City (4%) and Halifax (4%) for the three months ended September 30, 2014. The following charts and graphs set out the regional diversification of the portfolio by annualized NOI and GLA.

Region	# of Properties	Total GLA	Current Occupancy Rate <sup>(1)</sup>	Avg. In-place Net Rent (psf)
Western Canada	16	1,275,304	95.6%	\$20.89
Ontario	34	1,999,049	87.6%	15.96
Quebec	15	744,274	94.9%	12.52
Atlantic Canada	9	543,568	93.7%	12.74
<b>Total</b>	<b>74</b>	<b>4,562,195</b>	<b>91.8%</b>	<b>\$16.39</b>

**Geographic diversification by annualized NOI <sup>(2)</sup>**

Region	Percentage
Ontario	41%
Western Canada	37%
Quebec	12%
Atlantic Canada	10%

**Geographic diversification By GLA <sup>(1)</sup>**

Region	Percentage
Ontario	44%
Western Canada	28%
Quebec	16%
Atlantic Canada	12%

**Notes:**  
(1) As at September 30, 2014  
(2) Based on NOI for the 3 months ended September 30, 2014, excluding property management fees.

### Tenant Mix

The portfolio has a well diversified tenant profile, reflecting an attractive mix of healthcare-related tenants, including regional health authorities, primary care networks, family health teams, medical and diagnostic imaging clinics, medical practitioners, pharmacies and laboratories, as well as institutional and non-healthcare tenants. Approximately 77% of the REIT's tenants are healthcare-oriented. The average tenant occupies approximately 2,800 square feet of GLA. The primary source of revenue for a large portion of the REIT's tenants is government funding, either directly or indirectly, through medical practitioners, which supports the credit quality of the REIT's tenants. The weighted average in place net rent per square foot for the properties is \$16.39.

The following table summarizes the REIT's 10 largest tenants by percentage of gross rent for the three months ended September 30, 2014:

Tenant	% of Gross Rent	No. of Locations
1 Bantrel Corporation	4.5%	1
2 CLSC/CSSS	3.8%	6
3 Shoppers Drug Mart	2.3%	8
4 Lawtons Drugs	2.0%	5
5 Alberta Health Services	1.9%	5
6 Province of Ontario	1.9%	3
7 Centric Health	1.3%	7
8 Albany Medical Clinic	1.2%	1
9 Primary Care Network	1.2%	5
10 Medical Imaging Consultants	1.2%	2
<b>Total</b>	<b>21.3%</b>	
Weighted average lease term		6.2 years

## Leasing Activity

<b>Leasing Activity (square feet) – three months ended September 30, 2014</b>				
	<b>Total GLA</b>	<b>Occupied</b>	<b>Vacant</b>	<b>Committed<sup>(1)</sup></b>
June 30, 2014	4,572,882	4,210,368	362,514	219,061
Acquired	-	-	-	-
Disposition	(12,227)	(4,335)	(7,892)	-
Expiries	-	(162,209)	162,209	-
Renewal	-	130,115	(130,115)	<sup>(2)</sup> (54,557)
Early Terminations	-	(19,350)	19,350	-
New Leasing	-	44,218	(44,218)	<sup>(3)</sup> (8,163)
Month to month	-	(13,779)	13,779	-
Re-measurements and other	1,540	841	699	-
September 30, 2014	<u>4,562,195</u>	<u>4,185,869</u>	<u>376,326</u>	<u>156,341</u>

**Notes:**

(1) Represents existing tenants that have early renewed prior to lease expiry or new tenant leasing where the lease commences subsequent to the quarter end.

(2) Net change of 54,557 square feet during the quarter equals 39,393 square feet of early renewals during the quarter less 93,950 square feet of prior quarter early renewals that commenced during the current quarter.

(3) Net change of 8,163 square feet during the quarter equals 9,911 square feet of leasing, with lease commencement subsequent to the quarter, less 18,074 square feet of prior quarter new leasing that commenced during the current quarter.

<b>Leasing Activity (square feet) – nine months ended September 30, 2014</b>				
	<b>Total GLA</b>	<b>Occupied</b>	<b>Vacant</b>	<b>Committed<sup>(1)</sup></b>
December 31, 2013	4,695,333	4,288,723	406,610	184,389
Acquired	-	-	-	-
Disposition	(140,944)	(84,482)	(56,462)	-
Expiries	-	(411,464)	411,464	-
Renewal	-	327,047	(327,047)	(24,316)
Early Terminations	-	(34,880)	34,880	-
New Leasing	-	109,766	(109,766)	(3,732)
Month to month	-	(15,655)	15,655	-
Re-measurements and other	7,806	6,814	992	-
September 30, 2014	<u>4,562,195</u>	<u>4,185,869</u>	<u>376,326</u>	<u>156,341</u>

**Notes:**

(1) Represents existing tenants that have early renewed prior to lease expiry or new tenant leasing where the lease commences subsequent to the quarter end.

### Renewal leasing:

During the quarter the REIT completed 130,115 square feet of renewal leasing inclusive of 6,073 square feet of month to month tenants that renewed during the quarter. In addition 6,586 square feet of expiries remained in occupancy on a month to month basis, and are expected to renew. The REIT also early renewed 39,393 square feet of future expiries during the quarter.

Tenant renewals were completed at an initial net rent per square foot of \$15.48 versus an expiring net rent per square foot of \$16.50, a decrease of 6.2%. The decrease is directly attributable to the renewal of one core medical representing approximately 25% of the space renewed during the quarter. Excluding this tenant, there would have been an increase in net rent per square foot of \$0.19, or 1.2%.

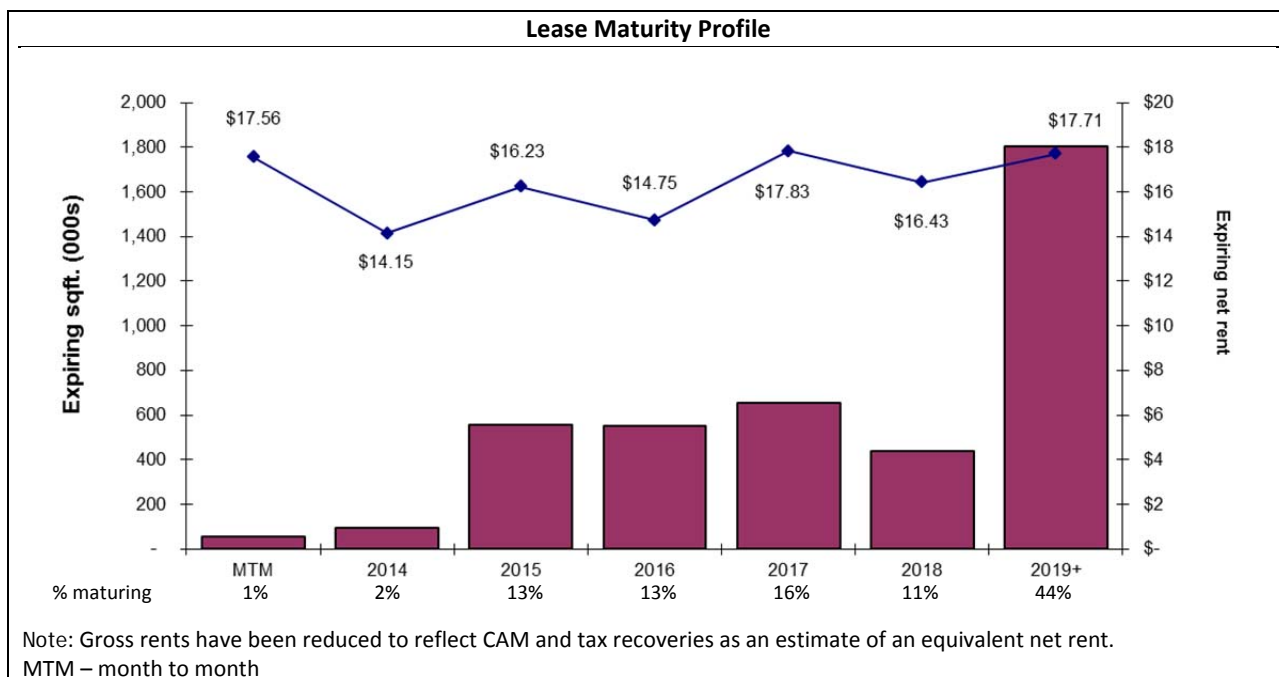
### New leasing:

During the quarter the REIT completed 44,218 square feet of new leasing commencing in the quarter, plus 9,911 square feet of leasing with lease commencement subsequent to the quarter. New leasing commencing during the quarter was completed at an initial net rent per square foot of \$10.80. This is lower than the REIT's average in-place net rent because the leasing activity did not include any support service tenant leasing, which is typically at net rents higher than our in-place average, but it did include leasing in some of our lower rent markets, such as southwestern Ontario.



### Lease Expiry Profile

The REIT's diverse tenant base is complemented by a balanced lease maturity profile, with an average of 13% of GLA maturing each year between 2015 and 2018, as illustrated by the chart below, and, as of September 30, 2014, a weighted average term to maturity of 4.6 years.



Expiring Square Feet						
	Western Canada	Ontario	Quebec	Atlantic Canada	Total	Committed
Month to month	6,756	44,184	-	5,666	56,606	-
2014	20,481	29,665	38,827	7,482	96,455	47,657
2015	167,162	235,322	50,532	104,554	557,570	69,112
2016	95,617	282,773	116,633	54,669	549,692	9,299
2017	280,834	242,480	68,137	62,837	654,288	855
2018	169,873	163,197	61,262	43,348	437,680	3,003
2019+	451,035	753,139	371,239	230,905	1,806,318	3,631
Total Expiries	1,191,758	1,750,760	706,630	509,461	4,158,609	133,557
Residential	27,260	-	-	-	27,260	-
	1,219,018	1,750,760	706,630	509,461	4,185,869	133,557
Vacant	56,286	248,289	37,644	34,107	376,326	22,784
Total GLA	1,275,304	1,999,049	744,274	543,568	4,562,195	156,341
<b>Occupancy percentage</b>	<b>95.6%</b>	<b>87.6%</b>	<b>94.9%</b>	<b>93.7%</b>	<b>91.8%</b>	

Expiring Net Rent						
	Western Canada	Ontario	Quebec	Atlantic Canada	Total	Committed <sup>(1)</sup>
Month to month	\$17.96	\$19.24	\$-	\$3.92	\$17.56	\$-
2014	17.23	12.77	14.63	8.65	14.15	16.20
2015	19.85	15.91	17.01	10.77	16.23	16.74
2016	17.51	14.90	10.54	18.12	14.75	19.93
2017	23.20	14.26	13.37	12.47	17.83	10.00
2018	20.17	16.23	10.77	10.46	16.43	22.77
2019+	21.25	17.92	13.36	12.92	17.71	20.98
Total Expiries	<u>\$21.49</u>	<u>\$16.44</u>	<u>\$13.00</u>	<u>\$13.31</u>	<u>\$16.92</u>	<u>\$16.98</u>

**Notes:**  
(1) Weighted average initial net rent per square foot.

The REIT has 22,784 square feet of committed future leasing against vacant space at an initial net rent per square foot of \$12.98.

## INVESTMENT PROPERTIES

The fair value of investment properties as at September 30, 2014 was \$1,230,154 representing an implied weighted average capitalization rate ("Implied Cap Rate") of 6.8%. At September 30, 2013 investment properties were valued at \$1,294,375 representing an Implied Cap Rate of 6.7%.

The change in value is summarized as follows:

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Expressed in thousands of dollars	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Opening Balance</b>	<b>\$1,226,632</b>	<b>\$1,264,659</b>	<b>\$1,286,843</b>	<b>\$1,244,875</b>
Acquisitions of investment properties	-	21,683	-	35,612
Additions	6,845	7,765	13,650	19,503
Disposition of investment properties	(275)	-	(18,372)	(1,035)
Increase in straight-line rents receivable	159	485	849	1,169
Fair value adjustment	(3,207)	(217)	(52,816)	(5,749)
<b>Closing Balance</b>	<b><u>\$1,230,154</u></b>	<b><u>\$1,294,375</u></b>	<b><u>\$1,230,154</u></b>	<b><u>\$1,294,375</u></b>

When valued internally the REIT determines the fair value of each investment property using the discounted cash flow method. The discounted cash flow method discounts the expected future cash flows, generally over a term of ten years, including a terminal value based on the application of a capitalization rate to estimated year 11 cash flows.

The discounted cash flows reflect rental income from current leases and assumptions about rental income from future leases reflecting market conditions at the reporting date, less future cash outflows in respect of such leases.

Given the state of office space markets in most of the country and the continued pressure on provincial government budgets, which is the primary source of funding for most of the REIT's tenancy base, during the second quarter of 2014 the REIT revised some key assumptions about the REIT's business, resulting in a reduction of projected rental rate growth in certain markets over the next several years as well as an increase in projected capital to enhance the future leaseability of the REIT's properties. These changes, together with some valuation changes at specific properties to

reflect property-specific or local market conditions in the current and prior quarters, reduced our internal assessment of the value of the portfolio by \$52,816 for the nine months ended September 30, 2014.

During the nine months ended September 30, 2014 external valuations were performed on properties with an aggregate value of \$32,880. The REIT expects to have a portion, likely one-quarter to one-third, of the value of the portfolio externally appraised each year, depending on management's assessment that such valuations would be appropriate given the market conditions and/or material changes at the properties at that time.

The key valuation assumptions for the REIT's commercial properties are set out in the following table:

	<b>September 30, 2014</b>	<b>September 30, 2013</b>
	(Unaudited)	(Unaudited)
Discount rate – range	6.0% - 9.8%	6.3% - 10.0%
Discount rate – weighted average	7.5%	7.7%
Terminal capitalization rate - range	5.8% - 9.0%	6.0% - 9.3%
Terminal capitalization rate - weighted average	7.1%	7.2%
Implied capitalization rate – range	5.4% - 9.5%	5.6% - 9.1%
Implied capitalization rate – weighted average	6.8%	6.7%

During the nine months ended September 30, 2014 the REIT sold four non-core investment properties for gross proceeds of \$18,372.

## ACQUISITIONS

There were no property acquisitions during the quarter.

## DISPOSITIONS

During the quarter the REIT sold a non-core property in Welland, Ontario (Welland Professional Arts Building) for \$275, before adjustments, resulting in net proceeds of approximately \$239 after transaction costs.

During the second quarter the REIT sold a non-core property in Toronto, Ontario (2065 Finch Avenue West) for \$10,050, before adjustments, resulting in net proceeds of approximately \$2,886 after transaction costs and a mortgage of \$6,223 assumed by the purchaser.

During the first quarter the REIT sold a property in London, Ontario (Wharncliffe Health Centre) for net proceeds of approximately \$3,375. The property was designated by the REIT as a non-core asset and was sold to a user group.

During the first quarter the REIT also sold a property in Montreal, Quebec (Centre Medical Saint Urbain) for net proceeds of approximately \$2,196 with a mortgage of \$2,430 assumed by the purchaser. The property was designated by the REIT as a non-core asset and was sold to a local developer group.

## LEASING COSTS AND CAPITAL EXPENDITURES

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Expressed in thousands of dollars	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Leasing costs <sup>(1)</sup>	\$583	\$467	\$1,277	\$1,384
Tenant improvements <sup>(2)</sup>	3,930	3,942	7,925	10,271
Capital expenditures <sup>(3)</sup>	2,332	3,356	4,448	7,848
Additions to investment properties	6,845	7,765	13,650	19,503
Internal leasing costs expensed	365	356	1,216	1,076
	7,210	8,121	14,866	20,579
Less: recoverable maintenance capital expenditures	(1,556)	(1,711)	(3,179)	(4,663)
Less: value enhancing and non-recurring capital expenditures	(2,022)	(1,787)	(2,447)	(5,150)
Total adjusted leasing costs and capital expenditures	<u>\$3,632</u>	<u>\$4,623</u>	<u>\$9,240</u>	<u>\$10,766</u>
Reserve for stabilized capital expenditures, leasing costs and tenant improvements <sup>(4)</sup>	<u>\$2,225</u>	<u>\$2,237</u>	<u>\$6,816</u>	<u>\$6,661</u>
Actual leasing and capital expenditures in excess of reserve	<u>\$1,407</u>	<u>\$2,386</u>	<u>\$2,424</u>	<u>\$4,105</u>
<b>Notes:</b>				
(1) The leasing costs exclude the base salary and benefits of the internal leasing department which have been expensed.				
(2) Tenant improvements include tenant allowances and landlord's work where the REIT has determined, for accounting purposes, that it is the owner of the tenant improvements. These amounts are added to the carrying value of investment properties.				
(3) The REIT's capital expenditures include capital costs required to maintain the existing property portfolio (i.e. maintenance capital expenditures) as well as capital costs in relation to the on-going expansion and continuous improvement of the portfolio.				
(4) Based on a reserve of 6.0% of quarterly revenue from investment properties. Prior year comparatives have increased from a reserve of 4.5% to 6.0% to conform with current year presentation.				

On a quarterly basis and during portfolio repositioning, leasing costs, tenant improvements and capital expenditures can fluctuate and as such, should not be regarded as stabilized. Further, in accordance with the REIT's strategy of extending average lease term whenever possible, especially for primary medical tenancies, often non recurring leasing costs are involved.

In the quarter over 65% of leasing costs and tenant improvement costs related to lease deals of ten years or longer, which typically require greater upfront costs, and over 83% were primary medical. During the quarter the REIT also expended costs related to some specific operational objectives, including:

- Approximately \$550 of costs associated with the revitalization of the parking garage at its Queensway Professional Centre property. The project is expected to take place over several quarters and is expected to improve parking revenue at the property.
- Approximately \$430 for the extension of certain important leases with Alberta Health Services, one of the REIT's largest tenants by gross revenue.

During the second quarter the REIT changed the AFFO reserve for non-recoverable leasing and capital costs from 4.5% of gross revenue to 6.0%. A portion of this increase (1.0%) was related to an off-setting increase to FFO as a result of the

REIT adopting REALpac's FFO White Paper position on the treatment of internalized leasing costs, with the remainder (0.5%) related to a revised projection of leasing and capital costs as we continue to invest in our properties. Comparative periods have been adjusted to reflect the REIT's revised presentation.

## **PART IV**

### **FUNDS FROM OPERATIONS**

FFO is a supplemental non-IFRS industry wide financial measure of a REIT's operating performance. The REIT calculates FFO as net income (computed in accordance with IFRS), excluding gains (or losses) from sales of investment properties and extraordinary items plus distributions on Class B Exchangeable Units, and adjusted for fair value adjustments on Class B Exchangeable Units, other financial instruments and investment properties, plus internal leasing costs and deferred income tax, and after adjustments for equity accounted for entities and non-controlling interests. The REIT calculates FFO substantially in accordance with the definition adopted by the Real Property Association of Canada ("REALpac") with the exception of adding back to FFO the issuance costs of the Convertible Debentures. The issuance costs are expensed to income calculated in accordance with IFRS and the REIT believes adding back these non-recurring issuance costs improves the comparability of FFO to other periods. The REIT's method of calculating FFO may differ from other issuers' methods and accordingly may not be directly comparable to FFO reported by other issuers. A reconciliation of IFRS net income to FFO for the three and nine months ended September 30, 2014 is set out below:

	Three months ended September 30, 2014	Three months ended September 30, 2013	Variance	Nine months ended September 30, 2014	Nine months ended September 30, 2013	Variance
Expressed in thousands of dollars	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Net income / (loss)</b>	<b>\$7,467</b>	<b>\$11,487</b>	<b>(\$4,020)</b>	<b>(\$22,522)</b>	<b>\$35,762</b>	<b>(\$58,284)</b>
Add / (Deduct):						
Finance cost – Class B Exchangeable Unit distributions	1,510	1,511	(1)	4,531	4,540	(9)
Finance cost - Fair value adjustment of Class B Exchangeable Units	(1,888)	(2,341)	453	(5,211)	(9,944)	4,733
Finance cost - Fair value adjustment of Convertible Debentures	865	(805)	1,670	1,268	(805)	2,073
Finance cost – Convertible Debenture issuance costs <sup>(7)</sup>	-	2,092	(2,092)	-	2,092	(2,092)
Finance costs – Fair value adjustments of other financial instruments	110	(194)	304	1,880	(2,609)	4,489
Fair value adjustment of investment properties	3,207	217	(2,990)	52,816	5,749	47,067
Net loss on disposal of investment properties	36	-	36	1,023	73	950
Internal leasing costs <sup>(4)</sup>	365	356	9	1,216	1,076	140
Fair value adjustment to deferred unit plan liability <sup>(5)</sup>	(17)	6	(23)	(57)	(24)	(33)
<b>FFO <sup>(1)(6)</sup></b>	<b>\$11,655</b>	<b>\$12,329</b>	<b>(\$674)</b>	<b>\$34,944</b>	<b>\$35,910</b>	<b>(\$966)</b>
Adjusted basic FFO per unit <sup>(2)</sup>	\$0.25	\$0.27	(\$0.02)	\$0.75	\$0.78	(\$0.03)
Adjusted fully diluted FFO per unit <sup>(2)</sup>	\$0.25	\$0.26	(\$0.01)	\$0.74	\$0.77	(\$0.03)
<b>Adjusted weighted average units outstanding <sup>(3)</sup>:</b>						
Basic	46,512,943	46,242,692	270,251	46,440,095	46,189,833	250,262
Fully diluted	49,724,187	47,094,002	2,630,185	49,623,750	46,626,845	2,996,905
<b>Notes:</b>						
(1) FFO is a non-IFRS measure of a REIT's operating performance. FFO is only one measure of real estate operating performance and does not reflect amounts available for tenant installation costs, property capital expenditures, debt service obligations, commitments or uncertainties. FFO should not be interpreted as an indicator of cash generated from operating activities and is not indicative of cash available to fund operating expenditures, or for the payment of cash distributions.						
(2) FFO per unit amounts are based on basic and fully diluted adjusted weighted average number of units, which includes Class B Exchangeable Units.						
(3) Under IFRS the REIT's Class B Exchangeable Units are treated as a financial liability rather than equity. As is permitted under IFRS the REIT has chosen to present an adjusted basic and diluted per unit measure that includes the Class B Exchangeable Units in basic and diluted units outstanding/weighted average units outstanding. As a result the adjusted basic and diluted weighted average units outstanding include 7,551,546 outstanding Class B Exchangeable Units for the three and nine months ended September 30, 2014, and 7,551,546 and 7,571,004 outstanding Class B Exchangeable Units for the three and nine months ended September 30, 2013, respectively. Adjusted diluted weighted average units outstanding includes 2,834,507 Units issuable on the conversion of Convertible Debentures for the three and nine months ended September 30, 2014, and 584,048 and 196,822 REIT Units issuable on the conversion of Convertible Debentures for the three and nine months ended September 30, 2013, respectively. Fully diluted adjusted units outstanding includes the impact of deferred units outstanding.						
(4) In April 2014, an update to the FFO White Paper was released by REALpac to provide that the costs of full-time or salaried leasing personnel, and related internal costs, that can be reasonably and directly attributed to signed leases, and that would otherwise be capitalized if incurred from external sources, be added back to net income in determining FFO. In accordance with the update to the FFO White Paper, management determined that internal leasing costs, that aren't incremental and as a result expensed in accordance with IFRS when determining net income, would be added back to FFO. This amount includes the base salary and benefits of the internal leasing department which have been expensed. The REIT has amended prior period comparative figures retrospectively to improve comparability.						
(5) In accordance with the FFO White Paper the REIT has begun to adjust for fair value changes to the deferred unit plan liability when determining FFO. These fair value changes were previously part of the AFFO adjustment. The REIT has also amended prior period comparative figures retrospectively to improve comparability.						
(6) See Summary of Quarterly Results for a reconciliation of prior quarter FFO presentation to current FFO presentation.						
(7) Non-recurring issuance costs of the Convertible Debentures.						

The FFO per unit of \$0.25 for the three months ended September 30, 2014 is \$0.02 lower than that of the three months ended September 30, 2013. FFO was negatively impacted by reduced management fee income, weak same property performance (albeit on a cash basis same property performance was comparable to prior year quarter) and the near term dilutive impact of property dispositions, partially offset by a net reduction in interest costs.

FFO per unit for the nine months ended September 30, 2014 is \$0.03 lower than that of the nine months ended September 30, 2013 primarily as a result of reduced management fee income, the reduction of the amortization of debt premiums and the near term dilutive impact of property disposition, partially offset by interest cost savings and the income generated from properties acquired subsequent to December 31, 2012.

## **ADJUSTED FUNDS FROM OPERATIONS AND DISTRIBUTIONS**

### **AFFO**

AFFO is a supplemental non-IFRS industry wide financial measure of a REIT's cash generating activities after providing for stabilized operating capital requirements. Management considers AFFO to be a useful measure of cash available for distributions. The REIT calculates AFFO as net income (computed in accordance with IFRS), subject to certain adjustments, including: (i) adding back the following items: any fair value losses on investment properties or the Class B Exchangeable Units, the finance cost associated with distributions on the Class B Exchangeable Units, deferred unit plan compensation expense, amortization of any net discount on long-term debt assumed from vendors of properties at rates of interest less than fair value, and incremental leasing costs; (ii) deducting the following items: any fair value gains on investment properties or the Class B Exchangeable Units and amortization of any net premium on long-term debt assumed from vendors of properties at rates of interest greater than fair value; (iii) adjusting for differences, if any, resulting from recognizing rental revenues on a straight-line basis as opposed to contractual rental amounts; (iv) adjusting for differences, if any, resulting from recognizing acquired contracts at fair value rather than the contracted rate; and (v) deducting reserves for tenant inducements, leasing commissions, financing costs and sustaining capital expenditures, as determined by the REIT. The REIT's method of calculating AFFO may differ from other issuers' methods and accordingly may not be directly comparable to AFFO reported by other issuers. A reconciliation of FFO to AFFO for the three and nine months ended September 30, 2014 is set out below:

	Three months ended September 30, 2014	Three months ended September 30, 2013	Variance	Nine months ended September 30, 2014	Nine months ended September 30, 2013	Variance
Expressed in thousands of dollars	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>FFO</b>	<b>\$11,655</b>	<b>\$12,329</b>	<b>(\$674)</b>	<b>\$34,944</b>	<b>\$35,910</b>	<b>(\$966)</b>
Add / (Deduct):						
Amortization of mark-to-market adjustment	(172)	(297)	125	(603)	(1,078)	475
Amortization of finance fees <sup>(2)</sup>	106	126	(20)	306	398	(92)
Amortization of straight-line rent	(104)	(229)	125	(364)	(616)	252
Deferred unit plan compensation expense <sup>(3)</sup>	276	253	23	971	615	356
Debt repayment costs <sup>(4)</sup>	38	-	38	438	208	230
Reserve for stabilized leasing costs, tenant improvements and growth capital expenditures <sup>(5)</sup>	(2,225)	(2,237)	12	(6,816)	(6,661)	(155)
<b>AFFO <sup>(1)(8)</sup></b>	<b>\$9,574</b>	<b>\$9,945</b>	<b>(\$371)</b>	<b>\$28,876</b>	<b>\$28,776</b>	<b>\$100</b>
Adjusted basic AFFO per Unit <sup>(6)</sup>	\$0.21	\$0.22	(\$0.01)	\$0.62	\$0.62	\$-
Adjusted fully diluted AFFO per Unit <sup>(6)</sup>	\$0.20	\$0.21	(\$0.01)	\$0.61	\$0.62	(\$0.01)
<b>Adjusted weighted average units outstanding <sup>(7)</sup>:</b>						
Basic	46,512,943	46,242,692	270,251	46,440,095	46,189,833	250,262
Fully diluted	49,724,187	47,094,002	2,630,185	49,623,750	46,626,845	2,996,905
<b>Notes:</b>						
(1) AFFO is a non-IFRS measure of a REIT's operating performance. AFFO is only one measure of real estate operating performance and is an alternative measure of determining available cash flow. AFFO should not be interpreted as an indicator of cash generated from operating activities as it does not consider changes in working capital.						
(2) Represents costs related to the REIT's Revolving Credit Facility, loans and mortgages.						
(3) As noted under Funds From Operations the REIT has begun to adjust FFO for fair value changes in the REIT's deferred unit plan liability in accordance with the FFO White Paper. As a result the REIT has adjusted the deferred unit plan compensation expense AFFO adjustment to exclude this fair value adjustment already accounted for under FFO. The change in presentation does not impact AFFO.						
(4) During the quarter the REIT refinanced one mortgage. Debt repayment cost include the difference between the carrying amount and the settlement amount of mortgages payable that were settled during the three months ended September 30, 2014, including unamortized mark-to-market adjustment written off on the debt extinguishments, prepayment penalty and other costs.						
(5) Based on an estimate of 6.0% of revenue from investment properties. In April 2014, an update to the FFO White Paper was released by REALpac to provide that the costs of full-time or salaried leasing personnel, and related internal costs, that can be reasonably and directly attributed to signed leases, and that would otherwise be capitalized if incurred from external sources, be added back to net income in determining FFO. In accordance with the update to the FFO White Paper, management determined that internal leasing costs, that aren't incremental and as a result expensed in accordance with IFRS when determining net income, would be added back to FFO. This amount includes the base salary and benefits of the internal leasing department which have been expensed. As a result of this amendment to the REIT's FFO calculation the REIT has increased its AFFO reserve by 1% to offset the increase in FFO as a result of adding back internal leasing costs. In addition the REIT increased the reserve by 0.5% to reflect a revised projection of leasing and capital costs as the REIT continues to invest in its properties. Comparative figures have been revised retrospectively to enhance comparability.						
(6) AFFO per unit amounts are based on basic and fully diluted adjusted weighted average number of units, which includes Class B Exchangeable Units. Fully diluted adjusted units outstanding includes the impact of Convertible Debentures and deferred units outstanding.						
(7) Under IFRS the REIT's Class B Exchangeable Units are treated as a financial liability rather than equity. As is permitted under IFRS the REIT has chosen to present an adjusted basic and diluted per unit measure that includes the Class B Exchangeable Units in basic and diluted units outstanding/weighted average units outstanding. As a result the adjusted basic and diluted weighted average units outstanding include 7,551,546 outstanding Class B Exchangeable Units for the three and nine months ended September 30, 2014, and 7,551,546 and 7,571,004 outstanding Class B Exchangeable Units for the three and nine months ended September 30, 2013, respectively. Adjusted diluted weighted average units outstanding includes 2,834,507 Units issuable on the conversion of Convertible Debentures for the three and nine months ended September 30, 2014, and 584,048 and 196,822 REIT Units issuable on the conversion of Convertible Debentures for the three and nine months ended September 30, 2013, respectively. Fully diluted adjusted units outstanding includes the impact of deferred units outstanding.						
(8) See Summary of Quarterly Results for a reconciliation of prior quarter AFFO presentation to current AFFO presentation.						



The AFFO per unit of \$0.21 for the three months ended September 30, 2014 is \$0.01 lower than that of the three months ended September 30, 2013. AFFO for the quarter was negatively impacted by reduced management fee income and the near term dilutive impact of property dispositions, partially offset by a net reduction in interest costs.

The AFFO per unit for the nine months ended September 30, 2014 is comparable to that of the nine months ended September 30, 2013 as a reduction of management fee income was offset by same property income improvement (on a cash basis) and interest cost savings.

A reconciliation of cash provided by operating activities to AFFO for the three and nine months ended September 30, 2014 is set out below:

Expressed in thousands of dollars	Three months ended	Three months ended	Variance	Nine months ended	Nine months ended	Variance
	September 30, 2014	September 30, 2013		September 30, 2014	September 30, 2013	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Net cash from operating activities</b>	<b>\$12,135</b>	<b>13,954</b>	<b>(\$1,819)</b>	<b>\$27,984</b>	<b>\$33,908</b>	<b>(\$5,924)</b>
Add / (Deduct):						
Change in non-cash operating items	(1,496)	(2,038)	542	4,796	409	4,387
Net increase in restricted cash	-	-	-	(175)	-	(175)
Decrease (increase) in accrued interest expense	602	(120)	722	883	(139)	1,022
Debt repayment costs	38	-	38	438	208	230
Amortization of straight line rent	(104)	(229)	125	(364)	(616)	252
Deferred unit plan compensation expense	276	253	23	971	615	356
Fair value adjustment to deferred unit plan liability	(17)	6	(23)	(57)	(24)	(33)
Incremental leasing costs	365	356	9	1,216	1,076	140
Reserve for stabilized leasing costs, tenant improvements and growth capital expenditures <sup>(2)</sup>	(2,225)	(2,237)	12	(6,816)	(6,661)	(155)
<b>AFFO <sup>(1)</sup></b>	<b>\$9,574</b>	<b>\$9,945</b>	<b>(\$371)</b>	<b>\$28,876</b>	<b>\$28,776</b>	<b>\$100</b>

**Notes:**

(1) AFFO is a non-IFRS measure of a REIT's operating performance. AFFO is only one measure of real estate operating performance and is an alternative measure of determining available cash flow. AFFO should not be interpreted as an indicator of cash generated from operating activities as it does not consider changes in working capital.

(2) Based on an estimate of 6.0% of revenue from investment properties.

Pursuant to National Policy 41-201, "Income Trusts and Other Indirect Offerings", the following table outlines the differences between cash flow from operating activities and distributions paid and payable as well as the differences between net income and distributions paid and payable, in accordance with the guidelines.

Expressed in thousands of dollars	Three months ended	Three months ended	Variance	Nine months ended	Nine months ended	Variance
	September 30, 2014	September 30, 2013		September 30, 2014	September 30, 2013	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net income	\$7,467	\$11,487	(\$4,020)	(\$22,522)	\$35,762	(\$58,284)
Class B Exchangeable Unit distributions	1,510	1,511	(1)	4,531	4,540	(9)
Adjusted net income	8,977	12,998	(4,021)	(17,991)	40,302	(58,293)
Net cash from operating activities	12,135	13,954	(1,819)	27,984	33,908	(5,924)
Distributions	7,796	7,740	56	23,341	23,180	161
Class B Exchangeable Unit distributions	1,510	1,511	(1)	4,531	4,540	(9)
Distributions paid and payable	9,306	9,251	55	27,872	27,720	152
Excess (shortfall) of adjusted net income over distributions paid and payable	(329)	3,747	(4,076)	(45,863)	12,582	(58,445)
Excess of cash flow from operating activities over distributions paid and payable	2,829	4,703	(1,874)	112	6,188	(6,076)

Net income is not necessarily indicative of the REIT's ability to pay distributions as it includes certain non-cash items including fair value changes on investment properties and financial instruments.

### **Distributions**

The REIT has adopted a distribution policy pursuant to which the REIT intends to make cash distributions to Unitholders and to holders of Class B Exchangeable Units on each monthly distribution date equal to, on an annual basis, approximately 90% of AFFO calculated with reserves. The REIT currently intends on making monthly distributions of \$0.06667 per Unit, equating to \$0.80 per Unit on an annualized basis.

The REIT's AFFO payout ratio based on reserves for the three months ended September 30, 2014 is calculated below:

	For the three months ended	For the three months ended
	September 30, 2014	September 30, 2013
	(Unaudited)	(Unaudited)
AFFO per unit	\$0.21	\$0.22
Distributions per Unit	\$0.20	\$0.20
<b>Payout Ratio</b>	<b>97%</b>	<b>93%</b>
Fully diluted AFFO per unit	\$0.20	\$0.21
Distributions per Unit	\$0.20	\$0.20
<b>Payout Ratio (fully diluted)</b>	<b>98%</b>	<b>94%</b>

The REIT payout ratio was higher compared to that of the prior year period on lower AFFO per unit.

### **Distribution Reinvestment Plan**

Participants in the DRIP have their cash distributions used to purchase Units of the REIT and also receive a "bonus distribution" of Units equal in value to 3% of each distribution. During the quarter 75,235 Units were issued pursuant to the DRIP and the DRIP participation rate was approximately 9% during the quarter.

## **LIQUIDITY AND CAPITAL RESOURCES**

The REIT expects to be able to meet all of its obligations as they become due and have sufficient liquidity from the following sources: (i) cash flow from operating activities; (ii) financing availability through a Revolving Credit Facility and conventional mortgage debt secured by investment properties; and (iii) the ability to issue equity and convertible unsecured debentures.

The following table details the changes in cash and cash equivalents during the period:

	<b>Three months ended September 30, 2014</b>	<b>Three months ended September 30, 2013</b>	<b>Nine months ended September 30, 2014</b>	<b>Nine months ended September 30, 2013</b>
Expressed in thousands of dollars				
<b>Cash provided by / (used in):</b>	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Operating activities	\$12,135	\$13,954	\$27,984	\$33,908
Investing activities	(6,616)	(28,729)	(4,964)	(43,520)
Financing activities	(6,125)	16,079	(24,456)	7,430
<b>Increase / (Decrease) in cash and cash equivalents during the period</b>	<b>(\$606)</b>	<b>\$1,304</b>	<b>(\$1,436)</b>	<b>(\$2,182)</b>
Cash and cash equivalents, beginning of period	\$1,075	\$703	\$1,905	\$4,189
<b>Cash and cash equivalents, end of period</b>	<b>\$469</b>	<b>\$2,007</b>	<b>\$469</b>	<b>\$2,007</b>
<b>Notes:</b>				
(1) The REIT reclassified certain items for the three months ended September 30, 2013 to conform to the current year's presentation.				

Cash flow activity for the three months ended September 30, 2014 is primarily related to the results of the REIT's operations, distributions to Unitholders, refinancing of mortgages, the utilization of the Revolving Credit Facility and disposition of investment properties. The financing activities included a net decrease in the draw on the Revolving Credit Facility during the quarter of \$9,000 such that the balance of the facility at September 30, 2014 was \$11,000.

## CAPITALIZATION AND DEBT PROFILE

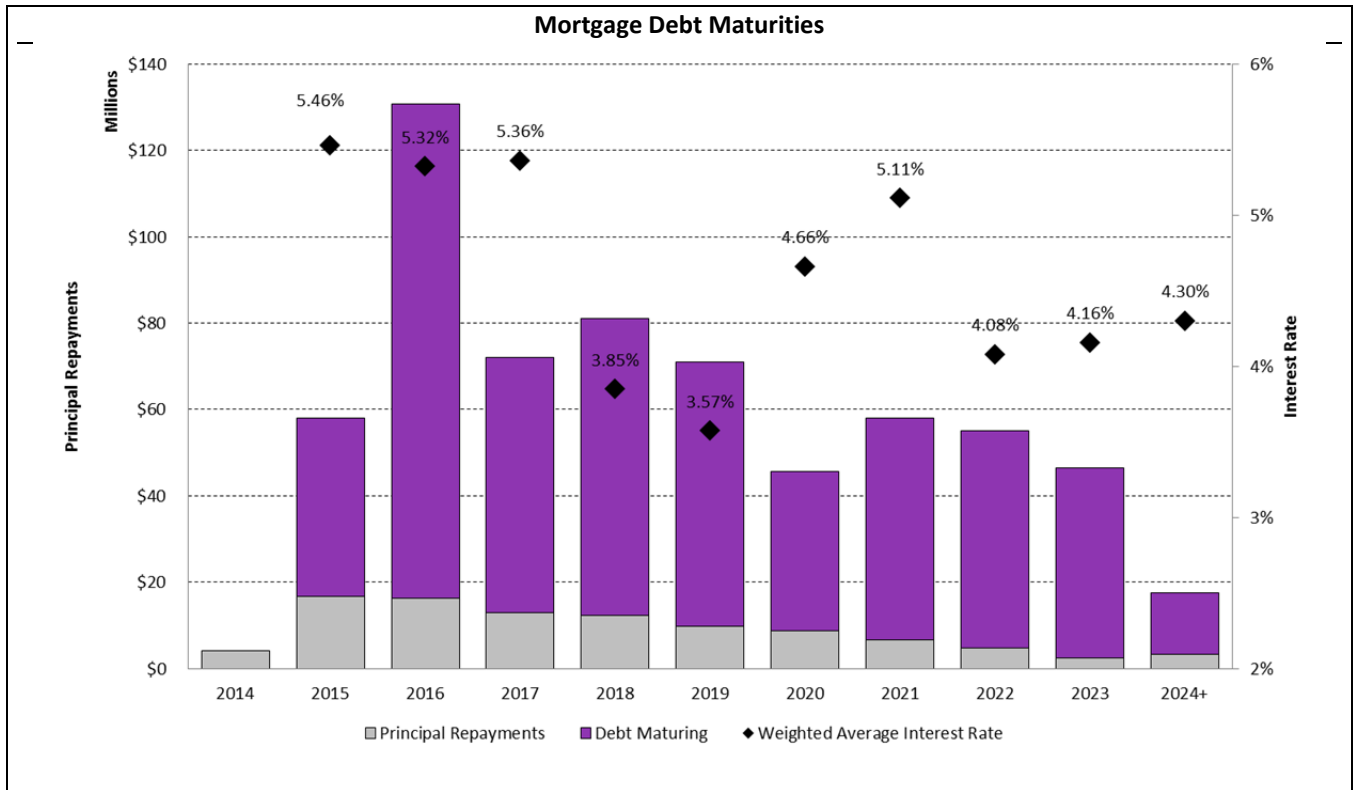
Expressed in thousands of dollars	As at September 30, 2014 (Unaudited)	As at December 31, 2013 (Unaudited)
<b>Indebtedness</b>		
Mortgages Payable	\$639,599	\$647,458
Mark-to-Market premium on Mortgages	1,285	1,927
Unamortized financing costs	(1,614)	(1,473)
	<u>639,270</u>	<u>647,912</u>
Convertible Debenture (inclusive of \$1,268 Mark-to-Market premium)	41,518	40,250
Loans Payable (net of \$219 of unamortized financing fees, December 31, 2013 - \$254)	11,507	10,467
	<u>692,295</u>	<u>698,629</u>
<b>Class B Exchangeable Units</b> (Authorized – unlimited; Issued: September 30, 2014 - 7,551,546, December 31, 2013 - 7,551,546)	73,627	78,838
<b>Unitholders' Equity</b>		
Units (Authorized – unlimited; Issued: September 30, 2014 – 39,007,026, December 31, 2013 – 38,783,403)	\$401,100	\$398,903
Retained Earnings	63,878	109,741
	<u>464,978</u>	<u>508,644</u>
<b>Total capitalization</b>	<u><b>\$1,230,900</b></u>	<u><b>\$1,286,111</b></u>

As at September 30, 2014, the REIT had a market capitalization of approximately \$453,900 (including 7,551,546 Class B Exchangeable Units) based on a closing Unit price of \$9.75 on the Toronto Stock Exchange.

### Mortgage Debt Maturities

The following table sets out, as at September 30, 2014, scheduled principal payments, debt maturity amounts and weighted average interest rate of maturing mortgages:

Expressed in thousands of dollars				Weighted Average Interest Rate of Maturing Mortgages	Percentage of Total Mortgages Payable
Year Ending December 31 <sup>st</sup>	Scheduled Principal Payments	Debt Maturing during the Year	Total Mortgages Payable		
2014	4,228	-	4,228	n/a	1%
2015	16,699	41,341	58,040	5.46%	9%
2016	16,363	114,267	130,630	5.32%	20%
2017	12,984	58,962	71,946	5.36%	11%
2018	12,333	68,812	81,145	3.85%	13%
2019	9,810	61,179	70,989	3.57%	11%
2020	8,768	36,907	45,675	4.66%	7%
2021	6,637	51,308	57,945	5.11%	9%
2022	4,857	50,264	55,121	4.08%	9%
2023	2,407	43,978	46,385	4.16%	7%
2024+	3,270	14,225	17,495	4.30%	3%
Sub-total	<u>98,356</u>	<u>541,243</u>	<u>639,599</u>	<u>4.63%</u>	<u>100%</u>
Marked to market adjustment			1,285	(0.11%)	
			640,884	<u>4.52%</u>	
Unamortized financing costs			(1,614)		
Total			<u><u>639,270</u></u>		



### **Mortgage Financing**

During the quarter the REIT completed the financing of its Mira Health Centre with a \$15,000 fixed rate mortgage, at 3.22% for a 5 year term. The previous mortgage of \$10,495 at 5.76% was early repaid in the second quarter of 2014.

During the quarter, the REIT refinanced its New Glasgow Medical Centre with fixed rate mortgage of \$7,300 at 3.90% (previous rate at 5.07%) for 10 year terms, resulting in net proceeds to the REIT of approximately \$720.

As a result of these transactions the weighted average interest rate on the REIT’s mortgages decreased to 4.63% at the end of the quarter, from 4.67% in the previous quarter, with a term to maturity of 4.8 years.

### **Revolving Bank Credit Facility**

The REIT has a \$50 million Revolving Credit Facility, which bears interest at a rate equal to the bank’s prime rate plus 1.00% or Bankers’ Acceptances plus 2.00%, with a term to March 25, 2016. The REIT also has a \$5,000 revolving Letter of Credit Facility. The Revolving Credit Facility and Letter of Credit Facility are secured by a pool of first ranking mortgages on certain properties.

Net mortgage funding during the quarter allowed the REIT to pay down the balance outstanding as at September 30, 2014 to \$11,000 from \$20,000 as at June 30, 2014.

### **Convertible Debenture**

Between September 11, 2013 and September 19, 2013 the REIT raised net proceeds of approximately \$38,158, after issuance costs of \$2,092, through the issuance of \$40,250 aggregate principal amount of 5.25% convertible unsecured subordinated debentures due September 30, 2020 (the “Convertible Debentures”) on a bought deal basis, including the subsequent exercise of an over-allotment option, to a syndicate of underwriters. The REIT used the net proceeds of the offering to repay indebtedness outstanding under its Revolving Credit Facility and for general trust purposes, thus replacing shorter-term debt with longer-term debt and improving liquidity; without materially increasing its aggregate indebtedness.

The Convertible Debentures bear interest at an annual rate of 5.25%, payable semi-annually in arrears on March 31 and September 30 in each year, commencing March 31, 2014. Each Convertible Debenture is convertible into freely-tradable REIT Units at the option of the holder at any time prior to the earlier of September 30, 2020, and the last business day immediately preceding the date specified by the REIT for redemption of the Convertible Debentures, at a conversion price of \$14.20 per REIT Unit (the "Conversion Price").

The Convertible Debentures may not be redeemed by the REIT on or prior to September 30, 2016, except in the event of the satisfaction of certain conditions after a change of control has occurred. On or after October 1, 2016 to, and including, September 30, 2018, the Convertible Debentures may be redeemed by the REIT, in whole or in part from time to time at the option of the REIT, at a price equal to the principal amount thereof plus accrued and unpaid interest to, but excluding, the date fixed for redemption on not more than 60 days' and not less than 30 days' prior written notice, provided that the current market price on the date on which notice of redemption is given is not less than 125% of the Conversion Price. On, or after, October 1, 2018 and prior to the September 30, 2020, the Convertible Debentures may be redeemed in whole or in part from time to time at the option of the REIT at a price equal to the principal amount thereof plus accrued and unpaid interest to, but excluding, the date fixed for redemption on not more than 60 days' and not less than 30 days' prior written notice.

Subject to any required regulatory approvals and provided that no event of default has occurred and is continuing, the REIT may, at its option, elect to satisfy its obligation to pay, in whole or in part, the principal amount of the Convertible Debentures that are to be redeemed or that have matured, on not more than 60 days' and not less than 30 days' prior notice, by issuing that number of freely-tradeable REIT Units obtained by dividing the principal amount of the Convertible Debentures that are to be redeemed or that have matured, as the case may be, by 95% of the current market price on the date fixed for redemption or September 30, 2020, as applicable. In addition, subject to any required regulatory approvals and provided that no event of default has occurred and is continuing, freely-tradeable REIT Units may be issued with the proceeds used to satisfy the obligation to pay interest on the Convertible Debentures.

#### **Ratios / Covenants**

Pursuant to the Declaration of Trust, the REIT may not incur or assume any indebtedness if, after giving effect to the incurring or assumption of such indebtedness, the total indebtedness of the REIT would be more than 65% of the GBV of its assets. The REIT's overall borrowing policy is to obtain secured mortgage financing on a primarily fixed rate basis, with a term to maturity that is appropriate having regard to the lease maturity profile for each property and which allows the REIT to (i) achieve and maintain staggered debt maturities to lessen exposure to interest rate fluctuations and re-financing risk in any particular period and (ii) fix the rates and extend loan terms as long as possible when borrowing conditions are favourable. Subject to market conditions and the growth of the REIT, management of the REIT currently intends to maintain indebtedness in a range of 50% to 60% of GBV. The following summarizes the status of these key ratios as at and for the three months ended September 30, 2014:

Expressed in thousands of dollars	As at/for the three months ended September 30, 2014	As at/for the three months ended September 30, 2013	As at/for the year ended December 31, 2013
	(Unaudited)	(Unaudited)	(Unaudited)
Gross Book Value	\$1,255,827	\$1,333,118	\$1,314,992
Debt (excluding Class B Exchangeable Units)	\$692,295	\$704,714	\$698,629
Debt to Gross Book Value <sup>(1)</sup>	55.1%	52.9%	53.1%
Amount of debt at fixed rates	\$631,655	\$602,383	\$638,585
Amount of debt at variable rates <sup>(2)</sup>	\$60,139	\$102,331	\$60,044
Interest coverage <sup>(3)</sup>	2.42x	2.49x	2.44x
Debt Service coverage <sup>(4)</sup>	1.59x	1.67x	1.65x
Net debt/EBITDA <sup>(5)</sup>	9.0x	8.8x	8.7x
Weighted average mortgage interest rate (at contract) <sup>(6)</sup>	4.63%	4.76%	4.80%

**Notes:**

- (1) Defined by the Declaration of Trust as total debt (excluding Class B Exchangeable Units) divided by the book value of the total assets in the consolidated balance sheet.
- (2) The REIT has entered into interest rate swap contracts to limit its exposure to fluctuations in the interest rates on \$49,358 of its variable rate debt payable as at September 30, 2014 (\$50,598 – September 30, 2013). A 1.00% change in the interest rate, on the remaining variable rate debt will change the quarterly finance cost related to the outstanding balance by \$110.
- (3) Defined as net income before fair value adjustment of investment properties, loss on disposal of investment properties, plus finance costs divided by finance costs excluding amounts related to Class B Exchangeable Units, Convertible Debenture issuance costs and fair value adjustments of financial liabilities.
- (4) Defined as net income excluding finance costs (interest, amortization of debt premiums/discounts and financing costs, distributions on Class B Exchangeable Units) and the revaluation of Class B Exchangeable Units and investment properties divided by finance costs (excluding distributions on Class B Exchangeable Units and the revaluation of Class B Exchangeable Units) and scheduled debt repayments.
- (5) Defined as debt less cash and cash equivalents divided by annualized net income before fair value adjustment of investment properties plus finance costs.
- (6) Excludes Revolving Credit Facility and Convertible Debentures. Current market weighted average mortgage interest rate is approximately 3.6%.

The ratio of Debt to GBV of 55.1% did not increase materially in the quarter from 54.9% as at June 30, 2014.

Interest rates and debt maturities are reviewed regularly by the management and trustees of the REIT (“Trustees”) to ensure the appropriate debt management strategies are implemented. The REIT intends to finance its ongoing operations with a combination of, primarily, fixed rate secured debt with staggered maturities and floating rate secured short-term, construction and/or revolving debt. The fixed rate debt is expected to be comprised primarily of first charge mortgages.

The REIT is targeting to distribute 90% of its AFFO to Unitholders, based on utilizing a stabilized reserve for leasing and capital of 6.0% of revenue from investment properties. As such, the REIT does not retain a material amount of operating cash flow to finance its capital requirements including loan principal payments, acquisitions, redevelopments, and portfolio capital expenditures. Capital requirements for loan principal payments, acquisitions and redevelopment are generally sourced by financing for each project through mortgages and/or the Revolving Credit Facility.

## PART V

### RELATED PARTY TRANSACTIONS

In connection with the REIT's IPO on March 25, 2010, subsidiaries of the REIT acquired 45 properties from NorthWest Operating Trust ("NW Trust") for total consideration of \$171,900. Part of the consideration included 7,749,772 Class B Exchangeable Units of NHP LP, a subsidiary of the REIT. These Class B Exchangeable Units, each of which are exchangeable at the option of the holder for one Unit of the REIT and that are attached to Special Voting Units of the REIT, provide for voting rights in the REIT.

As at September 30, 2014 the interest of NW Trust and its affiliates in the REIT is approximately 25.6% (23.9% on a fully diluted basis).

NW Trust is indirectly 100% owned by NorthWest International Healthcare Properties REIT ("International REIT") which acquired NW Trust from NorthWest Value Partners Inc. ("NWVP") and certain of its affiliates in September, 2013 pursuant to a put/call agreement between International REIT and NWVP, and its affiliates, dated November 16, 2012 (the "Put/Call Agreement") (see "Exercise of Put/Call Agreement By Significant Unitholder" below).

Related party transactions are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

The following are the related party transactions for the periods ended September 30<sup>th</sup>:

Expressed in thousands of dollars	Note	Three months ended	Three months ended	Nine months ended	Nine months ended
		September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
		(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenue from investment properties:					
Head lease income	(a)	\$412	432	\$1,222	1,295
Rental income	(b)	21	223	227	715
Management fee revenue:					
Leasing and construction supervision services	(b)(c)	-	206	-	211
Management services and cost sharing	(d)	-	97	2	297
Support services provided	(e)	32	23	97	65
Property operating and trust expenses:					
Support services provided	(e)	103	64	315	64
Rental expense	(f)	77	77	230	235
Interest income:					
Interest	(h)	58	8	151	26
Owen Sound Loan interest	(g)	76	76	225	224
Finance cost:					
Class B Exchangeable Units distributions		1,510	1,511	4,531	4,540
Leasing costs reimbursement	(a)(b)	-	1,179	2	1,217



The following are the related party balances as at September 30<sup>th</sup>:

Expressed in thousands of dollars	<u>Note</u>	As at	As at
		September 30, 2014 (Unaudited)	September 30, 2013 (Unaudited)
Balance sheet balances:			
Accounts receivable		\$4,107	\$2,900
Working capital adjustment payable		92	92
Loan receivable	(g)	4,000	4,000

- (a) In conjunction with its IPO the REIT entered into head leases, originally with NW Trust and subsequently assigned to an affiliate of NW Trust, on three properties. The head leases commenced March 25, 2010 and expire March 24, 2015 subject to certain rights of termination upon third party leasing of such space. The tenant is responsible for any leasing costs incurred in leasing this space and reimburses the REIT for costs incurred.
- (b) The REIT earned rental revenue from a tenant which is an affiliate of NW Trust. The lease was surrendered on September 1, 2013 and the tenant is responsible for any rental shortfall (see "Lease Surrender Agreement" below).
- (c) The REIT has a Leasing and Construction Supervision Services Agreement with an affiliate of NW Trust for the provision of supervision and leasing services at the properties subject to the head leases for a period of five years commencing March 25, 2010.
- (d) The REIT had a Management and Cost Sharing Agreement with NW Trust for the REIT to provide property management services for one property for a period of five years commencing March 25, 2010. During the three months ended December 31, 2013 the agreement was terminated by the related party following sale of the property.
- (e) The REIT has entered into a Support Services Agreement with an affiliate of NW Trust to provide each party certain general management and administrative support services for a fee based on sharing the costs incurred.
- (f) The REIT has a monthly Sublease Agreement with an affiliate of NW Trust for the REIT to lease its head office premises.
- (g) The REIT earned interest on the Owen Sound Loan at 7.5% per annum (see "Owen Sound Loan and Right of First Offer" below).
- (h) The REIT charges interest on amounts receivables relating to (a) and (b).

Additional information on the agreements governing the relationship with NW Trust are discussed under "Relationship with NW Trust" in the Annual Information Form.

#### **Lease Surrender Agreement**

On September 1, 2013 the REIT leased the space, previously leased by a tenant which is an affiliate of NW Trust, to a third party healthcare tenant. The new lease is a 10 year term with rental steps during the term of the lease. As part of the surrender agreement the tenant agreed to reimburse the REIT \$1,160 for the restoration of the premises and \$200 as a leasing and construction supervision fee. As part of the agreement the tenant is responsible for any rental shortfall between the rent and parking income derived from the new tenant as compared to the rent that would have been paid by the tenant for the period September 1, 2013 to December 31, 2018, the original expiry date of the lease held by the tenant.

#### **Phase II Development Agreement – Glenmore Professional Centre**

As part of the REIT's acquisition of Glenmore Professional Centre in December, 2010, from an affiliate of NW Trust, the REIT and NW Trust contracted to enter into a development arrangement with respect to the vacant development parcel at the property. The timing for completion of such an arrangement remains subject to mutual agreement.

#### **Owen Sound Loan and Right of First Offer**

On December 23, 2011 the REIT granted a loan in the amount of \$8,000 (the "Owen Sound Loan") to a party which is indirectly owned 50% by NWVP, an affiliate of NW Trust. The Owen Sound Loan bears interest at 7.5% per annum with a maturity date extended to December 12, 2014. The Owen Sound Loan is secured by the pledge of certain securities of the borrower and is guaranteed by certain affiliates of the borrower; each limited to 50% of the obligations under the Owen Sound Loan. In exchange for the Owen Sound Loan, the REIT was granted a right of first offer to acquire a recently completed 73,500 square foot medical office building in Owen Sound, Ontario.

### Exercise of Put/Call Agreement By Significant Unitholder

On June 21, 2013, International REIT announced that, pursuant to a put right held by NWVP, an affiliate of NW Trust, under the Put/Call Agreement, International REIT had acquired NW Trust from NWVP and its affiliates. The interest in the REIT acquired by International REIT, by way of its purchase of NW Trust, consists of 4,345,900 Units of the REIT and 7,551,546 Class B Exchangeable Units of NHP LP, which are exchangeable on a one-for-one basis for Units of the REIT. NW Trust also holds certain board appointment rights, preemptive rights and registration rights related to the REIT.

Pursuant to the terms of the Put/Call Agreement, International REIT acquired the securities of the REIT at a price of \$13.22 per Unit, for total gross consideration of approximately \$157,300 less approximately \$73,800 of debt (at approximately 4.25%) that was indirectly assumed by International REIT.

Paul Dalla Lana, Chair and Chief Executive Officer of International REIT, is the sole shareholder of NWVP and is the Chair of the REIT.

### **HEAD LEASES**

A summary of Head Lease space as well as space which has been sub-leased to third parties is presented below. Pursuant to the terms of the Head Lease agreement, NW Trust is required to pay for any potential shortfalls in rent for space sub-leased to third parties for the duration of the Head Lease term.

<b>Property</b>	<b>Head Lease Summary</b>			<b>Sub-Leased to Third Parties<sup>(1)</sup></b>		
	<b>At September 30, 2014</b>			<b>GLA</b>	<b>Min. Rent (psf)<sup>(2)</sup></b>	<b>Lease Expiry</b>
Rockyview Professional Centre II	51,177	\$21.00	Mar-15	45,922	\$16.24	Jul-25 <sup>(3)</sup>
HealthPark	29,932	16.25	Mar-15	19,774 <sup>(4)</sup>	9.84	Apr-24 <sup>(3)</sup>
Riley Park Health Centre	20,271	30.00	Mar-15	-	-	
<b>Total / Weighted averages</b>	<b>101,380</b>	<b>\$21.40</b>		<b>61,225</b>	<b>\$14.64</b>	

**Notes:**  
(1) As at November 6, 2014  
(2) Represents straight line annual minimum rent psf for the Head Lease term and excludes subsequent rent escalations  
(3) Represents the latest lease expiry for the respective property.  
(4) Includes managed clinic space which provides ancillary revenue.

The REIT did not lease additional head lease space to third parties during the quarter. However the REIT commenced operations at its managed clinic which occupies 4,471 square feet of head lease space. This is in connection with the REIT's recently introduced strategy of opening and operating a 'turnkey' clinic at select properties where the demand for such an offering is evident. The REIT is actively pursuing leases for approximately 8,400 square feet of the remaining head lease space. Should no additional leasing be completed on the head lease space this would translate to an estimated reduction of revenue of \$1,646 on an annual basis.

## PART VI

### SUMMARY OF QUARTERLY RESULTS

The following sets out summary information for the eight most recently completed quarters since the REIT commenced operations:

Expressed in thousands of dollars	Q3 2014	Q2 2014	Q1 2014	Q4 2013
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Revenue from operations</b>	<b>\$37,103</b>	<b>\$37,411</b>	<b>\$39,190</b>	<b>\$38,425</b>
Property operating expenses	17,109	16,857	19,052	17,684
<b>Operating income</b>	<b>19,994</b>	<b>20,554</b>	<b>20,138</b>	<b>20,741</b>
Finance cost	7,965	8,382	8,160	8,260
Interest income	(210)	(233)	(213)	(196)
Trust expenses	932	1,254	864	823
<b>Income before undernoted items</b>	<b>11,306</b>	<b>11,151</b>	<b>11,327</b>	<b>11,854</b>
Finance cost:				
Class B Exchangeable Unit distributions	(1,510)	(1,511)	(1,510)	(1,510)
Fair value adjustment of Class B Exchangeable Units	1,888	(3,398)	6,721	5,437
Fair value adjustment of Convertible Debentures	(865)	(202)	(201)	(805)
Fair value adjustment of other financial instruments	(110)	(536)	(1,234)	210
Fair value adjustment of investment properties	(3,207)	(49,181)	(428)	(14,428)
Net loss on disposal of investment properties	(36)	(638)	(349)	-
<b>Net income / (loss)</b>	<b>7,467</b>	<b>(44,315)</b>	<b>14,326</b>	<b>758</b>
<b>NOI</b>	<b>19,994</b>	<b>20,554</b>	<b>20,138</b>	<b>20,741</b>
FFO – previous presentation			11,327	11,854
Internal leasing costs			401	405
Fair value adjustment to deferred unit plan liability			(219)	(101)
<b>FFO – current presentation<sup>(1)</sup></b>	<b>11,655</b>	<b>11,780</b>	<b>11,509</b>	<b>12,158</b>
FFO per unit (Adjusted basic) <sup>(1)(2)</sup>	\$0.25	\$0.25	\$0.25	\$0.26
FFO per unit (Adjusted fully diluted) <sup>(1)(2)</sup>	\$0.25	\$0.25	\$0.24	\$0.26
AFFO – previous presentation			\$9,522	\$10,042
Internal leasing costs			401	405
Reserve adjustment			(587)	(574)
Net reserve increase			(186)	(169)
<b>AFFO – current presentation<sup>(1)</sup></b>	<b>\$9,574</b>	<b>\$9,966</b>	<b>\$9,336</b>	<b>\$9,873</b>
AFFO per unit (Adjusted basic) <sup>(1)(2)</sup>	\$0.21	\$0.21	\$0.20	\$0.21
AFFO per unit (Adjusted fully diluted) <sup>(1)(2)</sup>	\$0.20	\$0.21	\$0.20	\$0.21
AFFO payout ratio (Adjusted basic)	97%	93%	99%	94%
AFFO payout ratio (Adjusted fully diluted)	98%	95%	100%	95%
Distributions <sup>(3)</sup>	9,306	9,291	9,275	9,263
Distributions per Unit	\$0.20	\$0.20	\$0.20	\$0.20
Total Assets	\$1,255,827	\$1,254,849	\$1,310,412	\$1,314,992
Debt (excluding Class B Exchangeable Units)	\$692,295	\$689,105	\$696,379	\$698,629
Debt to Gross Book Value	55.1%	54.9%	53.1%	53.1%
Number of properties	74	75	76	78
Gross leasable area	4,562,195	4,572,882	4,634,670	4,695,333
Occupancy % – period end	91.8%	92.1%	91.8%	91.3%
Number of employees	140	139	140	140

**Notes:**

- (1) Prior periods FFO comparative information has been restated to include the add-back of internal leasing costs to FFO and the impact of fair value adjustments to the REIT's deferred unit plan liability. Prior period AFFO comparative information has been restated to reflect the increase in AFFO reserve for stabilized leasing costs, tenant improvements and growth capital expenditures in the calculation of AFFO.
- (2) Under IFRS the REIT's Class B Exchangeable Units are treated as a financial liability rather than equity. As is permitted under IFRS the REIT has chosen to present an adjusted basic and diluted per unit measure for FFO and AFFO that includes the Class B Exchangeable Units in basic and diluted weighted average units outstanding.
- (3) Includes distributions on Class B Exchangeable Units.

Expressed in thousands of dollars	Q3 2013	Q2 2013	Q1 2013	Q4 2012
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Revenue from operations</b>	<b>\$37,683</b>	<b>\$36,882</b>	<b>\$37,120</b>	<b>\$36,704</b>
Property operating expenses	16,954	16,676	17,275	16,629
<b>Operating income</b>	<b>20,729</b>	<b>20,206</b>	<b>19,845</b>	<b>20,075</b>
Finance cost	10,124	7,970	7,721	8,118
Interest income	(200)	(235)	(185)	(502)
Trust expenses	930	933	956	808
<b>Income before undernoted items</b>	<b>9,875</b>	<b>11,538</b>	<b>11,353</b>	<b>11,651</b>
Finance cost:				
Class B Exchangeable Unit distributions	(1,511)	(1,510)	(1,519)	(1,523)
Fair value adjustment of Class B Exchangeable Units	2,341	9,515	(1,912)	4,569
Fair value adjustment of Convertible Debentures	805	-	-	-
Fair value adjustment of other financial instruments	194	2,316	99	8
Fair value adjustment of investment properties	(217)	(7,709)	2,177	9,101
Net loss on disposal of investment properties	-	-	(73)	-
<b>Net income / (loss)</b>	<b>11,487</b>	<b>14,150</b>	<b>10,125</b>	<b>23,806</b>
<b>NOI</b>	<b>20,729</b>	<b>20,206</b>	<b>19,845</b>	<b>20,075</b>
FFO – previous presentation	11,967	11,538	11,353	11,651
Internal leasing costs	356	372	348	302
Fair value adjustment to deferred unit plan liability	6	(133)	103	(31)
<b>FFO – current presentation</b> <sup>(1)</sup>	<b>12,329</b>	<b>11,777</b>	<b>11,804</b>	<b>11,922</b>
FFO per unit (Adjusted basic) <sup>(1)(2)</sup>	\$0.27	\$0.25	\$0.26	\$0.26
FFO per unit (Adjusted fully diluted) <sup>(1)(2)</sup>	\$0.26	\$0.25	\$0.25	\$0.26
AFFO – previous presentation	\$10,148	9,680	9,537	9,664
Internal leasing costs	356	372	348	302
Reserve adjustment	(559)	(551)	(555)	(549)
Net reserve increase	(203)	(179)	(207)	(247)
<b>AFFO – current presentation</b> <sup>(1)</sup>	<b>\$9,945</b>	<b>\$ 9,501</b>	<b>\$9,330</b>	<b>\$9,417</b>
AFFO per unit (Adjusted basic) <sup>(1)(2)</sup>	\$0.22	\$0.21	\$0.20	\$0.21
AFFO per unit (Adjusted fully diluted) <sup>(1)(2)</sup>	\$0.21	\$0.20	\$0.20	\$0.21
AFFO payout ratio (Adjusted basic)	93%	97%	99%	96%
AFFO payout ratio (Adjusted fully diluted)	94%	98%	99%	96%
Distributions <sup>(3)</sup>	9,242	9,239	9,230	9,103
Distributions per Unit	\$0.20	\$0.20	\$0.20	\$0.20
Total Assets	\$1,333,118	\$1,302,951	\$1,285,854	\$1,281,477
Debt (excluding Class B Exchangeable Units)	\$704,714	\$678,795	\$661,151	\$661,222
Debt to Gross Book Value	52.9%	52.1%	51.4%	51.6%
Number of properties	78	77	76	77
Gross leasable area	4,686,027	4,609,212	4,583,850	4,597,358
Occupancy % – period end	92.0%	91.6%	91.3%	91.2%
Number of employees	144	144	143	134
<b>Notes:</b>				
(1)	Prior periods FFO comparative information has been restated to include the add-back of internal leasing costs to FFO and the impact of fair value adjustments to the REIT's deferred unit plan liability. Prior period AFFO comparative information has been restated to reflect the increase in AFFO reserve for stabilized leasing costs, tenant improvements and growth capital expenditures in the calculation of AFFO.			
(2)	Under IFRS the REIT's Class B Exchangeable Units are treated as a financial liability rather than equity. As is permitted under IFRS the REIT has chosen to present an adjusted basic and diluted per unit measure for FFO and AFFO that includes the Class B Exchangeable Units in basic and diluted weighted average units outstanding.			
(3)	Includes distributions on Class B Exchangeable Units.			

## **PART VII**

### **SIGNIFICANT ACCOUNTING POLICIES**

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities as at each financial statement date, and revenues and expenses for the periods indicated. Actual results could differ from those estimates. The significant judgments and key estimates made by the management of the REIT, and the REIT's significant accounting policies, are described in note 1 and note 2 of the REIT's condensed consolidated interim financial statements for the three and nine months ended September 30, 2014 and in note 1 and note 2 of the REIT's consolidated financial statements for the year ended December 31, 2013.

Beginning January 1, 2014 the REIT has applied the following new accounting standards, or amendments to existing standards, for the first time:

- IAS 32, Financial Instruments: Presentation
- IFRIC 21, Levies

The adoption of these new accounting standards, or amendments, did not have a material impact on the REIT's condensed consolidated interim financial statements. For additional information on the adoption of these standards see note 2 of the REIT's condensed consolidated interim financial statements for the three and nine months ended September 30, 2014.

## **PART VIII**

### **RISKS AND UNCERTAINTIES**

There are certain risks inherent in an investment in the Units, Convertible Debentures and in the activities of the REIT, which current and prospective Unitholders and current or prospective investors in Convertible Debentures should carefully consider. For a full list and explanation of the REIT's risks and uncertainties refer to "Risks and Uncertainties" in the REIT's MD&A for the three months and year ended December 31, 2013 and in the Annual Information Form, both of which can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Real Property Ownership and Tenant Risks**

The REIT owns the properties in its portfolio and is expected in the future to acquire interests in other real property. All real property investments are subject to elements of risk. By specializing in a particular type of real estate, the REIT is exposed to adverse effects on that segment of the real estate market and does not benefit from a diversification of its portfolio by property type.

The value of real property and any improvements thereto depends on the credit and financial stability of tenants, and upon the vacancy rates of the properties. AFFO will be adversely affected if a significant number of tenants are unable to meet their obligations under their leases or if a significant amount of available space in the properties in which the REIT will have an interest become vacant and are not able to be leased on economically favourable lease terms.

Upon the expiry of any lease, there can be no assurance that the lease will be renewed or the tenant replaced. The terms of any subsequent lease may be less favourable to the REIT than the existing lease. In the event of default by a tenant, delays or limitations in enforcing rights as lessor may be experienced and substantial costs in protecting the REIT's investment may be incurred. Furthermore, at any time, a tenant of any of the properties in which the REIT has an interest may seek the protection of bankruptcy, insolvency or similar laws that could result in the disclaimer and termination of such tenant's lease, any of which events could have an adverse effect on the REIT's financial condition and results of operations and decrease the amount of cash available for distribution to Unitholders. Certain of the REIT's tenants may require licenses to operate their business, such as laboratories. To the extent these businesses are unable to obtain licenses or maintain existing licenses; the REIT's operations may be adversely impacted. The ability to rent unleased space in the properties in which the REIT will have an interest will be affected by many factors, including

general economic conditions, local real estate markets, changing demographics, supply and demand for leased premises, competition from other available premises and various other factors, many of which are beyond the REIT's control.

### **Liquidity**

Real property investments tend to be relatively illiquid, with the degree of liquidity generally fluctuating in relation to demand for and the perceived desirability of such investments. Such illiquidity may limit the REIT's ability to vary its portfolio promptly in response to changing economic or investment conditions. If the REIT were to be required to liquidate its real property investments, the proceeds to the REIT might be significantly less than the aggregate carrying value of its properties which could have an adverse effect on the REIT's financial condition and results of operation and decrease the amount of cash available for distribution to Unitholders.

### **Access to Capital**

The real estate industry is highly capital intensive. The REIT will require access to capital to maintain its properties, as well as to fund its growth strategy and significant capital expenditures from time to time. Although the REIT's Revolving Credit Facility is available for acquisitions, there can be no assurances that the REIT will otherwise have access to sufficient capital or access to capital on terms favourable to the REIT for future property acquisitions, financing or refinancing of properties, funding operating expenses or other purposes. In addition, the REIT may not be able to borrow funds under the Revolving Credit Facility due to the limitations on the incurrence of debt by the REIT set forth in the Declaration of Trust. Failure by the REIT to access required capital could adversely impact the REIT's financial condition and results of operations and decrease the amount of cash available for distribution.

### **Financing Risks**

As at September 30, 2014 the REIT had outstanding indebtedness of approximately \$692,295, excluding Class B Exchangeable Units. Although a portion of the cash flow generated by investment properties will be devoted to servicing such debt, there can be no assurance that the REIT will continue to generate sufficient cash flow from operations to meet required interest and principal payments. If the REIT is unable to meet interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing. The failure of the REIT to make or renegotiate interest or principal payments or obtain additional equity, debt or other financing could adversely impact the REIT's financial condition and results of operations and decrease the amount of cash available for distribution to Unitholders.

The REIT will be subject to the risks associated with debt financing, including the risk that the mortgages and banking facilities secured by the REIT's properties will not be able to be refinanced or that the terms of such refinancing will not be as favourable as the terms of existing indebtedness, which may reduce AFFO. In order to minimize this risk, the REIT will attempt to diversify the term structure of its debt so that in no one year a disproportionate amount of its debt matures. As at September 30, 2014, \$60,640 of the REIT's total indebtedness is at variable rates. This will result in fluctuations in the REIT's cost of borrowing as interest rates change. To the extent that interest rates rise, the REIT's operating results and financial condition could be adversely affected and decrease the amount of cash available for distribution. To mitigate this risk the REIT has entered into an interest rate swap contract to limit its exposure to fluctuations in the interest rates on \$49,640 of its variable rate debt payable as at September 30, 2014. In addition, the REIT has conduit loans outstanding as at September 30, 2014. Access to this type of financing has diminished. Although substantially all of the amounts outstanding under the REIT's conduit loans mature in 2015 or later, there is a risk that the REIT may not be able to refinance such loans on similar terms, although, based upon the REIT's current loan-to-value ratios and loan amortizations, the REIT expects to be able to refinance such conduit loans as they come due.

The Revolving Credit Facility contains covenants that require the REIT to maintain certain financial ratios on a consolidated basis. If the REIT does not maintain such ratios, its ability to make distributions will be limited.

### **Environmental Matters**

Environmental legislation and regulations have become increasingly important in recent years. As an owner of interests in real property in Canada, the REIT is subject to various Canadian federal, provincial and municipal laws relating to environmental matters. Such laws provide that the REIT could be, or become, liable for environmental harm, damage or costs, including with respect to the release of hazardous, toxic or other regulated substances into the environment, and the removal or other remediation of hazardous, toxic or other regulated substances that may be present at or under its properties. Further, liability may be incurred by the REIT with respect to the release of such substances from the REIT's

properties to properties owned by third parties, including properties adjacent to the REIT's properties. The failure to remove or otherwise address such substances or properties, if any, may adversely affect the REIT's ability to sell such property, realize the full value of such property or borrow using such property as collateral security, and could potentially result in claims against the REIT by public or private parties by way of civil action.

The REIT's operating policy is to obtain a Phase I environmental site assessment, conducted by an independent and experienced environmental consultant, prior to acquiring a property and to have Phase II environmental site assessment work completed where recommended in a Phase I environmental site assessment. Although such environmental site assessments would provide the REIT with some level of assurance about the condition of property, the REIT may become subject to liability for undetected contamination or other environmental conditions at its properties against which the REIT cannot insure, or against which the REIT may elect not to insure, which could negatively impact the REIT's financial condition and results of operations and decrease the amount of cash available for distribution.

The REIT is not aware of any material non-compliance with environmental laws at any of its properties, and is not aware of any pending or threatened investigations or actions by environmental regulatory authorities in connection with any of its properties. The REIT has implemented policies and procedures to assess, manage and monitor environmental conditions at its properties to manage exposure to liability.

The REIT will make the necessary capital and operating expenditures to comply with environmental laws and address any material environmental issues and such costs relating to environmental matters may have a material adverse effect on the REIT's business, financial condition or results of operation and decrease the amount of cash available for distribution. However, environmental laws can change and the REIT may become subject to even more stringent environmental laws in the future, with increased enforcement of laws by the government. Compliance with more stringent environmental laws, which may be more rigorously enforced, the identification of currently unknown environmental issues or an increase in the costs required to address a currently known condition may have an adverse effect on the REIT's financial condition and results of operation and decrease the amount of cash available for distribution to Unitholders.

#### **NW Trust Indemnity and Prior Commercial Operations**

The indirect acquisition of the properties owned by the REIT in connection with its IPO included the indirect acquisition from NW Trust of all of the outstanding partnership units of Healthcare Properties LP ("HPLP"). Pursuant to the related acquisition agreement ("Acquisition Agreement"), NW Trust made certain representations and warranties to the REIT with respect to HPLP. NW Trust also provided an indemnity to the REIT under the Acquisition Agreement that, subject to certain conditions and thresholds, NW Trust will indemnify the REIT for breaches of such representations and warranties. Prior to September 25, 2011, NW Trust covenanted to maintain (i) minimum net assets of \$20 million plus (ii) an amount equal to the present value of its basic and additional rent obligations under the Head Leases plus 25% of tenant inducement obligations, from time to time (the "Head Lease Security"), calculated using a discount rate equal to the appropriate Government of Canada bond rate. On September 25, 2011, NW Trust's covenant to maintain minimum net assets of \$20 million expired, but its covenant to maintain the Head Lease Security will survive for the remaining term of the Head Leases (which expire in March 2015). There can be no assurance that the REIT will be fully protected in the event of a breach of NW Trust's obligations under the Head Leases or a breach of the surviving representations and warranties or that NW Trust will be in a position to indemnify the REIT if any such breach occurs. The REIT may not be able to successfully enforce the indemnity contained in the Acquisition Agreement against NW Trust or such indemnity may not be sufficient to fully indemnify the REIT from third party claims. The REIT may also be subject to undisclosed liability to third parties as a result of the prior history of HPLP and such liability may be material, which could negatively impact the REIT's financial condition and results of operations and decrease the amount of cash available for distribution. The REIT has advanced an \$8 million loan to a joint venture in which NW Trust indirectly holds a 50% interest and is accordingly subject to the risks associated with having a loan outstanding.

See "Related Party Transactions."

#### **Phase II Development Agreement – Glenmore Professional Centre**

There can be no assurances that the prospective future development of the additional parcel at the Glenmore Professional Centre (the "Phase II Development Agreement") will be achieved, in which case the vendor has the right, after a mutually agreed upon future date, to require the REIT to obtain a severance of the development parcel and re-convey such parcel to the vendor or as it may direct for \$2,950. In such event, the vendor will be obligated to replace



any existing parking stalls lost as a result with on-site (except during construction) surface or underground parking stalls. There exist certain costs (which may be substantial) and certain risks traditionally associated with land severances including the availability of, or conditions to, municipal consent and accordingly, there is no guarantee that the REIT will be able to secure such land severance. Even if the Phase II Development Agreement is achieved, there exist certain risks traditionally associated with real estate development. The Phase II development would be subject to construction risks attributable to construction projects, including construction delays, the availability and timing of municipal approvals, and cost overruns.

#### **Tax-Related Risk Factors**

Management of the REIT believes the REIT currently qualifies as a mutual fund trust for income tax purposes. If the REIT were not to so qualify, the consequences could be material and adverse. The *Income Tax Act* (Canada) contains rules (the "SIFT Rules"), which tax certain publicly traded or listed trusts in a manner similar to corporations and taxes certain distributions from such trusts as taxable dividends from a taxable Canadian corporation. Distributions paid by a SIFT as returns of capital will generally not be subject to the tax.

The SIFT Rules are not applicable to a real estate investment trust that meets prescribed conditions relating to the nature of its assets and revenue (the "REIT Exception"). Unless the REIT qualifies for the REIT Exception, the SIFT Rules could impact the level of cash distributions which would otherwise be made by the REIT and the taxation of such distributions to Unitholders.

Management of the REIT has determined that the REIT is not subject to the SIFT tax as it currently meets the REIT Exception and plans to continue to do so in the future. Accordingly, no current income tax expense or deferred income tax assets or liabilities have been recorded in the condensed consolidated financial statements for the three and nine months ended September 30, 2014.

The REIT Exception is applied on an annual basis. As such, it will not be possible to determine if the REIT will satisfy the conditions of the REIT Exception for 2014 or any subsequent year until the end of the particular year.

## **PART IX**

### **CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures and Internal Controls Over Financial Reporting**

The REIT's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, utilizing the 1992 Internal Control-Integrated Framework ("1992 Framework") issued by the Committee of Sponsoring Organization of the Treadway Commission ("COSO"), the REIT's disclosure controls and procedures to provide reasonable assurance that (i) material information relating to the REIT, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the filings are being prepared, and (ii) material information required to be disclosed in the filings or other reports filed or submitted by the REIT under securities legislation is recorded, processed, summarized and reported on a timely basis and within the time period specified by securities legislation.

#### **Changes in Internal Controls Over Financial Reporting**

There were no significant changes made in internal controls over financial reporting during the three months ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, the REIT's internal controls over financial reporting.

In 2013, COSO issued an updated Internal Control – Integrated Framework. COSO will continue to make available the original 1992 Framework during the transition period extending to December 15, 2014 after which time the REIT will consider if it is superseded by the updated version.

For additional information on the REIT's disclosure controls and procedures and internal controls over financial reporting refer to "Controls and Procedures" in the REIT's MD&A for the three months and year ended December 31, 2013, which can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **PART X**

### **SUBSEQUENT EVENTS**

- Following the retirement of Ernie Spraggs, the REIT's chief financial officer ("CFO"), Matthew Berridge, the REIT's Director, Financial Reporting, assumed the role of interim CFO.
- The REIT declared distributions of \$0.06667 per Unit to Unitholders of record as at October 31, 2014.

## **PART XI**

### **FINANCIAL OUTLOOK AND MARKET GUIDANCE**

There is no material change to the operating or economic environment within which the REIT operates.

In order to achieve its objectives the REIT will focus on:

- Increasing occupancy in the portfolio
- Maximizing net operating income
- Acquiring assets on an accretive basis
- Improving operational productivity
- Selling non-core assets to recycle capital to maximize returns

Since the IPO, to date, the REIT has completed or announced the acquisition of over \$570,000 of healthcare assets. The REIT will continue to pursue accretive acquisitions of quality properties, with a focus on properties within markets the REIT already operates, and a preference for well-occupied, well-built and well-located properties in order to consistently improve the REIT's portfolio quality. The REIT will also dispose of certain non-core properties from time to time, when market conditions warrant, to improve portfolio quality and recycle capital for other investments.