Consolidated Financial Statements

For the years ended December 31, 2013 and 2012

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 Properties Inc. 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, 2013, 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 Shareholders, have examined the consolidated financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the Shareholders 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 Directors and its Audit Committee. This committee meets regularly with management and the auditors, who have full and free access to the Audit Committee.

Philip Fraser
President and Chief Executive Officer
February 18, 2014

Robert Richardson
Executive Vice President and Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Killam Properties Inc.

We have audited the accompanying consolidated financial statements of **Killam Properties Inc**., which comprise the consolidated statements of financial position as at December 31, 2013 and 2012, 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 auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Killam Properties Inc.** as at December 31, 2013 and 2012, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Halifax, Canada,
February 18, 2014.

Chartered accountants

Consolidated Statements of Financial Position

In thousands of Canadian dollars,
As at

	Note	**December 31, 2013**	December 31, 2012
ASSETS			
Non-current assets			
Investment properties	[5]	**$1,476,116**	$1,354,665
Investments in joint ventures	[6]	**11,469**	10,289
Property and equipment	[7]	**4,527**	4,574
Other non-current assets		**17**	45
		1,492,129	1,369,573
Current assets			
Cash		**27,678**	56,726
Rent and other receivables	[8]	**2,751**	3,767
Inventory	[9]	**570**	762
Other current assets	[10]	**9,303**	12,300
		40,302	73,555
TOTAL ASSETS		**$1,532,431**	$1,443,128
EQUITY AND LIABILITIES			
Shareholders' equity		**$590,724**	$575,335
Non-controlling interest		**13,336**	13,101
Total Equity		**604,060**	588,436
Non-current liabilities			
Mortgages and loans payable	[12]	**545,541**	519,712
Convertible debentures	[14]	**96,419**	94,924
Other liabilities		**2,171**	2,427
Deferred tax	[21]	**93,221**	83,871
		737,352	700,934
Current liabilities			
Mortgages and loans payable	[12]	**153,589**	105,369
Construction loans	[13]	**14,775**	14,062
Subordinated debentures	[15]	-	9,998
Accounts payable and other liabilities	[11]	**22,655**	24,329
		191,019	153,758
Total Liabilities		**928,371**	854,692
TOTAL EQUITY AND LIABILITIES		**$1,532,431**	$1,443,128

See accompanying notes to the consolidated financial statements.
Commitments (Note 26)
Guarantees (Note 27)

Approved on Behalf of the Board

G. W. Watson

Director

Philip Fraser

Director

Consolidated Statements of Income and Comprehensive Income

In thousands of Canadian dollars (except per share amounts)
For the Years Ended December 31,

	Note	2013	2012
Property revenue		**$141,112**	$133,641
Property operating expenses		**(58,072)**	(53,197)
Net operating income		**83,040**	80,444
Other income			
Equity income	[6]	**1,296**	758
Home sales	[18]	**323**	469
Corporate income	[19]	**746**	962
		2,365	2,189
Other expenses			
Financing costs	[20]	**(35,231)**	(34,633)
Depreciation		**(589)**	(540)
Amortization of deferred financing costs		**(1,643)**	(1,605)
Administration		**(7,878)**	(8,832)
		(45,341)	(45,610)
Income before fair value gains, loss on disposition and income taxes		**40,064**	37,023
Fair value gains	[5]	**13,070**	37,726
Loss on disposition		**(1,401)**	(1,286)
Income before income taxes		**51,733**	73,463
Current tax expense	[21]	**(1,451)**	-
Deferred tax expense	[21]	**(9,350)**	(19,234)
Net income and comprehensive income		**$40,932**	$54,229
Net income and comprehensive income attributable to:			
Common shareholders		**39,779**	51,727
Non-controlling interest		**1,153**	2,502
		$40,932	$54,229

Net income per share attributable to common shareholders:	[22]		
-basic		**$0.74**	$1.03
-diluted		**$0.69**	$0.97

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

In thousands of Canadian dollars,

For the Years Ended December 31,

2013	**Share Capital**	**Contributed Surplus**	**Other Paid- in Capital**	**Retained Earnings**	**Non-Controlling Interest**	**Total Equity**
At January 1, 2013	**$391,120**	**$2,241**	**$5,681**	**$176,293**	**$13,101**	**$588,436**
Comprehensive income	**-**	**-**	**-**	**39,779**	**1,153**	**40,932**
Dividends	**-**	**-**	**-**	**(31,512)**	**-**	**(31,512)**
Distributions to non-controlling interest	**-**	**-**	**-**	**-**	**(918)**	**(918)**
Dividend reinvestment plan	**3,346**	**-**	**-**	**-**	**-**	**3,346**
Stock options exercised	**1,036**	**(111)**	**-**	**-**	**-**	**925**
Share-based compensation	**-**	**624**	**-**	**-**	**-**	**624**
Issuance of shares for acquisitions	**2,390**	**-**	**-**	**-**	**-**	**2,390**
Restricted share units redeemed	**289**	**(452)**	**-**	**-**	**-**	**(163)**
At December 31, 2013	**$398,181**	**$2,302**	**$5,681**	**$184,560**	**$13,336**	**$604,060**

2012	Share Capital	Contributed Surplus	Other Paid- in Capital	Retained Earnings	Non-Controlling Interest	Total Equity
At January 1, 2012	$339,178	$2,251	$5,681	$153,895	$11,538	$512,543
Comprehensive income	-	-	-	51,727	2,502	54,229
Dividends	-	-	-	(29,341)	-	(29,341)
Acquisition of non-controlling interest	-	-	-	12	(30)	(18)
Distributions to non-controlling interest	-	-	-	-	(909)	(909)
Issuance of shares for cash	32,877	-	-	-	-	32,877
Dividend reinvestment plan	4,367	-	-	-	-	4,367
Stock options exercised	4,195	(589)	-	-	-	3,606
Tax benefit of share issuance costs	503	-	-	-	-	503
Warrants exercised	10,000	-	-	-	-	10,000
Share-based compensation	-	579	-	-	-	579
At December 31, 2012	$391,120	$2,241	$5,681	$176,293	$13,101	$588,436

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

In thousands of Canadian dollars,

For the Years Ended December 31,

		2013	2012
OPERATING ACTIVITIES			
Net income		**$40,932**	$54,229
Add (deduct) items not affecting cash			
Fair value gains	[5]	**(13,070)**	(37,726)
Depreciation and amortization		**2,233**	2,145
Non-cash compensation expense		**385**	579
Equity income		**(1,296)**	(758)
Deferred income taxes		**9,350**	19,234
Loss on disposition		**1,101**	1,029
Financing costs	[20]	**35,231**	34,633
Interest paid	[24]	**(35,156)**	(34,883)
Net change in non-cash operating activities	[24]	**(630)**	7,545
Cash provided by operating activities		**$39,080**	$46,027
FINANCING ACTIVITIES			
Increase in deferred financing		**(3,425)**	(1,260)
Proceeds on issuance of common shares		**869**	46,486
Repayment of subordinated debentures		**(10,000)**	-
Mortgage financing		**190,152**	56,291
Mortgages repaid on maturity		**(70,015)**	(27,237)
Mortgage principal repayments		**(30,043)**	(18,829)
Proceeds from construction loans		**21,223**	14,062
Construction loans repaid on maturity		**(20,511)**	-
Distributions paid to non-controlling interest		**(918)**	(909)
Dividends		**(28,094)**	(24,726)
Cash provided by financing activities		**$49,238**	$43,878
INVESTING ACTIVITIES			
Decrease in restricted cash		**3,160**	(65)
Acquisition of non-controlling interest		**-**	(17)
Investments in joint ventures		**116**	(1,112)
Net proceeds on sale of investment properties		**43,122**	34,326
Acquisition and development of investment properties, net of debt assumed		**(141,154)**	(86,426)
Capital expenditures		**(22,610)**	(23,233)
Cash used in investing activities		**$(117,366)**	$(76,527)
Net (decrease) increase in cash		**(29,048)**	13,378
Cash, beginning of the year		**56,726**	43,348
Cash, end of year		**$27,678**	$56,726

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

1. Corporate Information

Killam Properties Inc ("Killam" or the "Company") is a real estate company specializing in the acquisition, management and development of multi-residential apartment buildings and manufactured home communities in Canada. Killam is incorporated under the Canada Business Corporations Act. Killam's common shares are publicly traded and listed on the Toronto Stock Exchange under the symbol "KMP". The consolidated financial statements comprise the financial statements of Killam and its subsidiaries as at December 31, 2013. The Company's head office operations are located at 3700 Kempt Road, Halifax, Nova Scotia, B3K 4X8 and the Company's registered office is located at 2571 Windsor Street, Halifax, Nova Scotia, B3K 5C4.

The consolidated financial statements of the Company for the year ended December 31, 2013, were authorized for issue in accordance with a resolution of the Board of Directors on Tuesday, February 18, 2014.

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").

(B) Basis of Presentation

The consolidated financial statements of the Company have been prepared on a historical cost basis, except for investment properties that 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 when otherwise noted. Standards and guidelines not effective for the current accounting period are described in Note 4.

(C) Basis of Consolidation

(i) Subsidiaries

The consolidated financial statements include the accounts of Killam and its subsidiaries. Non-controlling interests represent 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 Statement of Financial Position, separately from shareholders' 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.

The Company's significant investment in subsidiaries and a joint venture, all of which are incorporated in Canada, are listed in the following table:

Subsidiary	**% Interest**
Killam Properties Inc.	100%
Killam Investments Inc.	100%
Killam Investments (PEI) Inc.	100%
Killam Properties Apartments Trust	100%
Killam Properties M.H.C. Trust	100%
661047 N.B. Inc.	100%
Blackshire Court Limited	100%
Blackshire Court Limited Partnership	95.92%
Killam KFH (180 Mill St.) Inc.	100%
Killam KFH (Kanata Lakes) Inc.	100%
Killam KFH (1355 Silver Spear Road) Inc.	100%
Killam KFH Sigma GP Inc.	50%
Killam KFH-Sigma Properties LP	25%

2. Significant Accounting Policies (continued)

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;
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.

(ii) Joint Arrangements

The Company has contractual arrangements with other parties which represent joint ventures. These take the form of agreements to share control over the entities.

Where a joint venture is established through an interest in a company (a jointly controlled entity), the Company recognizes an interest in the entity's assets and liabilities using the equity method of accounting. Under the equity method, the interest in the joint venture is carried in the Consolidated Statement of Financial Position at cost plus post acquisition changes in the Company's share of the net assets, less distributions received and less any impairment in the value of individual investments.

(D) Property Asset Acquisitions and Business Combinations

Where property is acquired, management considers the substance of the assets and activities of the acquired entity in determining whether the acquisition represents the acquisition of a business. The basis of this judgmental assessment is set out in Note 3.

Where such acquisitions are not judged to be an acquisition of a business, they are not treated as business combinations. Rather, the cost to acquire the corporate entity is allocated between the identifiable assets and liabilities of the entity based on their relative fair values at the acquisition date and acquisition related transaction costs are capitalized to the property. Accordingly, no goodwill or additional deferred tax balances.

All of Killam's acquisitions have been determined to be asset acquisitions and therefore none are treated as a business combination.

(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. The Company 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. Incentives for lessees to enter into lease agreements are spread evenly over the lease term as a reduction of rental income, even if the payments are not made on such a basis. The lease term is the non-cancelable period of the lease.

(ii) 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.

(iii) 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 the Company does not manufacture these homes itself.

2. Significant Accounting Policies (continued)

(F) Investment Properties

Investment properties includes multi-family residential properties and manufactured home communities held to earn rental income and properties that are under construction or development for future use as investment properties.

(i) Completed investment property

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 income statement 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 property are recognized in the Statements of Income and Comprehensive Income in the year of retirement or disposal.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by the commencement of operating leases. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of development.

(ii) Investment property under construction ("IPUC")

The cost of development properties includes direct development costs, realty taxes and borrowing costs directly attributable to the development. Under the requirements of International Accounting Standard 40 - Investment Property ("IAS 40"), IPUC is measured at fair value at each reporting date, with the recognition of gains or losses in the income statement. If the fair value of IPUC is not reliably determinable, but the Company expects the fair value of the property to be reliably determinable when construction is complete, it measures that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier).

(iii) Borrowing costs related to IPUC

Although IPUC is measured at fair value, Killam's policy is to present its Statements of Income and Comprehensive Income as if borrowing costs related to the construction are capitalized. Borrowing costs directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are recorded as part of the cost of the respective assets. The interest is calculated using the Company's weighted average cost of borrowings after adjusting for borrowings associated with specific developments. Where borrowings are associated with specific developments, the amount is the gross interest incurred on those borrowings less any investment income arising on their temporary investment. Interest is capitalized from the commencement of the development work until the date of substantial completion. The capitalization of borrowing costs is suspended if there are prolonged periods when development activity is interrupted. Interest is also capitalized on the purchase cost of a site or property acquired specifically for redevelopment but only where activities necessary to prepare the asset for redevelopment are in progress. The Company considers substantial completion to have occurred when the property is capable of operating in the manner intended by management.

(G) Property and Equipment

Property and equipment are stated at historical cost less accumulated depreciation and are mainly comprised of head office buildings, leasehold improvements and IT systems. The estimated useful lives, residual values and depreciation method are reviewed at each yearend, with the effect of any changes in estimate accounted for prospectively. These items are amortized on a straight-line basis over their estimated useful lives ranging as follows:

Building	40 years
Heavy equipment	15 years
Vehicles	10 years
Furniture, fixtures and office equipment	5-10 years
Leaseholds	Lease term

2. Significant Accounting Policies (continued)

(H) 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.

(I) Cash

Cash is comprised of bank balances and interest-earning bank accounts.

(J) Share-Based Compensation

The Company issues share-based awards to certain employees and non-employee directors whereby employees render services as consideration for equity instruments (equity-settled transactions).

The cost of equity-settled transactions is recognized, together with a corresponding increase in contributed surplus in equity, over the period in which the performance and/or service conditions are fulfilled. The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The movement in cumulative expense recognized at the beginning and end of a period is recognized in administration expense.

Where the terms of an equity-settled transaction award are modified, the minimum expense recognized is the expense as if the terms had not been modified, if the original terms of the award are met. An additional expense is recognized for any modification that increases the total fair value of the share-based payment transaction, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. This includes any award where non-vesting conditions within the control of either the entity or the employee are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of share-based awards is reflected as additional share dilution in the computation of diluted earnings per share (further details are given in Note 22).

(K) Financial Assets and Liabilities

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

Measurement in subsequent periods depends on the classification of the financial instrument as follows:

Financial assets at fair value through profit or loss ("FVTPL")

Financial assets are classified as FVTPL when acquired principally for the purpose of trading, if so designated by management (fair value option), or if they are derivative assets. Financial assets classified as FVTPL are measured at fair value, with changes recognized in the Consolidated Statements of Income and Comprehensive Income.

2. Significant Accounting Policies (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets that have fixed or determinable payments and are not quoted in an active market. Subsequent to initial recognition, loans and receivables are carried at amortized cost, using the effective interest method, less a provision for impairment. A provision for impairment is established when there is objective evidence that collection will not be possible under the original terms of the contract. Indicators of impairment include delinquency of payment and significant financial difficulty of the holder. The carrying amount of the financial asset is reduced through an allowance account, and the amount of the loss is recognized in the Consolidated Statements of Income and Comprehensive Income. Any subsequent reversal of an impairment loss is recognized in profit or loss.

Financial liabilities at FVTPL

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.

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 method. The effective interest 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.

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.

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 the Company’s classification and measurement of financial assets and liabilities:

Financial Asset and Liability	Classification	Subsequent Measurement
Cash	Fair value through Profit and Loss	Fair Value
Rent and other receivables	Loans and Receivables	Amortized cost
Accounts payable and other liabilities	Other Financial Liabilities	Amortized cost
Mortgages, loans payable and construction loans	Other Financial Liabilities	Amortized cost
Convertible debentures	Other Financial Liabilities	Amortized cost
Subordinated debentures	Other Financial Liabilities	Amortized cost

(i) 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.

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. Canada Mortgage and Housing Corporation ("CMHC") insurance premiums are amortized over the mortgage amortization period.

2. Significant Accounting Policies (continued)

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.

(ii) Financial guarantee contracts

Financial guarantee contracts issued by the Company are those contracts that require a payment to be made to reimburse the holder of the guarantee for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognized initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the balance sheet date and the initial amount recognized less cumulative amortization.

(iii) Convertible Debentures

Convertible debentures are separated into liability and equity components based on the terms of the contract. On issuance of the Convertible debenture, the fair value of the liability component is determined using a market rate for an equivalent nonconvertible bond. This amount is classified as a financial liability measured at amortized cost (net of transaction costs) until it is extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option that is recognized and included in shareholders' equity. The carrying amount of the conversion option is not remeasured in subsequent years. Transaction costs are apportioned between the liability and equity components of the convertible debenture based on the allocation of proceeds to the liability and equity components when the instruments are initially recognized. Upon conversion, no gain or loss is recognized.

(L) Taxation

(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 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.

The Company 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.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

3. Significant Accounting Judgments, Estimates and Assumptions

In the application of Killam's accounting policies, which are described in Note 2, Management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The judgments, estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments Other Than Estimates

In the process of applying the Company's accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Property Acquisitions

When investment properties are acquired, management considers whether the acquisition represents the acquisition of an asset or a business. The Company accounts for an acquisition as a business combination where an integrated set of activities is acquired in addition to the property. More specifically, consideration is made of the extent to which significant processes are acquired and, in particular, the extent of ancillary services provided by the subsidiary (e.g., maintenance, cleaning, security, bookkeeping, leasing operations, etc.).

Management believes that the majority of the Company's acquisitions will be classified as asset acquisitions. During the acquisition of most properties, Killam buys the asset itself and any short-term leases that are in place. Generally, Killam does not purchase any business systems or processes with a property. Management considers an acquisition to be a business combination if all the following criteria are met:

- The acquisition includes a property portfolio (multiple buildings),
- A significant staff complement is included, including a maintenance team, leasing representatives and property management personnel, and
- Systems are acquired and continue to be incorporated into operations.

Investment Properties

The Company's accounting policies relating to investment properties are described in Note 2(F). In applying this policy, judgment is applied in determining whether certain costs are additions to the carrying amount of the property and, for properties under construction, identifying the point at which substantial completion of the property occurs and identifying the directly attributable borrowing costs to be included in the carrying value of the development property. Judgment is also applied in determining the extent and frequency of independent appraisals.

Leases

The Company has entered into residential property leases on its investment property portfolio. The Company has determined, based on an evaluation of the terms and conditions of the arrangements, that it has not transferred all the significant risks and rewards of ownership of these properties and accounts for the contracts with tenants as operating leases.

Financial Instruments

The Company's accounting policies relating to financial instruments are described in Note 2(K). The critical judgments inherent in these policies relate to applying the criteria set out in IAS 39 to designate financial instruments as FVTPL and determining whether the Company has significant influence over investees with which it has contractual relationships in addition to the financial instrument it holds.

3. Significant Accounting Judgments, Estimates and Assumptions (continued)

Taxes

The Company is subject to income and capital gains taxes in numerous jurisdictions. Significant judgment is required to determine the total provision for current and deferred taxes. There are many transactions and calculations for which the ultimate tax determination and timing of payment is uncertain. The Company recognizes liabilities for current taxes based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income and deferred tax provisions in the period in which the determination is made. Deferred tax assets and liabilities are recognized on a net basis to the extent they are relating to the same fiscal entity and fall due in approximately the same period.

Consolidation and joint arrangements

The Company has determined that it controls and consolidates the subsidiaries where it owns a majority of the shares. The Company is part owner of one property in which it has a 47% interest. The Company has determined that it does control this property as it operates and manages the property, governs the financial and operating policies, and has the power to cast the majority of the votes at meetings of the board of directors given the widely held distribution of the remaining ownership percentage. This property is accounted for on a consolidated basis.

The Company is part owner of an investment in which it has a 25% ownership interest. The Company has determined that it does not have control as it holds less than a 50% ownership interest. This investment is a joint arrangement which is separately incorporated. It is deemed that the joint arrangement is separate from the Company, having no direct interest in the assets and obligation of the joint arrangement. The Company has (after considering the structure and form of the arrangement, the terms agreed by the parties in the contractual arrangement and the Company's rights and obligations arising from the arrangement) classified its interest as a joint venture under IFRS 11. As a consequence it accounts for its investment in the joint venture using the equity method.

Estimates

Valuation of Investment Properties

The fair value of investment property is partially determined by independent real estate valuation experts (the "External Valuator") using recognized valuation techniques and partially by Management. The External Valuator uses the capitalization of net income method to determine the fair market value. In some cases, the fair values are corroborated by recent real estate transactions with similar characteristics and location to those of the Company's assets. Management's internal valuation model is also based on a capitalization of normalized net operating income ("NOI") by property, using property specific quarterly capitalization rates ("cap-rates"), provided by an independent qualified valuation professional.

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

The determination of the fair value of investment property requires the use of estimates such as future cash flows from assets and cap-rates applicable to those assets. In addition, development risks (such as construction and leasing risks) are also taken into consideration when determining the fair value of IPUC. These estimates are based on local market conditions existing at the reporting date. In arriving at their estimates of market values, the External Valuator uses their market knowledge and professional judgment and does not rely solely on historical transaction comparables. The critical estimates and assumptions underlying the valuation of investment properties and developments are set out in Note 5.

Fair Value of Financial Instruments

Where the fair value of financial assets and financial liabilities recorded in the Notes to the Consolidated Financial Statements cannot be derived from active markets, they are determined using valuation techniques, including the discounted cash flow model. Inputs to these models are taken from observable markets where possible, but where this is not feasible a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

3. Significant Accounting Judgments, Estimates and Assumptions (continued)

Changes in Accounting Policies

The accounting policies applied during the year ended December 31, 2013 are consistent with those used in the audited consolidated financial statements for the year ended December 31, 2012, except for the following new and amended IFRS and International Financial Reporting Interpretations Committee ("IFRIC") interpretations which were effective for periods beginning on or after July 1, 2012, and January 1, 2013:

IAS 1 - Financial Statement Presentation ("IAS 1") — Presentation of Items of Other Comprehensive Income ("OCI")

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The adoption of this standard did not have an impact on the Company's financial position or performance.

IFRS 10 - Consolidated Financial Statements ("IFRS 10")

IFRS 10 replaces the portion of IAS 27 - Consolidated and Separate Financial Statements ("IAS 27") that addresses the accounting for consolidated financial statements. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 require Management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. The adoption of this standard did not have an impact on the Company's financial position or performance.

IFRS 11 - Joint Arrangements ("IFRS 11")

IFRS 11 replaces IAS 31 - Interests in Joint Ventures and SIC 13 - Jointly controlled Entities — Non monetary Contributions by Venturers. IFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Instead, joint arrangements that meet the definition of a joint venture must be accounted for using the equity method. Otherwise joint arrangements are classified as joint operations and are accounted for by recognizing the Company's share of the arrangement's assets and liabilities. The adoption of this standard did not have an impact on the Company's accounting treatment of its joint arrangements as they meet the definition of joint ventures and were previously accounted for using the equity method.

IFRS 12 - Disclosure of Interest in Other Entities ("IFRS 12")

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required, including:

- A requirement to disclose judgments made in determining if the Company controls, has joint control, or significant influence over an entity; and
- A requirement to disclose judgments made in determining the type of joint arrangement in which the Company has an interest.

The Company adopted this standard and included the required disclosures related to the Company's interest in subsidiaries, joint arrangements and associates in the notes of these consolidated financial statements.

IFRS 13 - Fair Value Measurement ("IFRS 13")

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Company adopted the standard and concluded that the definition of fair value applied in IFRS 13 does not differ materially from the Company's current definition and therefore there was no impact on the Company's financial position. However, IFRS 13 does expand the disclosure requirements in respect of fair value measurement, and these additional disclosures are included in Note 5 of these consolidated financial statements.

4. Future Accounting Policy Changes

IFRS 9 - Financial Instruments (“IFRS 9”)

IFRS 9, as issued in 2010, reflects the first phase of the IASB’s work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after January 1, 2013. In November 2013, Chapter 6 of IFRS 9 on hedge accounting was published. At the same time, Chapter 7, containing the effective date and transition provisions was amended to remove the mandatory effective date of IFRS 9. This was intended to provide sufficient time for preparers to make the transition to the new requirements. The Company may still choose to apply IFRS immediately, but is not required to do so.

In subsequent phases, the IASB is addressing impairment of financial assets. The adoption of the first phase of IFRS will have an effect on the classification and measurement of the Company's financial assets, but will not have an impact on the classification measurements of financial liabilities. The Company is in the process of assessing the impact IFRS 9 may have on future financial statements.

IFRIC Interpretation 21 - Levies (“IFRIC 21”)

IFRIC 21 clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. IFRIC 21 is effective for annual periods beginning on or after January 1, 2014. The Company is in the process of assessing the impact IFRIC 21 may have on future financial statements.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

5. Investment Properties

The Company has used the following hierarchy for determining the fair value measurement of its investment properties and IPUC:

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: Other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: Techniques which use inputs that have significant effect on the recorded fair value that are not based on observable market data.

As at and for the year ended December 31, 2013

Segment	Apartments	MHCs	Other	IPUC	Total
Level	**3**	**3**	**3**	**3**	
Balance, beginning of year	**$1,126,189**	**$168,401**	**$2,134**	**$57,941**	**$1,354,665**
Fair value gains included in net income					
Fair value gains on investment property	**1,272**	**11,798**	**-**	**-**	**13,070**
Acquisitions and dispositions					
Acquisitions	**118,277**	**1,390**	**-**	**7,294**	**126,961**
Dispositions	**-**	**(69,680)**	**-**	**-**	**(69,680)**
Other movements					
Transfer from IPUC	**70,315**	**-**	**-**	**(70,315)**	**-**
Capital expenditure on investment property	**18,100**	**3,505**	**42**	**-**	**21,647**
Capital expenditure on IPUC	**-**	**-**	**-**	**28,356**	**28,356**
Interest capitalized on IPUC	**-**	**-**	**-**	**1,097**	**1,097**
Balance, end of year	**$1,334,153**	**$115,414**	**$2,176**	**$24,373**	**$1,476,116**

As at and for the year ended December 31, 2012

Segment	Apartments	MHCs	Other	IPUC	Total
Level	3	3	3	3	
Balance, beginning of year	$1,012,847	$231,747	$2,051	$11,574	$1,258,219
Fair value gains (losses) included in net income					
Fair value gains (losses) on investment property	33,573	6,133	-	(1,980)	37,726
Acquisitions and dispositions					
Acquisitions	60,730	65	-	-	60,795
Dispositions	-	(72,889)	-	-	(72,889)
Other movements					
Capital expenditure on investment property	19,039	3,345	83	-	22,467
Capital expenditure on IPUC	-	-	-	47,284	47,284
Interest capitalized on IPUC	-	-	-	1,063	1,063
Balance, end of year	$1,126,189	$168,401	$2,134	$57,941	$1,354,665

During the year ended December 31, 2013, the Company capitalized salaries of $2.8 million (2012 - $2.0 million), as part of its project improvement, suite renovation and development programs.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

5. Investment Properties (continued)

For year ended December 31, 2013, interest costs associated with the general corporate borrowings used to fund development have been capitalized to the respective development using the Company's weighted average borrowing rate of 4.38% (December 31, 2012 - 4.50%). Interest costs associated with construction loans are capitalized to the respective development using the actual borrowing rate associated with the loan.

Investment properties with a fair value of $1,432,731 at December 31, 2013, (December 31, 2012 - $1,294,317) are pledged as collateral against the Company's mortgages payable.

Valuation Process

The management group that determines the Company’s valuation policies and procedures for investment property valuations comprises the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Each year, the CEO and CFO decide which external valuator to appoint to be responsible for the external valuations of the Company’s properties. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained.

The CEO and CFO decide each quarter after consultation with the Company's external valuator and the Company's finance department:

- whether a property’s fair value can be reliably determined (IPUC are valued at cost until such time as fair value becomes reliably determinable);
- which valuation method should be applied for each property; and
- the assumptions made for unobservable inputs that are used in the valuation methods.

Valuations are performed on a quarterly basis at each interim reporting date. Valuations for interim reporting purposes are prepared internally by the Company’s finance department using cap-rates provided by the Company's external valuator. On an annual basis the Company obtains full valuation reports from an external valuator for approximately 20% of its investment property portfolio, and therefore every property is externally valued at least once every five years.

At each reporting date, the finance department analyses the movement in each property’s value. For this analysis, the finance department verifies the major inputs applied in the latest valuation by referencing supporting information in the calculation to market reports and other relevant documents. For each property, the latest valuation is also compared with the valuations in the preceding quarter. If the fair value change (positive or negative) is more than 5%, the change is further analyzed to ensure reasonability, as well as absence of expected changes.

On a quarterly basis, the finance department discusses assumptions used in the valuations, with an emphasis on: (i) properties with fair value changes outside of the relevant threshold set out above; and (ii) IPUC.

The following table presents the following for each class of investment property:

- the level of the fair value hierarchy;
- the carrying amount or fair value of the investment property;
- a description of the valuation technique; and
- for Level 3 fair value measurements, quantitative information about significant unobservable inputs.

Class of property	Fair value at December 31, 2013	Fair value at December 31, 2012	Valuation technique	Unobservable inputs	2013 Inputs	2012 Inputs
Apartments			Income	- Capitalization rate (weighted average)	**5.88%**	6.02%
-Level 3	**$1,334,153**	$1,126,189	capitalization	- Vacancy rate (weighted average)	**3.50%**	3.50%
			approach	- Management fee rate	**3.50%**	3.50%
MHCs			Income	- Capitalization rate (weighted average)	**6.86%**	7.04%
-Level 3	**$115,414**	$168,401	capitalization	- Vacancy rate	**1.70%**	1.70%
			approach	- Management fee rate	**3.00%**	3.00%

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

5. Investment Properties (continued)

The investment property segment defined as Other consists of one commercial property of which the Company has a 50% ownership. The property has a fair value of $2.2 million (December 31, 2012 - $2.1 million).

IPUC includes land held for future development, which is recorded at a fair value of $2.8 million (December 31, 2012 - $5.2 million) and properties under construction of $21.6 million (December 31, 2012 - $52.7 million). Fair value cannot be reliably determined for properties under construction as the projects are in the early stages of development and therefore IPUC is recorded at cost.

Sensitivity Analysis

The significant unobservable inputs used in the fair value measurements categorized within Level 3 of the fair value hierarchy include cap-rates, vacancy rates and management fee rates. 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:

	December 31, 2013			December 31, 2012		
	Low	**High**	**Effective Weighted Average**	Low	High	Effective Weighted Average
Apartments			**5.88%**			**6.02%**
Halifax	5.15%	7.00%	5.87%	5.30%	7.00%	5.85%
Moncton	5.56%	8.00%	5.94%	6.00%	8.00%	6.30%
Fredericton	5.15%	6.25%	5.93%	5.75%	6.50%	6.30%
Saint John	6.25%	6.75%	6.63%	6.00%	6.75%	6.45%
St. John's	5.15%	6.25%	5.94%	6.25%	7.00%	6.36%
Charlottetown	5.65%	6.00%	5.88%	5.75%	6.50%	6.15%
Ontario	4.50%	5.25%	5.26%	4.50%	5.25%	5.25%
Other Atlantic	6.00%	7.00%	6.76%	6.25%	7.00%	7.31%
MHCs			**6.86%**			**7.04%**
Ontario	7.00%	8.00%	7.09%	7.00%	8.50%	7.34%
Nova Scotia	6.00%	7.50%	6.61%	6.50%	7.50%	6.96%
New Brunswick	8.25%	8.25%	8.25%	6.50%	8.50%	6.87%
Newfoundland and Labrador	7.25%	7.25%	7.25%	7.50%	7.50%	7.50%

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

Class of property	**Capitalization rate**		**Vacancy rate**	**Management fee rate**
	10 basis points increase	*10 basis points decrease*	*1% increase/ decrease in vacancy*	*1% increase/ decrease in management fees*
Apartments	$(22,408)	$22,947	$21,055	$22,206
MHCs	$(1,659)	$1,708	$1,483	$1,932

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

6. Investments in Joint Ventures

The Company has the following significant interest in a joint venture, which is measured using the equity method. Through this joint venture, Killam owns:

a) 25% share in a 127-unit property located in London, Ontario;
b) 25% share in a 140-unit property located in Ottawa, Ontario; and,
c) 25% share in a 199-unit property located in Mississauga, Ontario.

For the years ended December 31,	**2013**	2012
Balance, beginning of year	**$10,289**	$8,420
Additions	**97**	19,563
Share of net income	**1,296**	758
Distributions	**(213)**	(18,452)
Balance, end of year	**$11,469**	$10,289

As at	**2013**	2012
Current assets	**$5,920**	$3,293
Long-term assets	**115,425**	112,245
Current liabilities	**(4,979)**	(3,891)
Long-term liabilities	**(70,492)**	(70,492)
Net assets	**45,874**	41,155
Company's share of net assets of associate	**$11,469**	$10,289

For the years ended December 31,	**2013**	2012
Property revenue	**$11,968**	$6,708
Property operating expenses	**(6,696)**	(2,936)
Net operating income	**5,272**	3,772
Interest and deferred financing expense	**(2,744)**	(857)
Fair value gains	**2,655**	120
Net income and comprehensive income	**5,183**	3,035
Company's share of net income and comprehensive income	**$1,296**	**$758**

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

7. Property and Equipment

As at	December 31, 2013		December 31, 2012	
	Cost	**Accumulated Depreciation**	Cost	Accumulated Depreciation
Land	**$270**	**$-**	$270	$-
Building	**1,824**	**106**	1,763	54
Heavy equipment	**198**	**71**	622	220
Vehicles	**1,191**	**308**	1,076	273
Furniture, fixtures and equipment	**3,588**	**2,451**	3,181	2,052
Leaseholds	**428**	**36**	261	-
	7,499	**2,972**	7,173	2,599
Less: accumulated depreciation	**(2,972)**		(2,599)	
	$4,527		$4,574	

Land and building represents the Company's ownership of a 50% interest in the land and building 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 fair value of $4.2 million (December 31, 2012 - $4.2 million) is pledged as collateral against the Company's mortgages payable.

For the years ended December 31,	2013	2012
Balance, beginning of year	**$4,574**	$4,457
Disposals	**(420)**	(107)
Capital expenditures	**963**	764
Depreciation	**(590)**	(540)
Balance, end of year	**$4,527**	$4,574

8. Rent and Other Receivables

As at	December 31, 2013	December 31, 2012
Rent receivable	**$879**	$926
Insurance receivable	**337**	254
Other receivables	**1,535**	2,587
	$2,751	$3,767

Included in other receivables are laundry revenue, commission revenues and other non-rental income. The majority of these receivables are less than 60 days old.

The Company'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. The Company's bad debt expense experience has historically been less than 0.4% of revenues. As a result of the low bad debt experience, no allowance for doubtful accounts is recorded in the accounts.

9. Inventory

Inventory relates to manufactured homes for which sales have not closed at year-end, as well as four stock homes (2012 - eight stock homes) and related expenses. As at December 31, 2013, no amount of the inventory is pledged as collateral related to short-term or long-term financing.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

10. Other Current Assets

As at	**December 31, 2013**	December 31, 2012
Prepaid property tax	**$1,389**	$1,282
Prepaid insurance	**376**	335
Other prepaids	**720**	704
Restricted cash	**6,818**	9,979
	$9,303	$12,300

Restricted cash consists of security deposits, funds held in trust and property tax reserves.

11. Accounts Payable and Other Liabilities

As at	**December 31, 2013**	December 31, 2012
Accounts payable	**$6,024**	$7,450
Mortgage interest payable	**2,162**	1,924
Accrued payables	**5,015**	7,606
Rent received in advance	**915**	808
Dividends payable	**2,638**	2,609
Taxes payable	**1,451**	-
Security deposits	**4,195**	3,677
Promissory note payable	**255**	255
	$22,655	$24,329

12. Mortgages and Loans Payable

As at	**December 31, 2013**		December 31, 2012	
	Weighted Average Interest	Debt Balance	Weighted Average Interest	Debt Balance
Mortgages and loans payable				
Fixed rate	**4.05%**	**$694,789**	4.44%	$621,397
Variable rate	**4.18%**	**3,853**	4.13%	2,802
Vendor financing	**7.10%**	**488**	6.85%	882
Total		**$699,130**		$625,081
Current		**153,589**		105,369
Non-current		**545,541**		519,712
		$699,130		$625,081

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

As of December 31, 2013, unamortized deferred financing costs of $11.9 million (December 31, 2012 - $9.6 million) and mark-to-market premiums on mortgages assumed on acquisition of $1.7 million (December 31, 2012 – $1.7 million) are netted against mortgages and loans payable.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

12. Mortgages and Loans Payable (continued)

Estimated future principal payments required to meet mortgage obligations as at December 31, 2013 are as follows:

	Principal repayments by year
2014	$153,589
2015	107,321
2016	111,803
2017	55,214
2018	71,132
Subsequent	210,302
	709,361
Unamortized deferred financing costs	(11,936)
Unamortized mark-to-market adjustments	1,705
	$699,130

The Company has credit facilities set out as follows:

I. A credit facility with a major financial institution, which consists of a $2.0 million revolving demand facility that can be used for the Company's acquisition program and for general business purposes. The interest rate on the debt is prime plus 125 basis points on prime rate advances or 225 basis points over Banker's Acceptances ("BAs"). Killam has the right to choose between prime rate advances and BAs based on available rates and timing requirements. As at December 31, 2013, the Company had assets with a fair value of $1.7 million pledged as collateral to the line and had a balance outstanding of $Nil (December 31, 2012 - $Nil).

II. An operating facility which consists of a $1.0 million revolving demand facility for general business purposes, bearing interest at the lender's prime rate plus 1%. As at December 31, 2013, the Company had letters of credit totaling $0.5 million outstanding against this facility (December 31, 2012 - $0.3 million). The agreement includes certain covenants and undertakings of which the Company is in compliance.

13. Construction Loan

At December 31, 2013, the Company had access to a floating rate non-revolving demand construction loan for the purpose of financing the development of The Plaza and payments are made monthly on an interest-only basis. The construction loan has an interest rate of prime plus 0.75%. The construction loan will be repaid in full and converted into a first mortgage once rental targets have been achieved. As at December 31, 2013, $14.8 million was drawn at an interest rate of 3.75% (December 31, 2012 - $14.1 million at 3.68%).

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

14. Convertible Debentures

Face Interest Rate %	Effective Interest Rate %	Conversion Price	Face Amount	Maturity	**December 31, 2013**	December 31, 2012
5.65%	7.30%	$13.40	$57,500	November 30, 2017	**$54,395**	$53,733
5.45%	6.30%	$14.60	$46,000	June 30, 2018	**44,576**	44,309
					98,971	98,042
Less: Deferred financing charges					**(2,552)**	(3,118)
					$96,419	$94,924

Killam’s $57.5 million convertible subordinated debentures are redeemable at the option of Killam after November 30, 2013, and on or before November 30, 2015 (provided that the current market price of the common shares of the Company on the date on which the notice of redemption is given is not less than 125% of the conversion price). After November 30, 2015, the debentures are redeemable at face value. Upon maturity or redemption, Killam may elect to repay all or any portion of the debentures outstanding by issuing the number of common shares obtained by dividing the aggregate of the principal amount of the debentures that have matured or are being redeemed by 95% of the weighted average market price of the common shares for the preceding 20 days (ending 5 days preceding the fixed date for redemption or maturing). At the time of issuance, the fair value of Killam’s obligation to make principal and interest payments was $52.5 million and the fair value of the holders’ conversion option was $5.0 million (which is reflected in “Other paid-in capital”). The effective rate of interest on the liability component, which is paid semiannually, is calculated at 7.3%.

Killam’s $46.0 million convertible subordinated debentures are redeemable at the option of Killam after June 30, 2014, and on or before June 30, 2016 (provided that the current market price of the common shares of the Company on the date on which the notice of redemption is given is not less than 125% of the conversion price). After June 30, 2016, the debentures are redeemable at face value. Upon maturity or redemption, Killam may elect to repay all or any portion of the debentures outstanding by issuing the number of common shares obtained by dividing the aggregate of the principal amount of the debentures that have matured or are being redeemed by 95% of the weighted average market price of the common shares for the preceding 20 days (ending 5 days preceding the fixed date for redemption or maturing). At the time of issuance, the fair value of Killam’s obligation to make principal and interest payments was $43.9 million and the fair value of the holders’ conversion option was $2.1 million (which is reflected in “Other paid-in capital”). The effective rate of interest on the liability component, which is paid semiannually, is calculated at 6.3%.

15. Subordinated Debentures

The Company's $10.0 million of unsecured subordinated debentures expired, and were repaid, on January 4, 2013 and consisted of three tranches of $2.5 million, $2.5 million and $5.0 million, bearing interest at 5.92%, 6.06% and 6.33%, respectively. Related warrants associated with the subordinated debentures also expired on January 4, 2013.

Face Interest Rate %	Effective Interest Rate %	Face Amount	**December 31, 2013**	December 31, 2012
5.92 %	6.46 %	$2,500	**$-**	$2,500
6.06 %	6.62 %	2,500	-	2,500
6.33 %	7.10 %	5,000	-	4,998
			$-	$9,998

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

16. Capital Stock and Contributed Surplus

Capital Stock

Authorized:

Unlimited number of common shares, with no par value
Unlimited number of preferred shares, issuable in series, with no par value

Issued:
The following table summarizes the changes in issued common shares of the Company:

For the years ended December 31,		**2013**		2012
	Number of Shares	**Value**	Number of Shares	Value
Balance, beginning of year	**53,801,809**	**$391,120**	49,290,751	$339,178
Issued for cash (i)	**-**	**-**	2,875,000	32,877
Dividend reinvestment plan (ii)	**296,004**	**3,346**	347,473	4,367
Stock options exercised	**144,349**	**1,036**	471,593	4,195
Warrants exercised	**-**	**-**	816,992	10,000
Stock issued for acquisitions	**194,774**	**2,390**	-	-
Restricted share units redeemed	**21,838**	**289**	-	-
Tax benefit of issuance costs	**-**	**-**	-	503
Balance, end of year	**54,458,774**	**$398,181**	53,801,809	$391,120

(i) Net of issue costs of $Nil (2012 - $1,616)
(ii) Net of issue costs of $31 (2012 - $29)

Dividends

Killam paid monthly dividends as declared by the Board of Directors on or about the 15th day of each month. An annualized dividend of $0.58 was paid in 2013. The dividend increased to $0.60 on an annualized basis for the January 2014 dividend payable on February 17, 2014.

Dividend Reinvestment Plan

Killam's Dividend Reinvestment Plan ("DRIP") allows common shareholders to elect to have all cash dividends from Killam reinvested in additional common shares. Shareholders who participate in the DRIP receive an additional dividend of common shares equal to 3% of each cash dividend that was reinvested. The price per share is calculated by reference to a ten day volume weighted average closing price of Killam's common shares on the Toronto Stock Exchange preceding the relevant dividend date, which typically is on or about the 15th day of the month following the dividend declaration.

Contributed Surplus

	2013	2012
Balance, beginning of year	**$2,241**	$2,251
Stock options expensed	**44**	116
Stock options exercised	**(111)**	(589)
Restricted share units issued	**580**	463
Restricted share units redeemed	**(452)**	-
Balance, end of year	**2,302**	2,241

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

17. Share-Based Compensation

For the years ended December 31,	2013	2012
Stock option plan	$44	$116
Restricted share unit plan	421	463
Total share based compensation expense	$465	$579

Killam did not issue stock options during 2013 or 2012.

Options exercised or forfeited during the years ended December 31 are as follows:

	2013		2012	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	694,756	$7.40	1,180,766	$7.49
Exercised	(144,349)	6.40	(471,593)	7.65
Forfeited	-	-	(14,417)	7.00
Outstanding, end of year	550,407	$7.66	694,756	$7.40

The following table summarizes the stock options outstanding:

As at	December 31, 2013			December 31, 2012		
Exercise Price	Number of Options Outstanding	Remaining Contractual Life	Options Exercisable	Number of Options Outstanding	Remaining Contractual Life	Options Exercisable
$5.32	97,500	0.35 years	97,500	186,749	1.35 years	155,502
$8.11	-	-	-	1,250	0.10 years	1,208
$8.16	452,907	1.40 years	399,783	506,757	2.4 years	326,366
	550,407		497,283	694,756		483,076

The exercisable options had a weighted average exercise price of $7.60 at December 31, 2013 (December 31, 2012 - $7.25).

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

17. Share-Based Compensation (continued)

Restricted Share Unit Plan

The Restricted Share Unit ("RSU") Plan gives members of the senior executive team the right to receive a percentage of their annual bonus and non-executive members of the board of directors the right to receive a percentage of their annual retainer, in the form of restricted shares in lieu of cash. The Compensation Committee has established the following parameters on the percentage of the annual bonus and annual retainer which may be allocated to Restricted Shares:

	Minimum	Maximum
Non-executive board members	- %	100 %
Chief Executive Officer and Chief Financial Officer	50 %	50 %
Other executives	25 %	50 %

Killam will match the elected amount in the form of Restricted Shares having a value equal to the volume weighted average price of all common shares traded on the TSX for the five trading days immediately preceding the date on which the compensation is payable. The Restricted Shares earn notional dividends based on the same dividends paid on the common shares, and such notional dividends are used to acquire additional Restricted Shares. The initial Restricted Shares and Restricted Shares acquired through notional dividend reinvestment are credited to each person's account and are not issued to the employee or board member until they redeem such Restricted Shares.

The Restricted Shares will be redeemed and paid out by December 31 of the year in which the Restricted Shares have vested. The Restricted Shares shall vest with the following schedule; (a) 50% on the second anniversary of the grant date; and (b) 50% on the third anniversary of the grant date.

The details of the restricted share units issued under the RSU plan are shown below:

For the years ended December 31,		**2013**		2012
	Number of Shares	**Weighted Average Issue Price**	Number of Shares	Weighted Average Issue Price
Outstanding, beginning of year	**100,209**	**$11.89**	48,082	$10.96
Granted	**50,070**	**11.90**	49,265	12.84
Redeemed	**(50,090)**	**11.09**	-	-
Forfeited	**(12,226)**	**11.78**	-	-
Additional restricted share distributions	**6,382**	**12.06**	2,862	11.34
Outstanding, end of year	**94,345**	**$12.34**	100,209	$11.89

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

18. Home Sales

For the years ended December 31,	**2013**	2012
Home sales revenues	**$2,598**	$2,241
Cost of home sales	**(2,226)**	(1,789)
New home placement fees	**17**	98
Operating expenses	**(66)**	(81)
Income from home sales	**$323**	$469

19. Corporate Income

For the years ended December 31,	**2013**	2012
Property management fees	**$518**	$363
Interest and other revenue	**228**	599
	$746	$962

20. Financing Costs

For the years ended December 31,	**2013**	2012
Mortgage, loan and construction loan interest	**$30,090**	$28,590
Amortization of fair value adjustments on assumed debt	**(459)**	(229)
Convertible debenture interest	**6,687**	6,632
Subordinated debenture interest	**10**	703
Capitalized interest	**(1,097)**	(1,063)
	$35,231	$34,633

21. Income Taxes

The income tax provisions differ from that computed using the statutory rates for the following reasons:

For the years ended December 31,		**2013**		2012
Net income before income taxes	**$51,733**		$73,463	
Income tax expense at federal statutory rates	**14,977**	**29.0%**	21,069	28.7%
Non-taxable component of fair value gain	**(4,942)**	**(9.6)%**	(3,209)	(4.4)%
Non-deductible share compensation	**181**	**0.3%**	166	0.2%
Impact of change in effective tax rates	**1,608**	**3.1%**	578	0.8%
Other	**(1,023)**	**(2.0)%**	630	0.9%
Tax expense	**$10,801**	**20.9%**	$19,234	26.2%

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

21. Income Taxes (continued)

Deferred income taxes reflect the net effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred income tax assets and liabilities are as follows:

	Consolidated Statements of Financial Position		Consolidated Statements of Income	
	2013	2012	**2013**	2012
Real estate properties	**$90,871**	$86,980	**$3,981**	$22,610
Loss carryforwards	**-**	(3,884)	**3,884**	(3,884)
Convertible debentures	**1,324**	1,565	**(241)**	(231)
Other	**1,026**	(790)	**1,726**	739
Net deferred tax expense			**$9,350**	$19,234
Net deferred tax liabilities	**$93,221**	$83,871		

Reconciliation of net deferred tax liabilities		
Balance, beginning of year	**$83,871**	$65,139
Recognized in statement of income	**9,350**	19,234
Recognized in equity on issuance of shares	**-**	(502)
Balance, end of year	**$93,221**	$83,871

The temporary differences associated with investments in subsidiaries for which a deferred tax liability has not been recognized, aggregate to $Nil (December 31, 2012 - $65,186).

22. Per Share Information

The following is the weighted average number of shares outstanding for the years ended December 31, 2013 and 2012. The fully diluted amounts shown below exclude stock options and warrants whose exercise price exceeded the average market price for the year and are considered anti-dilutive.

For the years ended December 31,	**2013**	2012
Weighted average shares outstanding - basic	**54,142,897**	50,226,973
Unexercised dilutive options	**232,877**	506,233
Restricted share units	**126,014**	63,869
Convertible debentures	**9,875,954**	7,441,730
Weighted average shares outstanding - diluted	**64,377,742**	58,238,805

The following is the adjustment to net income applicable to common shareholders used in the diluted earnings per share calculation.

For the years ended December 31,	**2013**	2012
Net income applicable to common shareholders	**$39,779**	$51,727
Adjustment for dilutive effect of convertible debentures	**4,681**	4,642
Adjusted net income for diluted per share amounts	**$44,460**	$56,369

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

23. Segmented Information

The Company operates in two rental segments of the multi-family residential industry: apartments and MHCs, all located in Canada. The accounting policies of these segments are the same as those described in the summary of significant accounting policies. The segments are analyzed based on net operating income before interest, amortization and administration costs. The operating results, assets and liabilities, and capital expenditures of the segments are as follows:

As at and for the years ended December 31, 2013	**Apartments**	**MHCs**	**Other**	**Total**
Property revenue	**$121,305**	**$19,253**	**$554**	**$141,112**
Property operating expenses	**(50,435)**	**(7,336)**	**(301)**	**(58,072)**
Net rental income	**$70,870**	**$11,917**	**$253**	**$83,040**
Home sales, equity income & corporate income	-	**-**	**2,365**	**2,365**
Financing costs	**(24,837)**	**(4,116)**	**(6,278)**	**(35,231)**
Depreciation and amortization	**(942)**	**(254)**	**(1,036)**	**(2,232)**
Administration	**(1,457)**	**(362)**	**(6,059)**	**(7,878)**
Income before fair value gains, loss on disposition and income taxes	**$43,634**	**$7,185**	**$(10,755)**	**$40,064**
Total assets	**$1,386,826**	**134,760**	**10,845**	**$1,532,431**
Total liabilities	**$676,072**	**53,326**	**198,973**	**$928,371**
Capital expenditures	**$18,100**	**$3,505**	**$42**	**$21,647**

As at and for the years ended December 31, 2012	Apartments	MHCs	Other	Total
Property revenue	$110,463	$22,653	$525	$133,641
Property operating expenses	(44,888)	(8,421)	112	(53,197)
Net rental income	$65,575	$14,232	$637	$80,444
Home sales, equity income & corporate income	-	-	2,189	2,189
Financing costs	(22,954)	(5,035)	(6,644)	(34,633)
Depreciation and amortization	(846)	(559)	(740)	(2,145)
Administration	(1,710)	(461)	(6,661)	(8,832)
Income before fair value gains, loss on disposition and income taxes	$40,065	$8,177	$(11,219)	$37,023
Total assets	$1,244,087	$188,834	$10,207	$1,443,128
Total liabilities	$585,050	$84,148	$185,494	$854,692
Capital expenditures	$19,039	$3,345	$83	$22,467

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

23. Segmented Information (continued)

The apartment segment is further analyzed on property revenue, property operating expenses and fair value of investment property by region:

2013	**Property Revenue**	**Property Operating Expenses**	**Net Operating Income**	**Fair Value of Investment Properties**
Halifax, NS	**$53,733**	**$(20,101)**	**$33,632**	**$593,809**
Moncton, NB	**14,075**	**(7,052)**	**7,023**	**133,157**
Fredericton, NB	**13,070**	**(6,000)**	**7,070**	**142,881**
Saint John, NB	**9,483**	**(5,485)**	**3,998**	**70,074**
St. John's, NL	**7,687**	**(2,466)**	**5,221**	**103,211**
Charlottetown, PE	**8,168**	**(3,495)**	**4,673**	**91,984**
Ontario	**10,921**	**(4,026)**	**6,895**	**158,914**
Other Atlantic	**4,168**	**(1,810)**	**2,358**	**40,123**
	$121,305	**$(50,435)**	**$70,870**	**$1,334,153**

2012	Property Revenue	Property Operating Expenses	Net Operating Income	Fair Value of Investment Properties
Halifax, NS	$50,554	$(18,612)	$31,942	$555,778
Moncton, NB	13,113	(6,465)	6,648	114,712
Fredericton, NB	12,626	(5,548)	7,078	101,290
Saint John, NB	9,719	(5,104)	4,615	69,481
St. John's, NL	6,692	(2,196)	4,496	81,712
Charlottetown, PE	6,765	(2,855)	3,910	68,778
Ontario	6,926	(2,273)	4,653	109,195
Other Atlantic	4,068	(1,835)	2,233	25,243
	$110,463	$(44,888)	$65,575	$1,126,189

There are no transactions with a single tenant that account for 10% or more of the Company's total revenues.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

24. Supplemental Cash Flow Information

For the years ended December 31,	2013	2012
Net income items related to investing and financing activities		
Interest paid on mortgages payable and other	**$29,392**	$28,511
Interest paid on convertible debentures	**5,756**	5,756
Interest paid on subordinated debentures	**8**	616
	$35,156	$34,883
Changes in non-cash operating assets and liabilities		
Rent and other receivables	**$1,016**	$(2,061)
Income tax	**1,487**	53
Inventory	**192**	197
Other current assets	**(200)**	73
Accounts payable and other liabilities	**(3,125)**	9,283
	$(630)	$7,545

25. Financial Risk Management Objectives and Policies

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

The Company may also enter into derivative transactions, primarily natural gas and oil swap contracts, to manage the price risk arising from fluctuations in these commodities. The Company did not enter into any derivative transactions in 2013 or 2012. It is, and has been, the Company's policy that no speculative trading in derivatives shall be undertaken.

The main risks arising from the Company's financial instruments are interest rate risk, credit risk, and liquidity risk. These risks are managed as follows:

(i) Interest rate risk

The Company is exposed to interest rate risk as a result of its mortgages and loans payable, however this risk is mitigated through the Company's strategy to have the majority of its mortgages payable in fixed-term arrangements. The Company also structures its financings so as to stagger the maturities of its debt, minimizing the Company's exposure to interest rate volatility in any one year.

As at December 31, 2013, no mortgages or vendor debt had floating interest rates except for four demand loans totaling $3.9 million. These loans have an interest rate of prime plus 1.0% - 2.0% (December 31, 2012 - prime plus 1.0% - 1.5%). Killam also has one construction loan of $14.8 million with a floating interest rate of prime plus 0.75% and consequently, Killam is exposed to short-term interest rate risk on this loan.

An annualized 100 basis point change in the interest rate on Killam's entire mortgage and vendor debt at December 31, 2013, would affect financing costs by approximately $7.1 million per year. However, only $141.4 million of Killam's fixed mortgage and vendor debt matures in the next twelve months. Assuming these mortgages are refinanced at similar terms, except at a 100 basis point increase in interest rates, financing costs would increase by $1.4 million per year.

(ii) Credit risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease term commitments. The Company 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 with respect to all new leasing and the Company also obtains a security deposit to assist in potential recovery requirements. In addition, the receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debt is not significant. The Company's bad debt expense experience has historically been less than 0.4% of revenues. None of Killam's tenants account for more than 1% of the tenant receivables as at each of the year-ends presented in these financial statements. The maximum exposure to credit risk is the carrying amount of each class of financial assets as disclosed in this note.

(iii) Liquidity risk

Management manages the Company's cash resources based on financial forecasts and anticipated cash flows. The Company structures its financings so as to stagger the maturities of its debt, thereby minimizing the Company's exposure to liquidity risk in any one year. In addition, the Company's apartments qualify for CMHC insured debt, thereby reducing the refinancing risk on mortgage maturities. The Company's MHCs do not qualify for CMHC insured debt, however, they continue to have access to 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.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

25. Financial Risk Management Objectives and Policies (continued)

During the year ended December 31, 2013, the Company refinanced $66.7 million of maturing apartment mortgages with new mortgages totaling $96.7 million for net proceeds of $30.0 million. As well, during the year ended December 31, 2013, the Company refinanced $10.7 million of maturing MHC mortgages for net proceeds of $3.2 million.

The following table presents the contractual maturities of the Company's liabilities over the next five years:

Year	Mortgage and loans payable	Construction loans	Convertible debentures	Total
2014	$153,589	$14,775	$-	**$168,364**
2015	107,321	-	-	**107,321**
2016	111,803	-	-	**111,803**
2017	55,214	-	57,500	**112,714**
2018	71,132	-	46,000	**117,132**
Thereafter	210,302	-	-	**210,302**
	$709,361	$14,775	$103,500	**$827,636**

Capital Management

The primary objective of the Company's capital management is to ensure that it maintains a healthy capital ratio in order to support its business and maximize shareholder value. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, issue new shares, issue debt securities or adjust mortgage financing on properties.

The Company monitors capital using a total debt to total assets ratio. The Company's strategy is to maintain its total debt to total assets ratio between 55-65%. The calculation of the total debt to total assets is summarized as follows:

As at	**December 31, 2013**	December 31, 2012
Mortgages, loans payables and construction loans	**$713,905**	$639,143
Convertible debentures	**96,419**	94,924
Subordinated debentures	**-**	9,998
Total debt	**$810,324**	$744,065
Total assets	**$1,532,431**	$1,443,128
Total debt as a percentage of total assets	**52.9%**	51.6%

The above calculation is sensitive to changes in the fair value of investment properties, in particular, cap-rate changes. A 10 basis point increase in weighted average cap-rate as at December 31, 2013, would increase the debt as a percentage of assets by 80 basis points.

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

25. Financial Risk Management Objectives and Policies (continued)

Fair Value Measurement

Financial instruments are defined as a contractual right or obligation to receive or deliver cash or another financial asset. The following table presents the classification, subsequent measurement, carrying values and fair values of the Company's financial assets and liabilities:

		December 31, 2013		December 31, 2012	
Classification	Subsequent Measurement	Carrying Value	Fair Value	Carrying Value	Fair Value
Other Financial Liabilities:					
Mortgages (b)	Amortized Cost	**$699,130**	**$748,806**	$625,081	$687,119
Convertible debentures (a)	Amortized Cost	**$96,419**	**$100,461**	$98,042	$102,942
Subordinated debentures (b)	Amortized Cost	**$-**	**$-**	$9,998	$10,104

Cash and cash equivalents are classified as held for trading and carried at their fair values. The Company's short-term financial instruments, comprising accounts receivable, restricted cash, accounts payable and accrued liabilities, security deposits, loans and construction loans are carried at amortized cost which, due to their short-term nature, approximates their fair value.

(a) The fair value of the convertible debentures are based on a quoted market price as at the reporting date (level 1).

(b) The mortgages and subordinated debentures 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 the Company might pay or receive in actual market transactions (level 2).

The interest rates used to discount the estimated cash flows, when applicable, are based on the 5-year government yield curve at the reporting date, plus an adequate credit spread, and were as follows:

As at	**December 31, 2013**	December 31, 2012
Mortgages - Apartments	**2.60%**	2.27%
Mortgages - MHCs	**4.45%**	4.02%

As at December 31, 2013, the Company did not have any financial assets or liabilities measured at fair value on the Consolidated Statements of Financial Position.

26. Commitments

As at December 31, 2013, Killam has committed development costs of $16.6 million.

The Company 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 the Company. However, actual outcomes may differ from Management's expectations.

27. Financial Guarantees

Killam Properties Inc. is the guarantor for borrowings held through its three equity investments. As at December 31, 2013, the maximum potential obligation resulting from these guarantees is $70.5 million, all related to long-term mortgage financing (December 31, 2012 – $72.3 million). These loans are secured by a first ranking mortgage over the associated investment property. Management has reviewed the contingent liability associated with its financial guarantee contracts and, at December 31, 2013, determined that a provision is not required to be recognized in the Statement of Financial Position. (December 31, 2012 - $nil).

Dollar amounts in thousands of Canadian dollars (except share and per share amounts)

28. Related Party Transactions

Killam has contracted APM Construction Services Inc. ("APM") to act as Project Manager on the new construction project in St. John's, NL. APM was previously the Project Manager on The Plaza, which was completed in May 2013. APM is an entity controlled by a director of Killam. APM will be paid an industry standard management fee of approximately 4% of the construction costs. For the year ended December 31, 2013, Killam paid APM $0.5 million for construction management services (December 31, 2012 - $0.2 million).

On December 6, 2013, Killam acquired Northgate Apartments from a director of Killam for a purchase price of $3.7 million, the fair value at the acquisition date.

Killam has a 50% interest in a commercial complex that houses its head office. The remaining 50% interest is owned by a Company controlled by an executive and director of Killam. In addition, the property manager for the commercial complex is controlled by the executive and director and is paid an industry standard property management fee.

Key management personnel remuneration

The remuneration of directors and other key management personnel which include the Directors, President & Chief Executive Officer, Executive Vice-President and Chief Financial Officer, and Vice-Presidents of Killam during the years ended December 31, 2013, and 2012 was at follows:

	2013	2012
Salaries, board compensation and incentives	**$ 2,371**	$ 2,892
Restricted share awards	**847**	633
Total	**$ 3,218**	$ 3,525

29. Subsequent Events

On January 20, 2014, and February 18, 2014, the Company announced dividends of $0.05 per share, payable on February 17, 2014, and March 17, 2014, to shareholders of record on January 31, 2014, and February 28, 2014.