Consolidated Financial Statements
For the years ended December 31, 2017 and 2016

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements and management's discussion and analysis of results of operations and financial condition (MD&A) have been prepared by the management of Killam Apartment REIT in accordance with International Financial Reporting Standards, and include amounts based on management's informed judgements and estimates. Management is responsible for the integrity and objectivity of these consolidated financial statements. The financial information presented in the MD&A is consistent with that in the consolidated financial statements in all material respects.

To assist management in the discharge of these responsibilities, management has established the necessary internal controls designed to ensure that our financial records are reliable for preparing financial statements and other financial information, transactions are properly authorized and recorded, and assets are safeguarded.

As at December 31, 2017, our Chief Executive Officer and Chief Financial Officer evaluated, or caused an evaluation under their direct supervision of, the design and operation of our internal controls over financial reporting (as defined in National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings) and, based on that assessment, determined that our internal controls over financial reporting were appropriately designed and operating effectively.

Ernst & Young LLP, the auditors appointed by the Unitholders, have examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the Unitholders their opinion on the consolidated financial statements. Their report as auditors is set forth below.

The consolidated financial statements have been further reviewed and approved by the Board of Trustees and its Audit Committee. This committee meets regularly with management and the auditors, who have full and free access to the Audit Committee.

February 13, 2018

Philip Fraser
President and Chief Executive Officer

Dale Noseworthy
Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Unitholders of Killam Apartment Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of **Killam Apartment Real Estate Investment Trust,** which comprise the consolidated statements of financial position as at December 31, 2017 and 2016 and the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Killam Apartment Real Estate Investment Trust** as at December 31, 2017 and 2016 and its financial performance and cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Halifax, Canada
February 13, 2018

Chartered Professional Accountants
Licensed Public Accountants

Consolidated Statements of Financial Position

In thousands of Canadian dollars

As at December 31,

	Note	2017	2016
ASSETS			
Non-current assets			
Investment properties	[5]	**$2,279,763**	$1,942,809
Property and equipment	[7]	**5,192**	4,787
Other non-current assets	[8]	**659**	1,246
		$2,285,614	$1,948,842
Current assets			
Cash		**$12,000**	$24,652
Rent and other receivables	[10]	**2,355**	2,895
Other current assets	[9]	**11,241**	11,540
		25,596	39,087
TOTAL ASSETS		**$2,311,210**	$1,987,929
EQUITY AND LIABILITIES			
Unitholders' equity	[17]	**$967,618**	$750,450
Accumulated other comprehensive loss ("AOCL")		**(37)**	(97)
Non-controlling interest		**141**	113
Total Equity		**$967,722**	$750,466
Non-current liabilities			
Mortgages and loans payable	[11]	**$951,645**	$885,652
Convertible debentures	[15]	**—**	46,690
Other liabilities		**12,161**	12,859
Exchangeable units	[16]	**54,937**	46,158
Deferred income tax	[21]	**103,206**	84,547
Deferred unit-based compensation	[19]	**4,501**	2,988
		$1,126,450	$1,078,894
Current liabilities			
Mortgages and loans payable	[11]	**$136,862**	$111,862
Construction loans	[13]	**41,046**	18,509
Accounts payable and accrued liabilities	[14]	**39,130**	28,198
		217,038	158,569
Total Liabilities		**$1,343,488**	$1,237,463
TOTAL EQUITY AND LIABILITIES		**$2,311,210**	$1,987,929
Commitments and contingencies	[25]		
Financial guarantees	[26]		

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board of Trustees

G. W. Watson

Trustee

Philip Fraser

Trustee

Consolidated Statements of Income and Comprehensive Income

In thousands of Canadian dollars

For the years ended December 31,

	Note	2017	2016
Property revenue		**$187,377**	$175,269
Property operating expenses			
Operating expenses		**(30,444)**	(29,097)
Utility and fuel expenses		**(19,668)**	(20,462)
Property taxes		**(22,045)**	(20,286)
		(72,157)	(69,845)
Net operating income		**$115,220**	$105,424
Other income		**847**	1,227
Financing costs	[20]	**(33,126)**	(36,193)
Depreciation		**(787)**	(884)
Amortization of deferred financing costs		**(1,720)**	(1,505)
Administration		**(12,958)**	(12,733)
Fair value adjustment on convertible debentures		**690**	1,118
Fair value adjustment on unit-based compensation		**(534)**	(826)
Fair value adjustment on exchangeable units	[16]	**(8,811)**	(7,774)
Fair value adjustment on investment properties	[5]	**64,857**	(3,749)
Loss on disposition		**(259)**	(264)
Income before income taxes		**123,419**	43,841
Deferred tax (expense) recovery	[21]	**(18,659)**	27,598
Net income		**$104,760**	$71,439
Other comprehensive income			
Item that may be reclassified subsequently to net income			
Amortization of loss in AOCL to financing costs		**60**	59
Comprehensive income		**$104,820**	$71,498
Net income attributable to:			
Unitholders		**104,732**	67,982
Non-controlling interest		**28**	3,457
		$104,760	$71,439
Comprehensive income attributable to:			
Unitholders		**104,792**	68,041
Non-controlling interest		**28**	3,457
		$104,820	$71,498

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Equity

In thousands of Canadian dollars

Year ended December 31, 2017	**Trust Units**	**Contributed Surplus**	**Retained Earnings**	**AOCL**	**Non-controlling Interest**	**Total Equity**
As at January 1, 2017	**$560,197**	**$795**	**$189,458**	**($97)**	**$113**	**$750,466**
Exchange of exchangeable units	**32**	**—**	**—**	**—**	**—**	**32**
Distribution reinvestment plan	**11,104**	**—**	**—**	**—**	**—**	**11,104**
Deferred unit-based compensation	**349**	**—**	**—**	**—**	**—**	**349**
Issued for cash	**147,176**	**—**	**—**	**—**	**—**	**147,176**
Net income	**—**	**—**	**104,732**	**—**	**28**	**104,760**
Amortization of loss on forward interest rate hedge	**—**	**—**	**—**	**60**	**—**	**60**
Distributions declared and paid	**—**	**—**	**(42,028)**	**—**	**—**	**(42,028)**
Distributions payable	**—**	**—**	**(4,197)**	**—**	**—**	**(4,197)**
At December 31, 2017	**$718,858**	**$795**	**$247,965**	**($37)**	**$141**	**$967,722**

Year ended December 31, 2016	Trust Units	Capital Stock	Contributed Surplus	Other Paid-in Capital	Retained Earnings	AOCL	Non-controlling Interest	Total Equity
As at January 1, 2016	$—	$484,132	$2,150	$5,681	$177,863	($156)	$15,658	$685,328
REIT conversion	447,566	(484,132)	(1,355)	(5,681)	(12,463)	—	—	(56,065)
Exchange of exchangeable units	11,043	—	—	—	—	—	—	11,043
Distribution reinvestment plan	6,482	—	—	—	—	—	—	6,482
Deferred unit-based compensation	323	—	—	—	—	—	—	323
Issued for cash	93,623	—	—	—	—	—	—	93,623
Issuance of units for acquisitions	1,160	—	—	—	—	—	—	1,160
Net income	—	—	—	—	67,982	—	3,457	71,439
Amortization of loss on forward interest rate hedge	—	—	—	—	—	59	—	59
Distributions on non-controlling interest	—	—	—	—	—	—	(505)	(505)
Acquisition of non-controlling interest	—	—	—	—	(5,599)	—	(18,497)	(24,096)
Distributions declared and paid	—	—	—	—	(34,908)	—	—	(34,908)
Distributions payable	—	—	—	—	(3,417)	—	—	(3,417)
At December 31, 2016	$560,197	$—	$795	$—	$189,458	($97)	$113	$750,466

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

In thousands of Canadian dollars

For the years ended December 31,

	Note	2017	2016
OPERATING ACTIVITIES			
Net income		**$104,760**	$71,439
Add (deduct) items not affecting cash			
Fair value adjustments		**(56,203)**	11,231
Depreciation and amortization		**2,507**	2,389
Non-cash compensation expense		**1,021**	1,323
Deferred income taxes		**18,659**	(27,598)
Loss on disposition		**259**	264
Interest expense on exchangeable units		**2,383**	2,659
Net change in non-cash operating activities	[23]	**9,530**	2,304
Cash provided by operating activities		**$82,916**	$64,011
FINANCING ACTIVITIES			
Deferred financing costs paid		**(4,426)**	(4,685)
Net proceeds on issuance of units		**147,285**	93,491
Cash paid on vesting of restricted units		**(520)**	(427)
Redemption of convertible debentures		**(46,000)**	(57,500)
Proceeds of repayment of mezzanine loan		**—**	4,000
Mortgage financing		**183,835**	200,537
Mortgages repaid on maturity		**(76,073)**	(105,831)
Mortgage principal repayments		**(35,467)**	(31,662)
Proceeds from construction loans		**32,254**	10,558
Construction loans repaid on maturity		**(9,717)**	—
Distributions paid to non-controlling interest		**—**	(24,610)
Distributions to unitholders		**(36,711)**	(31,515)
Cash provided by financing activities		**$154,460**	$52,356
INVESTING ACTIVITIES			
Increase in restricted cash		**(700)**	(340)
Acquisition of investment properties, net of debt assumed		**(181,459)**	(46,897)
Disposition of investment properties		**16,616**	8
Development of investment properties		**(53,313)**	(25,324)
Capital expenditures		**(31,172)**	(33,460)
Cash used in investing activities		**($250,028)**	($106,013)
Net (decrease) increase in cash		**(12,652)**	10,354
Cash, beginning of year		**24,652**	14,298
Cash, end of year		**$12,000**	$24,652

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

Dollar amounts in thousands of Canadian dollars

1. Organization of the Trust

Killam Apartment Real Estate Investment Trust ("Killam" or the "Trust") is an unincorporated open-ended mutual fund trust created pursuant to the amended and restated Declaration of Trust ("DOT"), dated November 27, 2015, under the laws of the Province of Ontario. Killam specializes in the acquisition, management and development of multi-residential apartment buildings and manufactured home communities ("MHCs") in Canada.

The consolidated financial statements comprise the financial statements of Killam and its subsidiaries as at and for the year ended December 31, 2017. Killam's head office operations are located at 3700 Kempt Road, Halifax, Nova Scotia, B3K 4X8 and the Trust's registered office is located at 2571 Windsor Street, Halifax, Nova Scotia, B3K 5C4.

2. Significant Accounting Policies

(A) Statement of Compliance

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

The consolidated financial statements of the Trust for the year ended December 31, 2017 were authorized for issue in accordance with a resolution of the Board of Trustees of Killam on February 13, 2018.

(B) Basis of Presentation

The consolidated financial statements of Killam have been prepared on a historical cost basis, except for investment properties, deferred unit-based compensation, convertible debentures and Exchangeable Units, which have been measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets. The consolidated financial statements have been prepared on a going concern basis and are presented in Canadian dollars, which is Killam's functional currency, and all values are rounded to the nearest thousand ($000), except per unit amount or as noted.

(C) Basis of Consolidation

(i) Subsidiaries

The consolidated financial statements comprise the assets and liabilities of all subsidiaries and the results of all subsidiaries for the financial year. Killam and its subsidiaries are collectively referred to as Killam in these consolidated annual financial statements. Non-controlling interest represents the portion of profit or loss and net assets not held by Killam, and are presented separately in the consolidated statements of income and comprehensive income and within equity in the consolidated statements of financial position, separately from unitholders' equity.

Subsidiaries are entities controlled by Killam. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by Killam. In certain circumstances, Killam has control over entities in which it does not own more than 50% of the voting power.

In its evaluation, Management considers whether Killam controls the entity by virtue of the following circumstances:

a) Power over more than half of the voting rights by virtue of an agreement with other investors;
b) Power to govern the financial and operating policies of the entity under a statute or an agreement;
c) Power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; and
d) Power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses are attributed to the non-controlling interest even if that results in a deficit balance.

Killam owns 50% of the shares of a Corporation, which owns a property under development. Killam has determined that it controls the Corporation and therefore consolidates the Corporation's assets, liabilities and the results of its operations. As Killam will purchase the remaining 50% of the shares in the Corporation upon the completion of the development, the non-controlling interest is recorded as a liability and is included in other non-current liabilities.

Dollar amounts in thousands of Canadian dollars

2. Significant Accounting Policies (continued)

Killam's investment in subsidiaries, all of which are incorporated in Canada, are listed in the following table:

Subsidiary	**% Interest**
Killam Apartment General Partner Ltd.	100%
Killam Apartment Limited Partnership	100%
Killam Properties Inc.	100%
Killam Properties SGP Ltd.	100%
Killam Apartment Subsidiary Limited Partnership	100%
661047 N.B Inc.	100%
Killam Investments Inc.	100%
Killam Investments (PEI) Inc.	100%
Killam Properties Apartments Trust	100%
Killam Properties MHC Trust	100%
Blackshire Court Limited	100%
Blackshire Court Limited Partnership	96.94%
Killam KamRes (Silver Spear) Inc.	50%
Killam KamRes (Grid 5) Inc.	50%
Killam KamRes (Kanata Lakes) I Inc.	50%
Killam KamRes (Kanata Lakes) II Inc.	50%
Killam KamRes (Kanata Lakes) III Inc.	50%
Killam KamRes (Kanata Lakes) IV Inc.	50%
Killam - Keith Development Ltd.	50%
Riotrin Properties (Gloucester 3) Inc.	50%

(ii) Joint arrangements
Killam has joint arrangements in and joint control of four properties (eight buildings). Killam has assessed the nature of its joint arrangements as at December 31, 2017 and determined them to be joint operations. For joint operations, Killam recognizes its share of revenues, expenses, assets and liabilities, which are included in their respective descriptions on the consolidated statements of financial position and consolidated statements of income and comprehensive income. All balances and effects of transactions between joint operations and Killam have been eliminated to the extent of its interest in the joint operations.

(D) Property Asset Acquisitions
At the time of acquisition of a property or a portfolio of investment properties, Killam evaluates whether the acquisition is a business combination or asset acquisition. IFRS 3, *Business Combinations* (“IFRS 3”) is only applicable if it is considered that a business has been acquired. A business according to IFRS 3 is defined as an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors or lower costs or other economic benefits directly and proportionately to Killam. When determining whether the acquisition of an investment property or a portfolio of investment properties is a business combination or an asset acquisition, Killam applies judgment when determining whether an integrated set of activities is acquired in addition to the property or portfolio of properties.

When an acquisition does not represent a business as defined under IFRS 3, Killam classifies these properties or a portfolio of properties as an asset acquisition. Identifiable assets acquired and liabilities assumed in an asset acquisition are measured initially at their relative fair values at the acquisition date, except for financial instruments that are recognized initially at fair value. Acquisition-related transaction costs are capitalized to the property. All of Killam’s acquisitions have been classified as asset acquisitions.

2. Significant Accounting Policies (continued)

(E) Revenue Recognition

(i) Rental income

Revenue from rental properties is recognized when a tenant commences occupancy of a rental unit or site and rent is due. Rental income from investment properties is recognized on a straight-line basis over the lease term. Killam has not transferred substantially all of the benefits and risks of ownership of its rental properties, and therefore accounts for leases with its tenants as operating leases.

(ii) Other income

Other corporate income includes interest and management fees. Interest income is recognized as earned, and management fees are recorded as services are provided.

(iii) Service charges and expenses recoverable from tenants

Income arising from expenses recovered from tenants is recognized gross of the related expenses in the period in which the expense can be contractually recovered. Revenue related to laundry and parking are included gross of the related costs.

(iv) Manufactured home sales

Where revenue is obtained from the sale of manufactured homes, it is recognized when the significant risks and rewards have been transferred to the buyer. This will normally take place on the closing date of the home sale. Such sales are considered sales of goods, and not sales of real estate, as Killam does not manufacture these homes.

(F) Tenant Inducements

Incentives such as cash, rent-free periods and move-in allowances may be provided to lessees to enter into a lease. These incentives are amortized on a straight-line basis over the term of the lease as a reduction of rental revenue.

(G) Investment Properties

Investment properties include multi-family residential properties, manufactured home communities and commercial properties held to earn rental income and properties that are under construction or development for future use as investment properties. Killam considers its income properties to be investment properties under International Accounting Standard ("IAS") 40, *Investment Property* ("IAS 40"), and has chosen the fair value model to account for its investment properties in the consolidated financial statements. Fair value represents the amount at which the properties could be exchanged between a knowledgeable and willing buyer and a knowledgeable and willing seller in an arm's length transaction at the date of valuation.

Killam's investment properties have been valued on a highest and best use basis and do not include any portfolio premium that may be associated with the economies of scale from owning a large portfolio or the consolidation of value from having compiled a large portfolio of properties over a long period of time, many through individual property acquisitions.

Investment properties are measured initially at cost, including transaction costs. Transaction costs include deed transfer taxes and various professional fees. Subsequent to initial recognition, investment properties are recorded at fair value. Fair value is determined based on a combination of internal and external processes and valuation techniques. Gains and losses arising from changes in fair values are included in the consolidated statements of income and comprehensive income in the year in which they arise. Investment property is derecognized when it has been disposed of or permanently withdrawn from use and no future economic benefit is expected. Any gains or losses on the retirement or disposal of investment properties are recognized in the consolidated statements of income and comprehensive income in the year of retirement or disposal.

Transfers are made to and from Investment properties under construction *("*IPUC") when, and only when, there is a change in use, evidenced by the commencement of operating leases or commencement of redevelopment.

2. Significant Accounting Policies (continued)

The cost of a development property that is an asset acquisition comprises the amount of cash, or the fair value of other consideration, paid to acquire the property, including transaction costs. Subsequent to acquisition, the cost of a development property includes costs that are directly attributable to these assets, including development costs, property taxes and borrowing costs on both specific and general debt. Direct and indirect borrowing costs, development costs and property taxes are capitalized when the activities necessary to prepare an asset for development or redevelopment begin, and continue until the date that construction is substantially complete and all necessary occupancy and related permits have been received, whether or not the space is leased. If Killam is required as a condition of a lease to construct tenant improvements that enhance the value of the property, then capitalization of these costs continues until such improvements are completed. Capitalization of finance costs is suspended if there are prolonged periods when development activity is interrupted.

Interest is capitalized using Killam's weighted average cost of borrowing after adjusting for borrowing associated with specific developments. Where borrowing is associated with specific developments, the amount capitalized is the gross interest incurred on such borrowing less any investment income arising on temporary investment of such borrowing.

Properties under development are also adjusted for fair value at each consolidated balance sheet date with fair value adjustments recognized in net income.

(i) Investment properties under construction ("IPUC")
Properties under development include those properties, or components thereof, that will undergo activities that will take a substantial period of time to prepare the properties for their intended use as income properties.

(H) Property and Equipment
Property and equipment are stated at historical cost less accumulated depreciation and consist mainly of head office buildings, leasehold improvements and information technology systems. The estimated useful lives, residual values and depreciation methods are reviewed at each year-end, with the effect of any changes in estimates accounted for prospectively. These items are categorized into the following classes and their respective useful economic life is used to calculate the amount of depreciation or amortization for each period.

Category	Useful Life / Depreciation Rate	Depreciation method used
Building	40 years	Straight-line
Heavy equipment	7.5%	Declining balance
Vehicles	10%	Declining balance
Furnitures, fixtures and office equipment	10% to 30%	Declining balance
Computer software	100%	Declining balance
Leaseholds	Lease term	Straight-line

(I) Inventory
Inventory represents manufactured homes available for sale. The manufactured homes are valued at the lower of cost (purchase price plus delivery and setup costs) and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business based on market prices at the reporting date less costs to complete and the estimated costs of sale.

(J) Consolidated Statements of Cash Flows
Cash consists of cash on hand and bank account balances excluding cash on hand held for security deposits. Investing and financing activities that do not require the use of cash or cash equivalents are excluded from the consolidated statements of cash flows and are disclosed separately in the notes to the consolidated financial statements.

(K) Unit-based Compensation
Unit-based compensation benefits are provided to officers, trustees and certain employees and are intended to facilitate long-term ownership of Trust Units and provide additional incentives by increasing the participants' interest, as owners, in Killam. In accordance with IAS 32, Financial Instruments: Presentation ("IAS 32"), the restricted trust units ("RTUs") are presented as a liability on the consolidated statements of financial position as the Trust is obliged to provide the holder with Trust Units once the RTUs vest. The fair value of performance based RTUs is estimated using a Monte Carlo pricing model. The fair value estimate requires determination of the most appropriate inputs to the pricing model including the expected life, volatility, and dividend yield. The grant date fair value of the deferred unit-based compensation is determined based on the market value of the Trust's units on the date of grant and compensation expense is recognized over the vesting period and included in administration costs.

Dollar amounts in thousands of Canadian dollars

2. Significant Accounting Policies (continued)

Under IAS 19 – Employee Benefits, the RTUs are classified at fair value through profit or loss ("FVTPL") and are measured at each reporting period at fair value with changes in fair value recognized in the consolidated statements of income and comprehensive income.

(L) Financial Instruments

Financial instruments are accounted for, presented, and disclosed in accordance with IFRS 7, *Financial Instruments: Disclosures*, IAS 32, and IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). Killam recognizes financial assets and financial liabilities when it becomes a party to a contract. Financial assets and financial liabilities, with the exception of financial assets classified at FVTPL, are measured at fair value plus transaction costs on initial recognition. Financial assets classified at FVTPL are measured at fair value on initial recognition and transaction costs are expensed when incurred.

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement in its entirety. The following summarizes Killam's classification and measurement of financial assets and liabilities:

Type	Classification	Measurement
Rent, loans and other receivables	Loans and Receivables	Amortized cost
Accounts payable, accrued liabilities	Other Financial Liabilities	Amortized cost
Mortgages, loans payable and construction loans	Other Financial Liabilities	Amortized cost
Convertible debentures	FVTPL	Fair value
Exchangeable Units	FVTPL	Fair value
Unit-based compensation	FVTPL	Fair value
Other liabilities	FVTPL	Fair value

Financial liabilities at fair value through profit and loss

Convertible debentures issued by the Trust were convertible into Trust Units at the option of the holder and the number of Trust Units to be issued did not vary with changes in their fair value. As the Trust's Units were redeemable at the option of the holder and are, therefore, considered puttable instruments in accordance with IAS 32, the convertible debentures were considered a liability containing liability-classified embedded derivatives.

Effective January 1, 2016, the Trust elected to record the full outstanding amount of each convertible debenture at fair value determined using the closing trading price, for each publicly traded convertible debenture. Changes in fair value were recognized in the consolidated statements of income and comprehensive income.

The exchangeable Units of the Trust are exchangeable into units of the Trust at the option of the holder. These exchangeable Units are considered puttable instruments in accordance with IAS 32, and are required to be classified as financial liabilities at FVTPL. The distributions paid on the Exchangeable Units are accounted for as financing costs.

Killam owns 50% of the shares of a Corporation, which owns a property under development. Killam has determined that it controls the Corporation and therefore consolidates the Corporation's assets, liabilities and the results of its operations. The liability associated with the 50% unowned portion of these shares is considered a puttable instrument in accordance with IAS 32, and Killam has designated this as a financial liability at FVTPL. The carrying amount of this liability is accounted for as other liabilities on the consolidated statement of financial position. Changes in the fair value of the liability and an allocation of a 50% proportionate share of operating results are accounted for as a fair value adjustment on investment properties.

Financial liabilities are classified as FVTPL if they meet certain conditions and are designated as such by Management, or they are derivative liabilities. Financial liabilities classified as FVTPL are measured at fair value, with changes recognized in the consolidated statements of income and comprehensive income.

Loans and receivables

Such receivables arise when Killam provides services to a third party, such as a tenant, and are included in other current assets, except for those with maturities more than 12 months after the consolidated statement of financial position date, which are classified as other non-current assets. Loans and receivables are accounted for at amortized cost.

2. Significant Accounting Policies (continued)

Other financial liabilities
Other financial liabilities are financial liabilities that are not classified as FVTPL. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest rate method. The effective interest rate method is a method of calculating the amortized cost of an instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all transaction costs and other premiums or discounts) through the expected life of the debt instrument to the net carrying amount of the initial recognition.

Trust Units
Killam's Trust Units are redeemable at the option of the holder and, therefore, are considered puttable instruments. Puttable instruments are required to be accounted for as financial liabilities, except where certain conditions are met in accordance with IAS 32, in which case the puttable instruments may be presented as equity. Killam's Trust Units meet the conditions of IAS 32 as they are the most subordinate to all other classes of instruments and are, therefore, presented as equity on the consolidated statements of financial position.

Restricted Trust Units
The RTUs are considered a financial liability as there is a contractual obligation for the Trust to deliver Trust Units upon conversion of the RTUs. As the Trust Units are redeemable at the option of the holder and are, therefore, considered puttable instruments in accordance with IAS 32, the RTUs are also considered a financial liability. The RTUs are measured at fair value on each reporting date using Killam's unit price, the fair value of RTUs with performance conditions are estimated using a Monte Carlo pricing model, changes in fair value are recognized in the consolidated statements of income and comprehensive income.

Exchangeable Units
The Exchangeable Units are considered a financial liability as there is a contractual obligation for the Trust to deliver Trust Units upon exchange of the Exchangeable Units. The distributions on the Exchangeable Units are recognized as financing costs in the consolidated statements of income and comprehensive income. The distributions payable as at the reporting date is reported under other current liabilities on the consolidated statements of financial position. On initial recognition, the Exchangeable Units are measured at fair value, with the related fair value gain being recorded through retained earnings. Subsequently, the Exchangeable Units are remeasured at each reporting date at fair value, with changes in fair value recognized in the consolidated statements of income and comprehensive income.

Mortgages and loans payable
Mortgages and loans payable are initially recognized at fair value less directly attributable transaction costs. After initial recognition, mortgages and loans payable are subsequently measured at amortized cost using the effective interest rate method. Mortgage maturities and repayments due more than 12 months after the consolidated statement of financial position date are classified as non-current.

Financing costs
Financing fees and other costs incurred in connection with debt financing are deducted from the cost of the debt and amortized using the effective interest rate method. Upon refinancing, any financing costs associated with previous mortgages are written off to income. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate calculation.

Prepaid insurance premiums
Canada Mortgage and Housing Corporation ("CMHC") insurance premiums are netted against mortgages and loans payable. They are amortized over the amortization period of the underlying mortgage loans when incurred (initial period is typically 25 years) and are included in amortization of deferred financing costs in the consolidated statements of income and comprehensive income.

Transaction costs
Transaction costs related to loans and receivables and other liabilities, measured at amortized cost, are netted against the carrying value of the asset or liability and amortized over the expected life of the instrument using the effective interest rate method.

2. Significant Accounting Policies (continued)

Determination of fair value
The fair value of a financial instrument on initial recognition is generally the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair value of financial instruments is remeasured based on relevant market data. Killam classifies the fair value for each class of financial instrument based on the fair value hierarchy. The fair value hierarchy distinguishes between market value data obtained from independent sources and Killam's own assumptions about market value. See note 5 for a detailed discussion of valuation methods used for financial instruments quoted in an active market and instruments valued using observable data.

Derivatives
Derivative financial instruments are initially recognized at fair value on the date a derivative contract is entered into and subsequently re-measured at fair value. The method of recognizing the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument and, if so, the nature of the item being hedged. For Killam's accounting policy on hedging, see the *Hedging Relationships* section below. Derivatives not designated in a hedging relationship are measured at fair value with changes therein recognized directly through the consolidated statements of income and comprehensive income.

Embedded derivatives
Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative are the same as those of a free-standing derivative; and the combined instrument or contract is not measured at fair value. These embedded derivatives are measured at fair value with changes therein recognized within net income in the consolidated statements of income and comprehensive income.

(M) Hedging Relationships
Killam may use interest rate swaps to hedge its risks associated with interest rates. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

At the inception of a hedge relationship, Killam formally designates and documents the hedge relationship to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how Killam will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Cash flow hedges
For the purpose of cash flow hedge accounting, hedges are classified as cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction.

The effective portion of the gain or loss on the hedging instrument is recognized directly in equity through other comprehensive income, while any ineffective portion is recognized immediately in the consolidated statements of income and comprehensive income. Amounts taken to equity are transferred to profit or loss when the hedged transaction affects profit or loss, such as when the hedged financial income or financial expense is recognized.

If the forecast transaction or firm commitment is no longer expected to occur, amounts previously recognized in equity are transferred to the consolidated statements of income and comprehensive income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognized in equity remain in equity until the forecast transaction or firm commitment occurs.

(N) Comprehensive Income
Comprehensive income includes net income and other comprehensive income. Other comprehensive income includes the effective portion of cash flow hedges less any amounts reclassified to interest and other financing costs and the associated income taxes.

2. Significant Accounting Policies (continued)

(O) Accumulated Other Comprehensive Loss

AOCL is included in the consolidated statements of financial position as equity and includes the unrealized gains and losses of the changes in the fair value of cash flow hedges.

(P) Distributions

Distributions represent the monthly cash distributions on outstanding Trust Units and Exchangeable Units.

(Q) Provisions

In accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* ("IAS 37"), a provision is a liability of uncertain timing or amount. Provisions are recognized when the entity has a present legal or constructive obligation as a result of past events and when it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the date of the consolidated statements of financial position, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows, where the time value of money is material. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably. Provisions reflect Killam's best estimate at the reporting date. Killam's provisions are immaterial and are included in other payables.

(R) Taxation

Effective January 1, 2016, Killam qualified as a "mutual fund trust" as defined under the *Income Tax Act* (Canada) and as a REIT eligible for the "REIT Exemption" in accordance with the rules affecting the tax treatment of publicly traded trusts. Accordingly, the Trust is not taxable on its income provided that all of its taxable income is distributed to its unitholders. This exemption, however, does not extend to the corporate subsidiaries of Killam that are subject to income taxes.

(i) Current income tax

Current income tax assets and liabilities are measured at the amount expected to be paid to tax authorities, net of recoveries, based on the tax rates and tax laws enacted or substantively enacted at the reporting date. Current income tax relating to items recognized directly in equity is recognized in equity and not profit or loss. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

(ii) Deferred income tax

Deferred income tax is provided using the liability method on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes, except where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss.

Deferred income tax assets are recognized only to the extent that it is probable that taxable profit will be available against which deductible temporary differences, carried forward tax credits, or tax losses can be utilized. The carrying value of deferred income tax assets are reviewed at each reporting date and reduced to the extent it is no longer probable that the income tax asset will be recovered. Killam determines the deferred tax consequences associated with temporary differences relating to investment properties as if the carrying amount of the investment property is recovered entirely through sale. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

(S) Earnings Per Unit

As a result of the redemption feature of Killam's Trust Units, these Units are considered financial liabilities under IAS 33, *Earnings per share*, and they may not be considered as equity for the purposes of calculating net income on a per Unit basis. Consequently, Killam has elected not to report earnings per Unit calculation, as permitted under IFRS.

3. Critical Accounting Judgments, Estimates and Assumptions

Critical Judgments in Applying Accounting Policies

The following are the critical judgments, apart from those involving estimations (see *Key Accounting Estimates and Assumptions* below) that have been made in applying the Trust's accounting policies and that have the most significant effect on the reported amounts in the consolidated financial statements:

(i) Income taxes

The Trust applies judgment in determining the tax rates applicable to its corporate subsidiaries and identifying the temporary differences in each of such legal subsidiaries in respect of which deferred income taxes are recognized. Deferred taxes related to temporary differences arising from its corporate subsidiaries are measured based on the tax rates that are expected to apply in the year when the asset is realized or the liability is settled. Temporary differences are differences that are expected to reverse in the future and arise from differences between accounting and tax asset values.

(ii) Investment property and internal capital program

The Trust's accounting policy relating to investment properties is described in note 2(G). In applying this policy, judgment is applied in determining the extent and frequency of utilizing independent, third-party appraisals to measure the fair value of the Trust's investment properties. Additionally, judgment is applied in determining the appropriate classes of investment properties in order to measure fair value. The Trust also undertakes internal capital improvements and upgrades. Such work is specifically identified, and the Trust applies judgment in the estimated amount of directly attributable salaries to be allocated to capital improvements and upgrades of its investment properties.

(iii) Financial instruments

The Trust's accounting policies relating to financial instruments are described in note 2(L). Critical judgments inherent in these policies related to applying the criteria set out in IAS 39 to designate financial instruments into categories i.e. FVTPL, etc., assess the effectiveness of hedging relationships and determine the identification of embedded derivatives, if any, that are subject to fair value measurement.

(iv) Basis of consolidation

The consolidated financial statements of the Trust include the accounts of Killam and its wholly-owned subsidiaries, as well as entities over which the Trust exercises control on a basis other than ownership of voting interest within the scope of IFRS 10, *Consolidated Financial Statements*. Judgment is applied in determining if an entity meets the criteria of control as defined in the accounting standard.

Key Accounting Estimates and Assumptions

The following are the key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Actual results could differ from estimates.

(i) Valuation of investment properties

The choice of valuation method and the critical estimates and assumptions underlying the fair value determination of investment properties are set out in note 5. Significant estimates used in determining the fair value of the Trust's investment properties include capitalization rates and net operating income (which is influenced by inflation rates, vacancy rates and expected maintenance costs) used in the overall capitalization rate valuation method as well as discount rates and forecasted cash flows used in the discounted cash flow valuation method. A change to any one of these inputs could significantly alter the fair value of an investment property. Please refer to note 5 for sensitivity analysis.

IPUC are also valued at fair value, except if such values cannot be reliably determined. In the case when fair value cannot be reliably determined, such property is recorded at cost. The fair value of IPUC is determined using the direct income capitalization method.

(ii) Deferred unit-based compensation

The compensation costs relating to deferred unit-based compensation are based on estimates of how many deferred units will be awarded as well as how many will actually vest and be exercised, as well as valuation models, which by their nature are subject to measurement uncertainty.

(iii) Deferred taxes

The amount of the temporary differences between the accounting carrying value of the Trust's assets and liabilities held in various corporate subsidiaries versus the tax bases of those assets and liabilities and the tax rates at which the differences will be realized are outlined in note 21.

4. Future Accounting Policy Changes

The following new or amended accounting standards under IFRS have been issued or revised by the IASB; however, they are not yet effective and as such have not been applied to the consolidated financial statements.

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")
IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recording revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018, with early adoption permitted and Killam has concluded there will be no change to the pattern of recognition or the measurement of revenue, however, additional disclosure will be included. Killam intends to adopt the new standard on the required effective date.

IFRS 9, Financial Instruments ("IFRS 9")
In July 2014, the IASB issued the final version of IFRS 9, which introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. IFRS 9 also introduces an expected loss impairment model for all financial assets not measured at fair value through profit or loss that requires recognition of expected credit losses rather than incurred losses as applied under the current standard. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Killam has completed an assessment of the impact of IFRS 9 on its consolidated financial statements and does not expect a material impact on its consolidated financial statement upon adoption. Killam intends to adopt the new standard on the required effective date.

IFRS 16, Leases ("IFRS 16")
In January 2016, the IASB issued IFRS 16. The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting, however, remains largely unchanged, and the distinction between operating and finance leases is retained. This standard is effective for Killam's annual periods beginning after January 1, 2019, with early adoption permitted. To assess the impact of this new standard, Killam has formed an internal working group and continues to progress on its in-depth assessment of IFRS 16 on its consolidated financial statements. Killam does not expect a significant impact to its consolidated financial statements on adoption of this IFRS standard. Killam intends to adopt the new standard on the required effective date.

IFRS 2, Share-based Payment ("IFRS 2")
In June 2016, the IASB issued final amendments to IFRS 2, Share-based Payment, clarifying how to account for certain types of share-based payment transactions. The amendments, which were developed through the IFRS Interpretations Committee, provide requirements on the accounting for: (i) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; (ii) share-based payment transactions with a net settlement feature for withholding tax obligations; and (iii) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. Killam intends to adopt the amendments to IFRS 2 in the consolidated financial statements for the annual period beginning on or after January 1, 2018, however, since the current policy and practice is in line with the amendments, Killam does not expect any impact to its consolidated financial statements.

IAS 40, Investment Property (IAS 40)
In December 2016, the IASB issued an amendment to IAS 40 clarifying certain existing requirements. The amendment required that an asset be transferred to or from investment property only when there is a change in use. A change in use occurs when the property meets or ceases to meet, the definition of investment property and there is evidence of the change in use. In isolation, a change in management's intention for the use of a property does not provide evidence of a change in use. These amendments are effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Killam will apply the amendment when it becomes effective prospectively, however, since the current policy and practice is in line with the clarification issues, Killam does not expect any impact to its consolidated financial statements.

Dollar amounts in thousands of Canadian dollars

5. Investment Properties

As at December 31, 2017					
Segment	**Apartments**	**MHCs**	**Other**	**IPUC**	**Total**
Balance, beginning of year	**$1,721,399**	**$133,634**	**$32,269**	**$55,507**	**$1,942,809**
Fair value adjustment on investment properties	**62,380**	**2,922**	**(487)**	**—**	**64,815**
Acquisitions	**186,502**	**—**	**4,704**	**14,206**	**205,412**
Dispositions	**(16,616)**	**—**	**—**	**—**	**(16,616)**
Transfer from IPUC	**15,485**	**—**	**—**	**(15,485)**	**—**
Capital expenditure on investment properties	**26,959**	**3,227**	**809**	**—**	**30,995**
Other	**(965)**	**—**	**—**	**—**	**(965)**
Capital expenditure on IPUC	**—**	**—**	**—**	**51,331**	**51,331**
Interest capitalized on IPUC	**—**	**—**	**—**	**1,982**	**1,982**
Balance, end of year	**$1,995,144**	**$139,783**	**$37,295**	**$107,541**	**$2,279,763**

As at December 31, 2016					
Segment	Apartments	MHCs	Other	IPUC	Total
Balance, beginning of year	$1,636,744	$125,648	$32,188	$45,676	$1,840,256
Fair value adjustment on investment properties	(9,188)	5,896	(457)	—	(3,749)
Acquisitions	48,214	—	—	—	48,214
Dispositions	—	(8)	—	—	(8)
Transfer from IPUC	15,490	—	—	(15,490)	—
Capital expenditure on investment properties	30,139	2,098	538	—	32,775
Capital expenditure on IPUC	—	—	—	24,411	24,411
Interest capitalized on IPUC	—	—	—	910	910
Balance, end of year	$1,721,399	$133,634	$32,269	$55,507	$1,942,809

During the year ended December 31, 2017, Killam acquired the following properties:

Property	**Location**	**Acquisition Date**	**Ownership interest (%)**	**Year Built**	**Units**	**Purchase Price(1)**
Apartments						
Spruce Grove	Calgary	16-Jan-17	100%	1978	66	$12,800
Southport condominium units	Halifax	16-Feb-17	100%	2016	5	1,070
Kanata Lakes IV & V (2)	Ottawa	01-Mar-17	50%	2016	134	49,240
246 / 300 Innovation Drive	Halifax	04-Jul-17	100%	2015 / 2016	134	31,600
Waybury Park	Edmonton	18-Aug-17	100%	2016	124	28,277
Tisbury Crossing	Edmonton	1-Dec-17	100%	2017	172	39,200
Stoneybrook Apartments	Halifax	15-Dec-17	100%	2000	106	13,000
Fairview Terrace	London	15-Dec-17	100%	1950s	106	8,500
					847	$183,687
Other						
Vacant Land	Edmonton	13-Apr-17 / 23-Jun-17	100%			4,050
1459 Hollis Street(3)	Halifax	19-Apr-17	100%			4,600
Gloucester - Land(4)	Ottawa	21-Apr-17	50%			8,000
Total Acquisitions						$200,337

(1) Purchase price does not include transaction costs.
(2) Purchase price represents 50% ownership in two buildings with a cumulative total of 268 units; in addition, it includes 35% interest in a shared clubhouse. This building is part of a five-building complex; with this acquisition Killam and its 50/50 partner now own the entire complex.
(3) Included in the acquisition is $0.85 million in land value relating to adjacent development projects.
(4) Purchase price represents 50% interest in a multi-phase development project.

5. Investment Properties (continued)

During the year ended ended December 31, 2017, Killam capitalized salaries of $3.1 million (December 31, 2016 - $3.0 million), as part of its project improvement, suite renovation and development programs. For the year ended December 31, 2017, interest costs associated with the general corporate borrowings used to fund development were capitalized to the respective development projects using Killam's weighted average borrowing rate of 2.91% (December 31, 2016 - 3.11%). Interest costs associated with development specific loans were capitalized to the respective developments using the actual borrowing rate associated with the loan.

Investment properties with a fair value of $2.2 billion as at December 31, 2017 (December 31, 2016 - $1.9 billion), have been pledged as collateral against Killam's mortgages, construction loan and credit facilities.

Valuation methodology and processes

Investment properties carried at fair value are categorized by level according to the significance of the inputs used in making the measurements. As the fair value of investment properties is determined with significant unobservable inputs, all investment properties are classified as Level 3 assets.

Killam’s policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers in or out of Level 3 fair value measurements for investment properties during the year.

Killam’s internal valuation team consists of individuals who are knowledgeable and have recent experience in the fair value techniques for investment properties. Killam’s internal valuation team is responsible for determining the fair value of investment properties every quarter. The team reports directly to the Chief Financial Officer ("CFO") and the internal valuation team’s valuation processes and results are reviewed by Management at least once every quarter, in line with Killam’s quarterly reporting dates.

Killam has also engaged leading independent national real estate appraisal firms with representation and expertise across Canada to provide appraisals on approximately 20% of its portfolio by value annually. Properties are rotated annually to ensure that every property is externally valued at least once every five years. These external valuations are prepared to comply with the requirements of IAS 40, IFRS 13, *Fair Value Measurement*, and International Valuation Standards. On a quarterly basis, for properties that are not valued externally, appraisals are updated by Killam’s internal valuation team for current leasing and market assumptions, utilizing market capitalization rates determined in consultation with independent valuation firms.

At each external valuation date, the internal valuation team:

- Verifies all major inputs to the independent valuation report;
- Assesses property valuation movements when compared to the prior year valuation report; and
- Holds discussions with the independent appraisers.

Changes in fair values are analyzed at each reporting date during the quarterly valuation discussions between the EVP and CFO and the internal valuation team. As part of this discussion, the internal valuation team presents a report that explains the reasons for the fair value movements.

Valuation techniques underlying Management’s estimation of fair value

The investment properties were valued using the direct income capitalization method. In applying the direct income capitalization method, the stabilized net operating income (“NOI”) of each property is divided by an overall capitalization rate. The significant unobservable inputs include:

- Stabilized net operating income: based on the location, type and quality of the properties and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties, adjusted for estimated vacancy rates based on CMHC’s 10-year average rents by region and expected maintenance costs; and

- Capitalization rate: based on location, size and quality of the properties and taking into account market data at the valuation date.

Dollar amounts in thousands of Canadian dollars

5. Investment Properties (continued)

Valuation Basis

Using the direct income capitalization method, the apartment properties were valued using cap-rates in the range of 3.75% to 8.00%, applied to a stabilized NOI of $107.8 million (December 31, 2016 - 4.12% to 8.00% and $96.1 million), resulting in an overall weighted average cap-rate of 5.37% (December 31, 2016 - 5.49%). The stabilized occupancy rates used in the calculation of NOI were in the range of 93.1% to 98.3% (December 31, 2016 - 93.0% to 98.1%).

Using the direct income capitalization method, the MHC properties were valued using cap-rates in the range of 5.75% to 8.00%, applied to a stabilized NOI of $9.6 million (December 31, 2016 - 5.75% to 8.00% and $9.0 million), resulting in an overall weighted average cap-rate of 6.84% (December 31, 2016 - 6.81%). The stabilized occupancy rate used in the calculation of NOI was 97.8% (December 31, 2016 - 97.9%).

Investment property valuations are most sensitive to changes in the cap-rate. The cap-rate assumptions for the investment properties are included in the following table by region:

	December 31, 2017			December 31, 2016		
	Low	**High**	**Effective Weighted Average**	Low	High	Effective Weighted Average
Apartments	**3.75%**	**8.00%**	**5.37%**	4.12%	8.00%	5.49%
Halifax	4.85%	6.00%	5.34%	4.85%	7.33%	5.51%
Moncton	5.15%	7.00%	5.88%	5.15%	8.00%	6.00%
Fredericton	5.15%	6.50%	5.98%	5.15%	6.50%	5.98%
Saint John	6.00%	6.75%	6.40%	6.00%	6.75%	6.41%
St. John's	5.00%	6.00%	5.63%	5.00%	6.00%	5.68%
Charlottetown	5.50%	6.25%	5.94%	5.50%	6.25%	5.94%
Ontario	3.75%	5.08%	4.55%	4.12%	5.02%	4.63%
Alberta	4.52%	5.75%	5.30%	4.75%	4.75%	4.75%
Other Atlantic	5.75%	8.00%	6.83%	5.75%	8.00%	6.83%
MHCs	**5.75%**	**8.00%**	**6.84%**	5.75%	8.00%	6.81%
Ontario	7.00%	8.00%	7.48%	7.00%	8.00%	7.49%
Nova Scotia	5.75%	7.00%	6.26%	5.75%	7.00%	6.17%
New Brunswick	7.50%	7.50%	7.50%	8.00%	8.00%	8.00%
Newfoundland	7.00%	7.00%	7.00%	7.25%	7.25%	7.25%

The key valuation assumption used to determine the fair market value, using the direct capitalization method, is the cap-rate. A summary of the high, low and weighted average cap-rates used in the valuation model as at December 31, 2017 and 2016, as provided by Killam's external valuator, is included in the above table.

The quantitative sensitivity analysis shown below illustrates the value increase or decrease in Killam's portfolio of properties given the change in the noted input:

Class of property	**Capitalization rate**	
	10 basis points increase	*10 basis points decrease*
Apartments	($36,658)	$38,049
MHCs	($2,028)	$2,088

Dollar amounts in thousands of Canadian dollars

6. Joint Operations and Investments in Joint Venture

Killam has interests in four properties (eight buildings) that are subject to joint control and are joint operations. Accordingly, the consolidated statements of financial position and consolidated statements of income and comprehensive income include Killam's rights to and obligations for the related assets, liabilities, revenue and expenses.

7. Property and Equipment

As At	**Cost**	**December 31, 2017 Accumulated Depreciation**	Cost	December 31, 2016 Accumulated Depreciation
Land	**$270**	**$—**	$270	$—
Building	**1,913**	**325**	1,913	271
Heavy equipment	**257**	**113**	255	102
Vehicles	**1,827**	**657**	1,547	550
Furniture, fixtures and office equipment	**6,001**	**4,654**	5,225	4,153
Leasehold improvements	**963**	**290**	879	226
	11,231	**6,039**	10,089	5,302
Less: accumulated depreciation	**(6,039)**		(5,302)	
	$5,192		$4,787	

Land and building represent Killam's ownership of a 50% interest in the property that its head office occupies. Under IFRS, owner-occupied property is required to be accounted for as property and equipment and not investment property. Property with a carrying value of $1.9 million, representing Killam's 50% ownership interest (December 31, 2016 - $1.9 million), is pledged as collateral against Killam's mortgage payable.

For the years ended December 31,	**2017**	2016
Balance, beginning of the year	**$4,787**	$4,973
Capital expenditures	**1,142**	698
Depreciation	**(737)**	(884)
Balance, end of year	**$5,192**	$4,787

8. Other Non-Current Assets

As at	**December 31, 2017**	December 31, 2016
Vendor-take-back loan	**$—**	$950
Interest rate derivative	**659**	296
	$659	$1,246

The vendor-take-back loan for $0.95 million, bearing interest at a rate of 6.5%, was settled on November 16, 2017 through repossession of land with a fair value of $1.0 million that was held as collateral.

Dollar amounts in thousands of Canadian dollars

9. Other Current Assets

As at	**December 31, 2017**	December 31, 2016
Restricted cash	**$7,979**	$7,279
Prepaid expenses	**3,163**	4,162
Inventory	**99**	99
	$11,241	$11,540

Restricted cash consists of security deposits, funds held in trust and property tax reserves. Inventory relates to manufactured homes for which sales have not closed at year-end.

10. Rent and Other Receivables

As at	**December 31, 2017**	December 31, 2016
Rent receivable	**$748**	$1,014
Other receivables	**1,607**	1,881
	$2,355	$2,895

Included in other receivables are laundry revenue, commission revenue and other non-rental income. The majority of these receivables are less than 60 days old. Killam's policy is to write off tenant receivables when the tenant vacates the unit and any subsequent receipt of funds is netted against bad debts. Killam's bad debt expense experience has historically been less than 0.4% of revenue. As a result of the low bad debt experience, no allowance for doubtful accounts is recorded in the accounts.

11. Mortgages and Loans Payable

As at	**December 31, 2017**		December 31, 2016	
	Weighted Average Interest	**Debt Balance**	Weighted Average Interest	Debt Balance
Mortgages and loans payable				
Fixed rate	**2.89%**	**$1,070,387**	3.01%	$989,638
Variable rate	**4.56%**	**12,116**	4.28%	7,863
Vendor financing	**5.00%**	**6,004**	4.43%	13
Total		**$1,088,507**		$997,514
Current		**136,862**		111,862
Non-current		**951,645**		885,652
		$1,088,507		$997,514

Mortgages are collateralized by a first charge on the properties of Killam and vendor mortgages are collateralized by either a second charge on the property or a general corporate guarantee.

As at December 31, 2017, unamortized deferred financing costs of $26.0 million (December 31, 2016 - $22.9 million) and mark-to-market adjustments on mortgages assumed on acquisitions of $0.4 million (December 31, 2016 - $0.3 million) are netted against mortgages and loans payable.

Dollar amounts in thousands of Canadian dollars

11. Mortgages and Loans Payable (continued)

Estimated future principal payments and maturities required to meet mortgage obligations for the years ending December 31, are as follows:

	Principal Amount	% of Total Principal
2018	$136,862	12.3%
2019	208,110	18.7%
2020	210,401	18.9%
2021	147,286	13.2%
2022	127,689	11.4%
Subsequent to 2022	284,558	25.5%
	$1,114,906	100.0%
Unamortized deferred financing costs	(26,003)	
Unamortized mark-to-market adjustments	(396)	
	$1,088,507	

12. Credit Facilities

Killam has access to two credit facilities with credit limits of $70.0 million and $1.5 million (December 31, 2016 - $30.0 million and $1.5 million) that can be used for acquisition and general business purposes. Killam holds an accordion option to increase the $70.0 million facility by an amount not less than $10 million and up to an aggregate amount of not more than $20 million.

The $70.0 million facility bears interest at prime plus 75 bps on prime rate advances or 170 bps over bankers acceptances ("BAs"). Killam has the right to choose between prime rate advances and BAs based on available rates and timing. As at December 31, 2017, Killam has assets with a carrying value of $51.8 million pledged as first mortgage ranking and $302.1 million pledged as second mortgage ranking to the line and a balance outstanding of $nil (December 31, 2016 - $nil). The agreement includes certain covenants and undertakings with which Killam is in compliance as at December 31, 2017.

The $1.5 million facility bears interest at prime plus 175 bps on advances and 135 bps on issuance of letters of credit in addition to 50 bps per annum. As at December 31, 2017, Killam had assets with a carrying value of $1.8 million pledged as collateral (December 31, 2016 - $1.6 million) and letters of credit totaling $1.1 million outstanding against the facility (December 31, 2016 - $1.2 million). The agreement includes certain covenants and undertakings with which Killam is in compliance as at December 31, 2017.

As at December 31, 2017	**Maximum Loan Amount**	**Amount Drawn**	**Letters of Credit**	**Amount Available**
$70.0 million demand facility	$70,000	—	—	$70,000
$1.5 million demand facility	1,500	—	1,100	400
Total	**$71,500**	**—**	**$1,100**	**$70,400**

As at December 31, 2016	Maximum Loan Amount	Amount Drawn	Letters of Credit	Amount Available
$30.0 million demand facility	$30,000	—	—	$30,000
$1.5 million demand facility	1,500	—	1,200	300
Total	$31,500	—	$1,200	$30,300

Dollar amounts in thousands of Canadian dollars

13. Construction Loans

As at December 31, 2017, Killam had access to two floating rate non-revolving demand construction loans for the purpose of financing development projects, including a $51.8 million construction loan commitment related to The Alexander, where Killam has a 50% ownership interest, and a $18.8 million construction loan commitment related to the Saginaw Park development. Payments are made monthly on an interest only basis. The construction loans have interest rates of prime plus 0.625%. Once construction is complete and rental targets achieved, the construction loans will be repaid in full and replaced with conventional mortgages. The underlying assets are pledged as collateral against these loans.

As at December 31, 2017, $28.8 million and $12.2 million, respectively, were drawn on The Alexander and Saginaw Park loans (December 31, 2016 - The Alexander $8.8 million, Southport $9.7 million and Saginaw Gardens II $nil). The loans both have an interest rate of 3.83% (December 31, 2016 - The Alexander 3.33% and Southport 3.45%).

14. Accounts Payable and Accrued Liabilities

As at	**December 31, 2017**	December 31, 2016
Accounts payable and other accrued liabilities	**$25,431**	$16,356
Distributions payable	**4,388**	3,613
Mortgage interest payable	**2,343**	2,240
Security deposits	**6,968**	5,989
	$39,130	$28,198

15. Convertible Debentures

Face Interest Rate %	**Conversion Price**	**Face Amount**	**Maturity Date**	**December 31, 2017**	December 31, 2016[1]
5.45%	$14.60	$46,000	June 30, 2018	—	$46,690

(1) Recorded at fair value based on closing market trading prices of the debentures.

Killam redeemed its $46.0 million, 5.45% convertible debentures on April 13, 2017.

Dollar amounts in thousands of Canadian dollars

16. Exchangeable Units

For the years ended December 31,	2017		2016	
	Number of Exchangeable Units	**Value**	**Number of Exchangeable Units**	**Value**
Balance, beginning of year	3,865,836	$46,158	—	—
Trust units exchanged for exchangeable units on conversion	—	—	4,748,061	$36,567
Fair value adjustment on conversion	—	—	—	12,860
Exchangeable units exchanged	(2,500)	(32)	(882,225)	(11,043)
Fair value adjustment	—	8,811	—	7,774
Balance, end of year	**3,863,336**	**$54,937**	3,865,836	$46,158

The exchangeable units are non-transferable, but are exchangeable, on a one-for-one basis, into Killam trust units at any time at the option of the holder. Prior to such exchange, distributions will be made on these exchangeable units in an amount equivalent to the distributions that would have been made had the units been exchanged for Killam trust units.

17. Unitholders' Equity

By virtue of Killam being an open-ended mutual fund trust, unitholders of trust units are entitled to redeem their trust units at any time at prices determined and payable in accordance with the conditions specified in Killam's DOT. As a result, under IFRS, trust units are defined as financial liabilities; however, for the purposes of financial statement classification and presentation, the trust units may be presented as equity instruments as they meet the puttable instrument exemption under IAS 32.

All trust units outstanding are fully paid, have no par value and are voting trust units. The DOT authorizes the issuance of an unlimited number of trust units. Trust units represent a unitholder's proportionate undivided beneficial interest in Killam. No trust unit has any preference or priority over another. No unitholder has or is deemed to have any right of ownership in any of the assets of Killam. Each unit confers the right to one vote at any meeting of unitholders and to participate pro rata in any distributions and, on liquidation to a pro rata share of the residual net assets remaining after preferential claims thereon of debtholders.

Unitholders have the right to redeem their units at the lesser of (i) 90% of the market price of the trust unit (market price is defined as the weighted average trading price of the previous 10 trading days) and (ii) the most recent closing market price (closing market price is defined as the weighted average trading price on the specified date) at the time of the redemption. The redemption price will be satisfied by cash, up to a limit of $50 thousand for all redemptions in a calendar month, or a note payable. For the year ended December 31, 2017, no unitholders redeemed units.

The units issued and outstanding are as follows:

	Number of Trust Units	**Number of Common Shares**	**Value**
January 1, 2016	—	62,863,034	$484,132
REIT conversion, January 1, 2016	58,114,973	(4,748,061)	(36,567)
Distribution reinvestment plan	558,182	—	6,482
Restricted trust units redeemed	51,688	—	323
Units issued on exchange of exchangeable units	882,225	—	11,043
Units issued for cash	8,165,000	—	93,623
Units issued for acquisitions	97,734	—	1,161
December 31, 2016	67,869,802	—	$560,197
Distribution reinvestment plan	865,143	—	11,104
Restricted trust units redeemed	52,334	—	349
Units issued on exchange of exchangeable units	2,500	—	32
Units issued for cash	11,775,500	—	147,176
December 31, 2017	**80,565,279**	**—**	**$718,858**

Dollar amounts in thousands of Canadian dollars

17. Unitholders' Equity (continued)

New Units Issued

	Price per Unit	Gross Proceeds	Transaction Costs	Net Proceeds	Units Issued
Bought-deal (March 13, 2017)	$12.65	$70,018	$3,160	$66,858	5,535,000
Over-allotment (March 13, 2017)	$12.65	7,002	280	6,722	553,500
Bought-deal (November 29, 2017)	$13.55	70,054	3,183	66,871	5,170,000
Over-allotment (November 29, 2017)	$13.55	7,005	280	6,725	517,000
Total		$154,079	$6,903	$147,176	11,775,500

Distribution Reinvestment Plan ("DRIP")

Killam's DRIP allows unitholders to acquire additional units of the Trust through the reinvestment of distributions on their units. Unitholders who participate in the DRIP receive additional units equal to 3% of the units reinvested. Units issued with the DRIP are issued directly from the Trust at a price based on the 10-day volume weighted average closing price of the TSX preceding the relevant distribution date, which typically is on or about the 15th day of the month following the distribution declaration.

18. Distributions

Killam paid distributions to its unitholders during 2017 in accordance with its DOT. Distributions declared by the Board of Trustees were paid monthly, on or about the 15th day of each month.

For the year ended December 31, 2017, the distributions declared related to the trust units were $46.2 million (year ended December 31, 2016 - $38.3 million), respectively. For the year ended December 31, 2017, distributions declared related to the exchangeable units were $2.4 million (December 31, 2016 - $2.7 million). The distributions on the exchangeable units are recorded in financing costs.

19. Deferred Unit-based Compensation

Restricted Trust Units ("RTUs"), are awarded to members of the senior executive team and director-level employees as a percentage of their compensation. The Trust also grants RTUs subject to performance conditions under the RTU Plan for certain senior executives. Non-executive members of the Board of Trustees have the right to receive a percentage of their annual retainer in the form of RTUs.

The number of RTUs awarded are based on the volume weighted average price of all trust units traded on the TSX for the five trading days immediately preceding the date on which the compensation is awarded. The RTUs earn distributions based on the same distributions paid on the trust units, and such distributions translate into additional RTUs. The initial RTUs, and RTUs acquired through distribution reinvestment, are credited to each person's account and are not issued to the employee or Board member until they redeem such RTUs. For employees the RTUs will be redeemed and paid out in trust units by December 31 of the year in which the RTUs have vested. Effective Q3-2017, RTUs issued to Trustees will be redeemed and paid, in the issuance of trust units, upon retirement from the Board.

The RTUs subject to performance conditions will be subject to both internal and external measures consisting of both absolute and relative performance over a three-year period. Killam accounts for the RTUs subject to performance conditions under the fair value method of accounting, and uses the Monte-Carlo simulation pricing model to determine the fair value which allows for the incorporation of the market based performance hurdles that must be met before the RTUs subject to performance conditions vest. Pursuant to IFRS, compensation costs related to awards with a market-based condition are recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided and all performance conditions have been satisfied.

Dollar amounts in thousands of Canadian dollars

19. Deferred Unit-based Compensation (continued)

The RTUs are considered a financial liability because there is a contractual obligation for the Trust to deliver trust units (which are accounted for as liabilities, but presented as equity instruments under IAS 32) upon conversion of the RTUs. The RTUs are measured at fair value with changes flowing through the consolidated statements of income and comprehensive income. The fair value of the vested RTUs for the year ended December 31, 2017, is $4.5 million, which includes $0.2 million related to RTUs subject to performance conditions (December 31, 2016 - $3.0 million). For the year ended December 31, 2017, compensation expense of $1.0 million (December 31, 2016 - $1.3 million) has been recognized in respect of the RTUs.

The details of the RTUs issued are shown below:

For the year ended December 31,	**2017**		2016	
	Number of RTUs	**Weighted Average Issue Price**	Number of RTUs	Weighted Average Issue Price
Outstanding, beginning of year	**263,736**	**$10.78**	184,106	$10.40
Granted	**242,101**	**12.79**	155,918	10.93
Redeemed	**(91,202)**	**10.73**	(89,656)	10.44
Forfeited	**—**	**—**	(530)	10.88
Additional restricted trust unit distributions	**18,053**	**12.91**	13,898	11.89
Outstanding, end of year	**432,688**	**$12.09**	263,736	$10.78

20. Financing Costs

	2017	2016
Mortgage, loan and construction loan interest	**$32,526**	$30,919
Interest on exchangeable units	**2,383**	2,659
Amortization of fair value adjustments on assumed debt	**(214)**	(415)
Amortization of loss on interest rate hedge	**60**	59
Unrealized gain on derivative liability	**(362)**	(297)
Convertible debenture interest	**715**	4,178
Capitalized interest	**(1,982)**	(910)
	$33,126	$36,193

Dollar amounts in thousands of Canadian dollars

21. Deferred Income Tax

Trusts that satisfy the REIT Exemption are excluded from the specified investment flow-through ("SIFT") definition and therefore will not be subject to taxation under the SIFT Rules. Effective December 31, 2016, Killam qualified for the REIT Exemption and continues to meet the REIT Exemption as at December 31, 2017, and is therefore not subject to taxation to the extent that income is distributed to unitholders. However, this exemption does not extend to the corporate subsidiaries of Killam that are taxable legal entities. For the year ended December 31, 2017, the deferred tax expense relates to the corporate subsidiary entity of the REIT.

The source of deferred tax balances and movements were as follows:

As at December 31,	2016	Recognized in statement of income and comprehensive income	**2017**
Deferred tax liabilities (assets) related to:			
Real estate properties	$83,962	$17,774	**$101,736**
Loss carryforwards	(3,860)	673	**(3,187)**
Unrealized capital gains	2,777	(358)	**2,419**
Other	1,668	570	**2,238**
Net deferred tax liabilities	$84,547	$18,659	**$103,206**

As at December 31,	2015	Recognized on REIT conversion January 1, 2016	Revised opening balance	Recognized in statement of income and comprehensive income	2016
Deferred tax liabilities (assets) related to:					
Real estate properties	$108,785	($35,934)	$72,851	$11,111	$83,962
Loss carryforwards	(194)	(1,273)	(1,467)	(2,393)	(3,860)
Convertible debentures	720	(720)	—	—	—
Unrealized capital gains	—	—	—	2,777	2,777
Other	2,834	(2,070)	764	904	1,668
Net deferred tax liabilities	$112,145	($39,997)	$72,148	$12,399	$84,547

The deferred tax expense for the year can be reconciled to the accounting profit as follows:

For the years ended December 31,	**2017**	2016
Net income before taxes	**$123,419**	$43,841
Statutory tax rate	**29.6%**	29.7%
Income tax expense at statutory rates	**36,557**	13,008
Amounts not subject to tax	**(35,809)**	(12,113)
Effect of provincial tax rate changes	**148**	1,186
Initial derecognition of deferred tax liability on REIT conversion	**—**	(39,997)
Other	**(664)**	—
Change to tax basis in excess of book basis	**18,427**	10,318
Total tax expense (recovery)	**$18,659**	($27,598)

Dollar amounts in thousands of Canadian dollars

22. Segmented Information

For investment properties, discrete financial information is provided on a property-by-property basis to members of executive management, which collectively comprise the chief operating decision maker ("CODM"). The individual properties are aggregated into segments with similar economic characteristics such as the nature of the property, vacancy rates, long-term growth rates and other characteristics. Management considers that this is best achieved by aggregating into apartments, MHC and other segments. Consequently, Killam is considered to have three reportable segments, as follows:

- Apartment segment - acquires, operates, manages and develops multi-family residential properties across Canada;
- MHC segment - acquires and operates MHC communities in Ontario and Eastern Canada; and
- Other segment - includes five commercial properties.

Killam's administration costs, other income, financing costs, depreciation and amortization, fair value adjustments, loss on disposition and deferred tax expense are not reported to the CODM on a segment basis.

The accounting policies of these reportable segments are the same as those described in the summary of significant accounting policies described in note 2 of the consolidated financial statements for the year ended December 31, 2017. Reportable segment performance is analyzed based on NOI. The operating results, and assets and liabilities, of the reportable segments are as follows:

For the year ended December 31, 2017	**Apartments**	**MHCs**	**Other**	**Total**
Property revenue	**$167,718**	**$15,139**	**$4,520**	**$187,377**
Property operating expenses	**(63,767)**	**(5,762)**	**(2,628)**	**(72,157)**
Net operating income	**$103,951**	**$9,377**	**$1,892**	**$115,220**

For the year ended December 31, 2016	Apartments	MHCs	Other	Total
Property revenue	$155,839	$14,715	$4,715	$175,269
Property operating expenses	(61,450)	(5,728)	(2,667)	(69,845)
Net operating income	$94,389	$8,987	$2,048	$105,424

As at December 31, 2017	**Apartments**	**MHCs**	**Other**	**Total**
Total assets	**$2,108,686**	**$154,549**	**$47,975**	**$2,311,210**
Total liabilities	**$1,165,017**	**$89,510**	**$88,961**	**$1,343,488**

As at December 31, 2016	Apartments	MHCs	Other	Total
Total assets	$1,701,080	$142,071	$144,778	$1,987,929
Total liabilities	$966,870	$61,367	$209,226	$1,237,463

23. Supplemental Cash Flow Information

For the years ended December 31,	**2017**	2016
Net income items related to investing and financing activities		
Interest paid on mortgages payable and other	**$32,475**	$30,357
Interest paid on convertible debentures	**715**	4,178
	$33,190	$34,535
Net change in non-cash operating assets and liabilities		
Rent and other receivables	**$540**	($815)
Other current assets	**999**	(1,495)
Accounts payable and other liabilities	**7,991**	4,614
	$9,530	$2,304

Dollar amounts in thousands of Canadian dollars

24. Financial Instruments and Financial Risk Management Objectives and Policies

Killam's principal financial liabilities consist of mortgages, credit facilities, construction loans and trade payables. The main purpose of these financial liabilities is to finance investment properties and operations. Killam has various financial assets, such as trade receivables and cash, which arise directly from its operations.

Killam may enter into derivative transactions, primarily interest rate swap contracts to manage interest rate risk arising from fluctuations in bond yields, as well as natural gas and oil swap contracts to manage price risk arising from fluctuations in these commodities. It is, and has been, Killam's policy that no speculative trading in derivatives shall be undertaken. The main risks arising from Killam's financial instruments are interest rate risk, credit risk and liquidity risk. These risks are managed as follows:

(i) Interest Rate Risk

Killam is exposed to interest rate risk as a result of its mortgages and loans payable; however, this risk is mitigated through Management's strategy to structure the majority of its mortgages in fixed-term arrangements, as well as, at times, entering into cash flow hedges. Killam also structures its financings so as to stagger the maturities of its debt, minimizing the exposure to interest rate volatility in any one year.

As at December 31, 2017, $53.1 million of Killam's debt had variable interest rates, including two construction loans for $41.0 million and six demand loans totaling $12.1 million. These loans and facilities have interest rates of prime plus 0.63%-2.0% (December 31, 2016 - prime plus 0.63%-2.0%) and consequently, Killam is exposed to short-term interest rate risk on these loans.

Killam's fixed mortgage and vendor debt, which matures in the next 12 months, totals $90.3 million. Assuming these mortgages are refinanced at similar terms, except at a 100 bps increase in interest rates, financing costs would increase by $0.9 million per year.

(i) Credit Risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease term commitments. Killam mitigates the risk of credit loss through the diversification of its existing portfolio and limiting its exposure to any one tenant.

Credit assessments are conducted for all prospective tenants and Killam also obtains a security deposit to assist in potential recoveries. In addition, receivables balances are monitored on an ongoing basis. Killam's bad debt expense experience has historically been less than 0.4% of revenue. None of Killam's tenants account for more than 1% of the tenant receivables as at December 31, 2017, or 2016. The maximum exposure to credit risk is the carrying amount of each class of financial assets as disclosed in this note.

(ii) Liquidity Risk

Management manages Killam's cash resources based on financial forecasts and anticipated cash flows. Killam structures its financing so as to stagger the maturities of its debt, thereby minimizing Killam's exposure to liquidity risk in any one year. In addition, Killam's apartments qualify for CMHC insured debt, reducing the refinancing risk upon mortgage maturities.

Killam's MHCs do not qualify for CMHC insured debt; however, MHCs have access to conventional mortgage debt. Management does not anticipate liquidity concerns on the maturity of its mortgages as funds continue to be accessible in the multi-residential sector.

During the year ended December 31, 2017, Killam refinanced $56.3 million of maturing apartment mortgages with new mortgages totaling $77.2 million generating net proceeds of $20.9 million. As well, Killam refinanced $13.4 million of maturing MHC mortgages with new mortgages totaling $24.5 million for net proceeds of $11.1 million. The following table presents the principal payments (excluding interest) and maturities of Killam's liabilities for the next five years and thereafter:

For the twelve months ending December 31,	Mortgage and loans payable	Construction loans	Total
2018	$136,862	$28,809	$165,671
2019	208,110	12,237	220,347
2020	210,401	—	210,401
2021	147,285	—	147,285
2022	127,690	—	127,690
Thereafter	284,558	—	284,558
	$1,114,906	$41,046	$1,155,952

Dollar amounts in thousands of Canadian dollars

24. Financial Instruments and Financial Risk Management Objectives and Policies (continued)

Capital Management

The primary objective of Killam's capital management is to ensure a healthy capital structure to support the business and maximize unitholder value. Killam manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, Killam may adjust the distribution payment to unitholders, issue additional units, issue debt securities or adjust mortgage financing on properties.

Killam's primary measure of capital management is the total debt to total assets ratio. Killam's strategy, as outlined in the operating policies of its DOT, is for its overall indebtedness not to exceed 70% of total assets. However Killam's long-term target is to manage overall indebtedness to be below 50%. The calculation of the total debt to total assets is summarized as follows

As at	December 31, 2017	December 31, 2016
Mortgages, loans payables, credit facilities and construction loans(1)	**$1,115,149**	$1,011,623
Convertible debentures	**—**	$46,000
Total debt	**$1,115,149**	$1,057,623
Total assets(1)	**$2,288,445**	$1,976,133
Total debt as a percentage of assets	**48.7%**	53.5%

(1) Total assets adjusted for Killam's 50% interest in The Alexander development- $22.8 million (December 31, 2016 - $11.5 million). Total mortgages, loans payables and construction loans adjusted for Killam's non-controlling interest related to The Alexander - $14.4 million (December 31, 2016 - $4.4 million).

The above calculation is sensitive to changes in the fair value of investment properties, in particular, cap-rate changes. A 10 bps increase in the weighted average cap-rate as at December 31, 2017, would increase the debt as a percentage of assets by 90 bps.

Fair Value of Financial Instruments

Fair value is the amount that would be received in the sale of an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of interest-bearing financial assets and liabilities is determined by discounting the contractual principal and interest payments at estimated current market interest rates for the instrument. Current market rates are determined by reference to current benchmark rates for similar term and current credit spreads for debt with similar terms and risks. The fair values of the Trust's financial instruments were determined as follows:

(i) the fair values of the loans receivable are based upon discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks. Such fair value estimates are not necessarily indicative of the amounts Killam might receive or pay in actual market transactions;

(ii) the fair values of the mortgages payable are estimated based upon discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks. Such fair value estimates are not necessarily indicative of the amounts Killam might pay or receive in actual market transactions;

(iii) the fair value of the convertible debentures is based on a quoted market price as at the reporting date;

(iv) the fair value of the deferred unit-based compensation and the exchangeable units is estimated at the reporting date, based on the closing market price of the trust units listed on the TSX. The performance based RTUs are determined using a pricing model. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in estimates could significantly affect fair values;

(v) the fair value of the derivative liability is calculated based on an estimate of the mid-market arbitrage-free price of the swap. The arbitrage-free price comprises the present value of the future rights and obligations between two parties to receive or deliver future cash flows or exchange other assets or liabilities. Future obligations are valued as the sum of the present values as of the valuation date of contractually fixed future amounts and expected variable future amounts, the expected size of which is calculated from the projected levels of underlying variables. Future rights are valued as the sum of the present values of the expected values of contingent future amounts, the existence and size of which are calculated from the projected levels of underlying variables.

Dollar amounts in thousands of Canadian dollars

24. Financial Instruments and Financial Risk Management Objectives and Policies (continued)

The significant financial instruments and their carrying values as at December 31, 2017, and December 31, 2016, are as follows:

As at	**December 31, 2017**		December 31, 2016	
Classification	**Carrying Value**	**Fair Value**	Carrying Value	Fair Value
Financial assets carried at amortized cost:				
Loans(1)	**$—**	**$—**	$950	$955
Financial assets carried at FVTPL:				
Derivative asset (2)	**$659**	**$659**	$296	$296
Financial liabilities carried at amortized cost:				
Mortgages payable	**$1,088,507**	**$1,119,922**	$997,514	$1,036,288
Credit facilities	**$—**	**$—**	$—	$—
Financial liabilities carried at FVTPL:				
Exchangeable units	**$54,937**	**$54,937**	$46,158	$46,158
Convertible debentures	**$—**	**$—**	$46,690	$46,690
Deferred unit-based compensation	**$4,501**	**$4,501**	$2,988	$2,988

(1) The $1.0 million loan receivable is included in the other non-current assets within the consolidated financial statement of financial position as at December 31, 2016.

(2) The $0.7 million derivative asset is included in other non-current assets within the consolidated statements of financial position.

The interest rates used to discount the estimated cash flows, when applicable, are based on the five-year government yield curve at the reporting date, plus an adequate credit spread, and were as follows:

As at	**December 31, 2017**	December 31, 2016
Mortgages - Apartments	**2.82%**	2.34%
Mortgages - MHCs	**4.52%**	3.76%

Assets and Liabilities Measured at Fair Value

Fair value measurements recognized in the consolidated statements of financial position are categorized using a fair value hierarchy that reflects the significance of inputs used in determining the fair values:

Level 1: Quoted prices in active markets for identical assets or liabilities.
Level 2: Quoted prices in active markets for similar assets or liabilities or valuation techniques where significant inputs are based on observable market data.
Level 3: Valuation techniques for which any significant input is not based on observable market data.

The fair value hierarchy of assets and liabilities measured at fair value on a recurring basis in the consolidated statements of financial position is as follows:

As at	**December 31, 2017**			December 31, 2016		
	Level 1	**Level 2**	**Level 3**	Level 1	Level 2	Level 3
Assets						
Investment properties	—	—	**$2,279,763**	—	—	$1,942,809
Derivative asset	—	**$659**	—	—	$296	—
Liabilities						
Exchangeable units	—	**$54,937**	—	—	$46,158	—
Convertible debentures	—	—	—	$46,690	—	—
Deferred unit-based compensation	—	**$4,351**	**$150**	—	$2,988	—

Dollar amounts in thousands of Canadian dollars

24. Financial Instruments and Financial Risk Management Objectives and Policies (continued)

Transfers between levels in the fair value hierarchy are recognized on the date of the event or change in circumstances that caused the transfer. There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 during the year ended December 31, 2017.

25. Commitments and Contingencies

Killam has entered into commitments for development costs of $25.8 million as at December 31, 2017 (December 31, 2016 - $26.9 million).

Killam is subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. Management believes that the final outcome of such matters will not have a material adverse effect on the financial position, results of operations or liquidity of Killam. However, actual outcomes may differ from Management's expectations.

Killam and its 50% partner began construction in downtown Halifax on a 240-unit building, The Alexander, in late 2015. This project is scheduled to be completed in mid-2018. The cost to develop is approximately $77 million. At the completion of construction and following the achievement of certain leasing conditions, Killam has a commitment in place to purchase the other 50% interest in this development.

Killam entered into a physical supply contract for natural gas to hedge its own usage, which is summarized below:

Area	Usage Coverage	Term	Cost
Ontario	41%	November 1, 2017 - October 31, 2018	$0.1059/m3
Ontario	14%	December 1, 2017 - November 30, 2018	$0.1059/m3
Ontario	45%	December 1, 2017 - November 30, 2018	$0.1439/m3

26. Financial Guarantees

Killam is the guarantor on a joint and several basis for mortgage debt held through its joint operations. As at December 31, 2017, the maximum potential obligation resulting from these guarantees is $119.9 million, related to long-term mortgage financing (December 31, 2016 - $87.9 million). These loans are secured by a first ranking mortgage over the associated investment properties. Half of the total mortgages for these properties are recorded as a mortgage liability on the consolidated financial statements of financial position. Killam is also the guarantor on a joint and several basis for the construction loan related to The Alexander development project. As at December 31, 2017, the maximum potential obligation resulting from this guarantee is $14.4 million (December 31, 2016 - $4.4 million).

Management has reviewed the contingent liability associated with its financial guarantee contracts and, as at December 31, 2017, determined that a provision is not required to be recognized in the consolidated statements of financial position (December 31, 2016 - $nil).

27. Comparative Figures

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for the current year. Killam reclassified, on the consolidated statement of financial position, a derivative asset from "other liabilities" to "other non-current assets" as this derivative is in an asset position as at December 31, 2017 and 2016. Killam reclassified, on the consolidated statements of cash flows, a portion of cash related to interest expense on exchangeable units from "net change in non-cash operating activities" to "interest expense on exchangeable units" as this interest is not related to net working capital.

Dollar amounts in thousands of Canadian dollars

28. Related Party Transactions

For the year ended December 31, 2017, Killam paid $33 thousand in commercial leasing fees to a property management company controlled by an executive and Trustee of Killam (December 31, 2016 - $nil).

During the year ended December 31, 2017, Killam paid a sales commission, totaling $0.3 million to a property management company that is 50% owned by an executive and Trustee of Killam (December 31, 2016 - $nil).

Halkirk Properties Limited ("Halkirk") is a company that is partially owned by a Trustee of Killam. During 2016 and 2017, Killam and Halkirk have been developing a 240-unit building adjacent to the Brewery Market in Halifax, Nova Scotia. Construction of the development is managed by Killam and the cost of construction is funded 50/50 by each partner.

The remuneration of directors and other key management personnel, which include the Board of Trustees, President & Chief Executive Officer, EVP, CFO and Vice-Presidents of Killam, is as follows:

For the years ended December 31,	**2017**	2016
Salaries, board compensation and incentives	**$4,519**	$3,318
Deferred unit-based compensation	**959**	2,070
Total	**$5,478**	$5,388

29. Subsequent Events

On January 16, 2018, Killam announced a distribution of $0.05167 per unit, payable on February 15, 2018, to unitholders of record on January 31, 2018.

On February 9, 2018 KIllam agreed to acquire a 1.8 acre development site located in Kitchener, Ontario, which includes a small commercial building and a heritage residence for $6.0 million. This property is zoned for a 141-unit development and is scheduled to close in mid-March.

On February 12, 2018, Killam agreed to acquire a recently completed, twelve-storey, 110-unit apartment building located in Dartmouth, Nova Scotia for $33.0 million, which is expected to close by the end of February.

On February 13, 2018, the Board of Trustees approved a 3.2% increase to Killam's annual distribution, to $0.64 per unit from $0.62 per unit. The monthly distribution will be $0.05333 per unit, up from $0.05167 per unit. The increase will become effective for the March 2018 distribution, to be paid in April 2018.