Killam APARTMENT REIT

Condensed Consolidated Interim Financial Statements

[unaudited]

For the three and nine months ended September 30, 2016 and 2015

Condensed Consolidated Interim Statements of Financial Position

In thousands of Canadian dollars, [unaudited]

	Note	September 30, 2016	December 31, 2015
ASSETS			
Non-current assets			
Investment properties	[4]	**$1,911,883**	$1,840,256
Property and equipment		**4,716**	4,973
Other non-current assets		**950**	4,965
		1,917,549	1,850,194
Current assets			
Cash		**19,884**	11,673
Rent and other receivables		**2,183**	2,080
Other current assets		**16,598**	12,329
		38,665	26,082
TOTAL ASSETS		**$1,956,214**	$1,876,276
EQUITY AND LIABILITIES			
Unitholders'/shareholders' equity		**$753,015**	$669,827
Accumulated other comprehensive loss ("AOCL")		**(112)**	(157)
Non-controlling interest		**122**	15,658
Total Equity		**$753,025**	$685,328
Non-current liabilities			
Mortgages and loans payable	[5]	**$833,028**	$784,629
Convertible debentures	[7]	**47,150**	99,627
Other liabilities		**14,195**	8,723
Exchangeable units	[8]	**46,738**	—
Deferred income tax	[13]	**76,080**	112,145
Deferred unit-based compensation	[11]	**3,400**	—
		1,020,591	1,005,124
Current liabilities			
Mortgages and loans payable	[5]	**147,314**	156,218
Construction loans	[6]	**8,517**	4,115
Accounts payable and accrued liabilities		**26,767**	25,491
		182,598	185,824
Total Liabilities		**$1,203,189**	$1,190,948
TOTAL EQUITY AND LIABILITIES		**$1,956,214**	$1,876,276
Commitments and Contingencies	[18]		

See accompanying notes to the condensed consolidated interim financial statements

Approved on behalf of the Board of Trustees

(signed) "G. Wayne Watson "
Trustee

(signed) "Philip D. Fraser "
Trustee

Condensed Consolidated Interim Statements of Income and Comprehensive Income

In thousands of Canadian dollars, [unaudited]

	Note	Three months ended September 30, 2016	Three months ended September 30, 2015	Nine months ended September 30, 2016	Nine months ended September 30, 2015
Property revenue		**$45,078**	$43,193	**$131,133**	$124,181
Property operating expenses					
Operating expenses		**(7,752)**	(7,263)	**(21,664)**	(20,676)
Utility and fuel expenses		**(3,781)**	(3,807)	**(15,122)**	(15,925)
Property taxes		**(5,195)**	(4,945)	**(15,295)**	(14,551)
		(16,728)	(16,015)	**(52,081)**	(51,152)
Net operating income		**$28,350**	$27,178	**$79,052**	$73,029
Other income		**313**	378	**1,012**	1,105
Financing costs	[12]	**(8,735)**	(9,396)	**(28,015)**	(27,718)
Depreciation		**(224)**	(196)	**(651)**	(566)
Amortization of deferred financing costs		**(383)**	(480)	**(1,116)**	(1,409)
Administration		**(3,051)**	(2,474)	**(9,719)**	(7,356)
Income before fair value adjustments, loss on disposition and income taxes		**$16,270**	$15,010	**$40,563**	$37,085
Fair value adjustment on convertible debentures		**(104)**	—	**658**	—
Fair value adjustment on unit-based compensation		**181**	—	**(979)**	—
Fair value adjustment on exchangeable units		**2,428**	—	**(8,354)**	—
Fair value adjustment on investment properties		**1,144**	1,368	**(888)**	1,548
Gain (loss) on disposition		**—**	74	**(264)**	(109)
Income before income taxes		**19,919**	16,452	**30,736**	38,524
Deferred tax (expense) recovery	[13]	**(1,953)**	(4,831)	**36,065**	(10,793)
Net income		**$17,966**	$11,621	**$66,801**	$27,731
Other comprehensive income loss					
Item that may be reclassified subsequently to net income					
Amortization of loss in AOCL to financing costs		**15**	10	**45**	31
Comprehensive income		**$17,981**	$11,631	**$66,846**	$27,762
Net income attributable to:					
Unitholders/common shareholders		**17,964**	11,462	**63,336**	27,137
Non-controlling interest		**2**	159	**3,465**	594
		$17,966	$11,621	**$66,801**	$27,731
Comprehensive income attributable to:					
Unitholders/common shareholders		**17,979**	11,472	**63,381**	27,168
Non-controlling interest		**2**	159	**3,465**	594
		$17,981	$11,631	**$66,846**	$27,762

See accompanying notes to the condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Changes in Equity

In thousands of Canadian dollars, [unaudited]

Nine months ended September 30, 2016	**Trust Units**	**Capital Stock**	**Contributed Surplus**	**Other Paid-in Capital**	**Retained Earnings**	**AOCL**	**Non-controlling Interest**	**Total Equity**
At January 1, 2016	**$—**	**$484,133**	**$2,150**	**$5,681**	**$177,863**	**($157)**	**$15,658**	**$685,328**
REIT conversion, January 1, 2016 (note 3)	**447,566**	**(484,133)**	**(1,355)**	**(5,681)**	**(12,463)**	**—**	**—**	**(56,066)**
Unit capital								
Exchange of exchangeable units	**11,043**	**—**	**—**	**—**	**—**	**—**	**—**	**11,043**
Distribution reinvestment plan	**4,742**	**—**	**—**	**—**	**—**	**—**	**—**	**4,742**
Restricted trust unit plan	**208**	**—**	**—**	**—**	**—**	**—**	**—**	**208**
Issued for cash	**93,623**	**—**	**—**	**—**	**—**	**—**	**—**	**93,623**
Net income	**—**	**—**	**—**	**—**	**63,336**	**—**	**3,465**	**66,801**
Amortization of loss on forward interest rate hedge	**—**	**—**	**—**	**—**	**—**	**45**	**—**	**45**
Distributions on non-controlling interest	**—**	**—**	**—**	**—**	**—**	**—**	**(505)**	**(505)**
Acquisition of non-controlling interest	**—**	**—**	**—**	**—**	**(5,599)**	**—**	**(18,496)**	**(24,095)**
Distributions declared and paid	**—**	**—**	**—**	**—**	**(24,704)**	**—**	**—**	**(24,704)**
Distributions payable	**—**	**—**	**—**	**—**	**(3,395)**	**—**	**—**	**(3,395)**
At September 30, 2016	**$557,182**	**$—**	**$795**	**$—**	**$195,038**	**($112)**	**$122**	**$753,025**

Nine months ended September 30, 2015	Capital Stock	Contributed Surplus	Other Paid-in Capital	Retained Earnings	AOCL	Non-controlling Interest	Total Equity
At January 1, 2015	$459,138	$2,417	$5,681	$180,793	($198)	$14,852	$662,683
Share capital							
Dividend reinvestment plan	4,858	—	—	—	—	—	4,858
Stock options exercised	3,458	(486)	—	—	—		2,972
Issuance of shares for acquisitions	14,489	—	—	—	—	—	14,489
Restricted share units issued	—	662	—	—	—	—	662
Restricted share units redeemed	157	(322)	—	—	—	—	(165)
Repurchase through normal course issuer bid	(167)	(48)	—	—	—	—	(215)
Net Income	—	—	—	27,137	—	594	27,731
Amortization of loss on forward interest rate hedge	—	—	—	—	31	—	31
Distribution to non-controlling interest	—	—	—	—	—	(593)	(593)
Dividends declared and paid	—	—	—	(22,619)	—	—	(22,619)
Dividends payable	—	—	—	(5,394)	—	—	(5,394)
At September 30, 2015	$481,933	$2,223	$5,681	$179,917	($167)	$14,853	$684,440

See accompanying notes to the condensed consolidated interim financial statements.

Condensed Consolidated Interim Statements of Cash Flow

In thousands of Canadian dollars,
[unaudited]

		Three months ended		Nine months ended	
	Note	**September 30, 2016**	September 30, 2015	**September 30, 2016**	September 30, 2015
OPERATING ACTIVITIES					
Net income		**$17,966**	$11,621	**$66,801**	$27,731
Add (deduct) items not affecting cash					
Fair value adjustments	[3], [7], [8]	**(3,649)**	(1,368)	**9,563**	(1,548)
Depreciation and amortization		**607**	676	**1,767**	1,975
Non-cash compensation expense	[11]	**144**	128	**1,004**	265
Deferred income taxes		**1,953**	4,831	**(36,065)**	10,793
(Gain) loss on disposition		**—**	(74)	**264**	109
Financing costs	[12]	**8,735**	9,396	**28,015**	27,718
Interest paid		**(8,377)**	(7,802)	**(27,807)**	(26,356)
Net change in non-cash operating activities	[15]	**3,937**	(3,909)	**241**	(12,836)
Cash provided by operating activities		**$21,316**	$13,499	**$43,783**	$27,851
FINANCING ACTIVITIES					
Deferred financing costs paid		**(1,265)**	(603)	**(3,533)**	(3,167)
(Costs)/proceeds on issuance of units/common shares		**(205)**	—	**93,495**	2,941
Repurchase common shares through normal course issuer bid		**—**	(162)		(162)
Redemption of convertible debentures		**(57,500)**	—	**(57,500)**	—
Proceeds of repayment of mezzanine loan		**4,000**	—	**4,000**	—
Mortgage financing		**36,896**	52,312	**139,592**	157,658
Mortgages repaid on maturity		**(23,225)**	(32,919)	**(74,969)**	(77,014)
Mortgage principal repayments		**(8,034)**	(7,323)	**(23,419)**	(21,496)
Proceeds from construction loans		**841**	4,090	**4,402**	13,242
Construction loans repaid on maturity		**—**	—	**—**	(25,206)
Distributions paid to non-controlling interest		**—**	(186)	**(24,610)**	(593)
Distributions to unitholders/shareholders	[10]	**(8,700)**	(7,404)	**(23,054)**	(22,996)
Cash provided by (used in) financing activities		**($57,192)**	$7,805	**$34,404**	$23,207
INVESTING ACTIVITIES					
Decrease (increase) in restricted cash		**53,078**	(296)	**66**	(214)
Net proceeds on sale of land		**—**	—	**—**	50
Acquisition of investment properties, net of debt assumed		**—**	(6,595)	**(32,832)**	(16,062)
Disposition of investment property		**—**	—	**8**	—
Development of investment properties		**(3,634)**	(2,582)	**(15,024)**	(14,321)
Capital expenditures		**(10,274)**	(9,873)	**(22,194)**	(23,618)
Cash provided by (used in) investing activities		**$39,170**	($19,346)	**($69,976)**	($54,165)
Net increase (decrease) in cash		**3,294**	1,958	**8,211**	(3,107)
Cash, beginning of period		**16,590**	13,782	**11,673**	18,847
Cash, end of period		**$19,884**	$15,740	**$19,884**	$15,740

See accompanying notes to the condensed consolidated interim financial statements.

1. Organization of the Trust

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

Effective January 1, 2016, Killam Properties Inc. (the "Company") completed its plan of arrangement to convert into a real estate investment trust ("REIT") and approval was granted by the Toronto Stock Exchange ("TSX") on January 4, 2016. Under the reorganization, shareholders of Killam received one trust unit ("Trust Unit") or one Class B Limited Partnership Unit ("Exchangeable Unit") of a controlled limited partnership of the Trust, for each common share of Killam held. Consequently, any references to common shares, shareholders and per share amounts relate to periods prior to the conversion on January 1, 2016 and any references to Trust Units, unitholders and per unit amounts relate to periods subsequent to January 1, 2016.

Since the Trust is a continuation of Killam Properties Inc., the prior year comparatives included in these condensed consolidated interim financial statements are those of the Company. The condensed consolidated interim financial statements comprise the financial statements of Killam and its subsidiaries as at and for the nine months ended September 30, 2016. Killam's head office operations are located at 3700 Kempt Road, Halifax, Nova Scotia, B3K 4X8 and the Trust's registered office is located at 2571 Windsor Street, Halifax, NS, B3K 5C4.

2. Significant Accounting Policies

(A) Statement of Compliance
These condensed consolidated interim financial statements have been prepared in accordance with *IAS 34 Interim Financial Reporting* ("IAS 34") as issued by the International Accounting Standards Board ("IASB"). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the IASB, have been omitted or condensed.

The condensed consolidated interim financial statements of the Trust for the period ended September 30, 2016, were authorized for issue in accordance with a resolution of the Board of Trustees of Killam on November 1, 2016.

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

The condensed consolidated interim financial statements should be read in conjunction with the most recently issued Annual Report of Killam, which includes information necessary or useful to understanding the Trust's business and financial statement presentation. In particular, Killam's significant accounting policies were presented in note 2 to the consolidated financial statements for the year ended December 31, 2015, and, after the changes described in note 2(c) through note 2(e), have been consistently applied in the preparation of these condensed consolidated interim financial statements.

The operating results for the three and nine months ended September 30, 2016, are not necessarily indicative of results that may be expected for the full year ended December 31, 2016, due to seasonal variations in property expenses and other factors.

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

2. Significant Accounting Policies (continued)

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

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

Financial Liabilities at Fair Value Through Profit and Loss
Convertible debentures issued by the Trust are convertible into Trust Units at the option of the holder and the number of Trust Units to be issued does not vary with changes in their fair value. As the Trust’s Units are redeemable at the option of the holder and are, therefore, considered puttable instruments in accordance with IAS 32, the convertible debentures are considered a liability containing liability-classified embedded derivatives.

Effective January 1, 2016, the Trust elected to record the full outstanding amount of each convertible debenture at fair value determined using the closing trading price, for each publicly traded convertible debenture. Changes in fair value are recognized in the condensed consolidated interim statements of income and comprehensive income (refer to note 3).

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

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

(D) Unit-based Compensation
Unit-based compensation benefits in the form of restricted trust units ("RTUs") are provided to officers, trustees and certain employees and are intended to facilitate long-term ownership of Trust Units and provide additional incentives by increasing the participants’ interest, as owners, in Killam. In accordance with IAS 32, the RTUs are presented as a liability on the condensed consolidated interim statement of financial position as the Trust is obliged to provide the holder with Trust Units once the RTUs vest. Compensation expense is recognized over the vesting period and included in administration costs.

Under IAS 19 – *Employee Benefits*, the RTUs are classified at FVTPL and are measured at each reporting period at fair value with changes in fair value recognized in the condensed consolidated interim statements of income and comprehensive income. Fair value is determined with reference to the market price of the Trust’s Units.

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

Dollar amounts in thousands of Canadian dollars

3. REIT Conversion Adjustments

A description of the adjustments recorded effective January 1, 2016, related to Killam's conversion to a REIT are as follows:

(a) Exchangeable Units
The Exchangeable Units are considered a financial liability as there is a contractual obligation for the Trust to deliver Trust Units upon exchange of the Exchangeable Units. The Trust Units are redeemable at the option of the holders, and are, therefore, considered puttable instruments in accordance with IAS 32, while the Exchangeable Units are considered a financial liability. The distributions on the Exchangeable Units are recognized as financing costs in the condensed consolidated interim statements of income and comprehensive income. The interest payable as at the reporting date is reported under other current liabilities on the condensed consolidated interim statements of financial position. On initial recognition, the Exchangeable Units are measured at fair value, with the related fair value gain being recorded through retained earnings. Subsequently, the Exchangeable Units are remeasured at each reporting date at fair value, with changes in the carrying amount recognized as a fair value adjustment within net income.

Effective January 1, 2016, 4,748,061 Exchangeable Units were issued and $36.6 million was reclassified from unitholders' equity to Exchangeable Units on the condensed consolidated interim statement of financial position. The Exchangeable Units were recorded at fair value using Killam's unit price on January 4, 2016, and a fair value loss of $12.9 million was recorded through retained earnings.

(b) Convertible Debentures
The convertible debentures are considered a financial liability as there is a contractual obligation for the Trust to deliver Trust Units upon conversion of the convertible debentures. As the Trust Units are redeemable at the option of the holder, and are, therefore, considered puttable instruments in accordance with IAS 32, the convertible debentures are considered a liability containing liability-classified embedded derivatives. Effective January 1, 2016, Killam elected to record the full outstanding amount of each convertible debenture at fair value using the closing trading price for each convertible debenture on the TSX on each reporting date with changes in fair value recognized in the condensed consolidated interim statements of income and comprehensive income.

Effective January 1, 2016, the convertible debentures were re-measured at fair value. The difference between the fair value and the carrying amount included $5.7 million recorded in other paid-in capital, which represented the value of the conversion option of each convertible debenture on issuance. This balance net of $1.4 million in deferred financing costs was reclassified to the convertible debentures liability. The modification of the convertible debentures as a result of the REIT conversion was treated as an extinguishment and resulted in a fair value gain of $3.1 million included on the statement of income and comprehensive income.

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

Effective January 1, 2016, $1.4 million was reclassified from contributed surplus to unit-based compensation and a fair value gain of $0.4 million was recorded through retained earnings. The unit-based compensation was calculated using Killam's unit price on the TSX on January 4, 2016.

(d) *Deferred Income Taxes*
Effective January 1, 2016, Killam recorded the derecognition of a portion of the deferred tax liability to reflect the tax status of the Trust as a flow-through vehicle. The deferred tax liability recorded on the condensed consolidated interim statement of financial position relates only to the corporate subsidiary entity of the REIT. The derecognition of the deferred tax liability was recorded through net income.

The reconciliation of the deferred tax liability as at January 1, 2016, is as follows:

Deferred tax liability as at January 1, 2016, opening	$ 112,145
Derecognition on conversion to a REIT	(39,997)
Deferred tax liability as at January 1, 2016, closing	$ 72,148

Dollar amounts in thousands of Canadian dollars

4. Investment Properties

As at and for the nine month period ended September 30, 2016					
Segment	**Apartments**	**MHCs**	**Other**	**IPUC**	**Total**
Balance, beginning of period	**$1,636,744**	**$125,648**	**$32,188**	**$45,676**	**$1,840,256**
Fair value adjustment on investment properties	**(507)**	**(96)**	**(285)**	**—**	**(888)**
Acquisitions	**34,019**	**—**	**—**	**—**	**34,019**
Dispositions	**—**	**(8)**	**—**	**—**	**(8)**
Transfer from IPUC	**15,490**	**—**	**—**	**(15,490)**	**—**
Capital expenditure on investment properties	**20,336**	**1,010**	**424**	**—**	**21,770**
Capital expenditure on IPUC	**—**	**—**	**—**	**16,034**	**16,034**
Interest capitalized on IPUC	**—**	**—**	**—**	**700**	**700**
Balance, end of period	**$1,706,082**	**$126,554**	**$32,327**	**$46,920**	**$1,911,883**

As at and for the year ended December 31, 2015					
Segment	Apartments	MHCs	Other	IPUC	Total
Balance, beginning of year	$1,568,203	$122,629	$2,223	$40,840	$1,733,895
Fair value adjustment on investment properties	(6,837)	734	—	—	(6,103)
Acquisitions	13,020	—	28,904	17,973	59,897
Dispositions	—	—	—	(1,143)	(1,143)
Transfer from IPUC	36,147	—	—	(36,147)	—
Transfer to IPUC	(2,300)	—	—	2,300	—
Capital expenditure on investment properties	28,511	2,285	1,061	—	31,857
Capital expenditure on IPUC	—	—	—	20,764	20,764
Interest capitalized on IPUC	—	—	—	1,089	1,089
Balance, end of year	$1,636,744	$125,648	$32,188	$45,676	$1,840,256

During the three and nine months ended September 30, 2016, Killam capitalized salaries of $0.8 million and $2.2 million (three and nine months ended September 30, 2015 - $0.8 million and $2.2 million), as part of its project improvement, suite renovation and development programs.

For the nine months ended September 30, 2016, interest costs associated with the general corporate borrowings used to fund development were capitalized to the respective development projects using Killam's weighted average borrowing rate of 3.18% (September 30, 2015 - 3.65%). Interest costs associated with construction loans were capitalized to the respective developments using the actual borrowing rate associated with the loan.

Investment properties with a fair value of $1.9 billion as at September 30, 2016, (December 31, 2015 - $1.8 billion) have been pledged as collateral against Killam's mortgages, construction loan and credit facilities.

Valuation Basis

Killam has engaged a leading independent national real estate appraisal firm with representation and expertise across Canada to provide appraisals on approximately 20% of its portfolio by value, annually. Properties are rotated annually to ensure that every property is externally valued at least once every five years. The investment properties are valued using the direct income capitalization method. In applying the direct income capitalization method, the stabilized net operating income (“NOI”) of each property is divided by an overall capitalization rate ("cap-rate"); values are then adjusted for identified capital requirements. Each quarter, Killam utilizes cap-rates provided by the external appraiser to determine the fair value of the investment properties for interim reporting purposes. Changes in the externally provided cap-rates or results of operations from one reporting period to the next would increase or decrease the fair value of the investment properties.

Investment properties have been valued using the same valuation methods and key assumptions as those described in note 5 of Killam’s audited consolidated financial statements for the year ended December 31, 2015, contained in Killam’s 2015 Annual Report.

Dollar amounts in thousands of Canadian dollars

4. Investment Properties (continued)

Using the direct income capitalization method, the apartment properties were valued using cap-rates in the range of 4.12% to 7.75%, applied to a stabilized NOI of $93.8 million (December 31, 2015 - 4.12% to 8.00% and $91.3 million), resulting in an overall weighted average cap-rate of 5.50% (December 31, 2015 - 5.52%). The stabilized occupancy rates used in the calculation of NOI were in the range of 93.2% to 97.9% (December 31, 2015 - 93.2% to 97.9%).

Using the direct income capitalization method, the MHC properties were valued using cap-rates in the range of 5.75% to 8.00%, applied to a stabilized NOI of $8.5 million (December 31, 2015 - 5.75% to 8.00% and $8.5 million), resulting in an overall weighted average cap-rate of 6.80% (December 31, 2015 - 6.82%). The stabilized occupancy rate used in the calculation of NOI was 97.5% (December 31, 2015 - 97.5%).

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

	September 30, 2016			December 31, 2015		
	Low	**High**	**Effective Weighted Average**	Low	High	Effective Weighted Average
Apartments			**5.50%**			5.52%
Halifax	5.00%	7.33%	5.52%	5.00%	7.33%	5.58%
Moncton	5.15%	7.75%	6.01%	5.15%	8.00%	6.04%
Fredericton	5.15%	6.25%	5.90%	5.15%	6.25%	5.90%
Saint John	6.00%	6.75%	6.40%	6.00%	6.75%	6.40%
St. John's	5.00%	6.00%	5.68%	5.00%	6.00%	5.68%
Charlottetown	5.50%	6.25%	5.94%	5.50%	6.25%	5.94%
Ontario	4.12%	5.00%	4.64%	4.12%	5.00%	4.63%
Alberta	4.85%	4.85%	4.85%	4.85%	4.85%	4.85%
Other Atlantic	5.75%	7.00%	6.59%	5.75%	7.00%	6.57%
MHCs			**6.80%**			6.82%
Ontario	7.00%	8.00%	7.49%	7.00%	8.00%	7.49%
Nova Scotia	5.75%	7.00%	6.18%	5.75%	7.00%	6.22%
New Brunswick	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Newfoundland	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%

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

Class of property	**Capitalization rate**	
	10 basis points increase	*10 basis points decrease*
Apartments	$(30,503)	$31,634
MHCs	$(1,815)	$1,869

The investment property segment defined as "other" consists of three commercial properties.

Dollar amounts in thousands of Canadian dollars

5. Mortgages and Loans Payable

As at	September 30, 2016		December 31, 2015	
	Weighted Average Interest	**Debt Balance**	Weighted Average Interest	Debt Balance
Mortgages and loans payable				
Fixed rate	**3.08%**	**$968,603**	3.27%	$923,835
Variable rate	**4.34%**	**11,723**	4.34%	11,778
Vendor financing	**4.40%**	**16**	3.01%	5,234
Total		**$980,342**		$940,847
Current		**147,314**		156,218
Non-current		**833,028**		784,629
		$980,342		$940,847

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

As at September 30, 2016, unamortized deferred financing costs of $22.2 million (December 31, 2015 - $19.8 million) and mark-to-market premiums on mortgages assumed on acquisitions of $0.4 million (December 31, 2015 - $0.8 million) are netted against mortgages and loans payable.

Estimated future principal payments required to meet mortgage obligations by 12 month periods as at September 30, 2016, are as follows:

	Principal Amount	% of Total Principal
2017	$147,314	14.7%
2018	122,373	12.2%
2019	161,593	16.1%
2020	197,946	19.8%
2021	122,281	12.2%
Subsequent to 2021	250,604	25.0%
	$1,002,111	100.0%
Unamortized deferred financing costs	(22,184)	
Unamortized mark-to-market adjustments	415	
	$980,342	

Killam has two credit facilities with major financial institutions, which are set out as follows:

I. A $30 million revolving demand credit facility to be used for Killam's acquisition and development program, as well as general business purposes. The interest rate on the credit facility is prime plus 75 bps on prime rate advances or 175 bps over Banker's Acceptance. Killam has assets with an aggregate carrying value of $45.4 million pledged to the line. There is currently no balance drawn on the credit facility. The agreement includes certain covenants and undertakings of which Killam is in compliance.

II. A $1.5 million revolving demand facility that can be used for Killam's acquisition program and for general business purposes. The interest rate on the debt is prime plus 175 bps on advances and 135 bps on issuance of letters of credit in addition to 50 bps per annum. As at September 30, 2016, Killam had assets with a carrying value of $1.8 million pledged as collateral and letters of credit total $1.3 million outstanding against the facility (December 31, 2015 - $1.5 million). The agreement includes certain covenants and undertakings of which Killam is in compliance.

Dollar amounts in thousands of Canadian dollars

6. Construction Loan

As at September 30, 2016, Killam had access to a $10.1 million floating rate non-revolving demand construction loan for the purpose of financing a development project. Payments are made monthly on an interest only basis. The construction loan has an interest rate of prime plus 0.75%. Once construction has been completed and rental targets achieved, the construction loan will be repaid in full and replaced with a conventional mortgage. As at September 30, 2016, $8.5 million (December 31, 2015 - $4.1 million) was drawn at a weighted average interest rate of 3.45% (December 31, 2015 - 3.45%).

7. Convertible Debentures

Face Interest Rate %	Conversion Price	Face Amount	Maturity Date	September 30, 2016 (1)	December 31, 2015 (2)
5.65%	$13.40	$57,500	November 30, 2017	**$—**	$55,873
5.45%	$14.60	$46,000	June 30, 2018	**47,150**	45,160
				47,150	101,033
Less: Deferred financing charges				**—**	(1,406)
				$47,150	$99,627

(1) Recorded at fair value based on closing market trading prices of the debentures.
(2) Recorded at carrying value net of unamortized deferred financing costs.

On July 4, 2016, Killam completed the redemption of its $57.5 million, 5.65% convertible debentures.

Killam's $46.0 million convertible subordinated 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 Trust Units 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 Trust Units for the preceding 20 days (ending five days preceding the fixed date for redemption or maturity).

Effective January 1, 2016, the convertible debentures are classified as FVTPL and measured at fair value (refer to note 3).

8. Exchangeable Units

The Exchangeable Units, representing an aggregate fair value of $46.7 million as at September 30, 2016 (December 31, 2015 - $nil), are non-transferable, but are exchangeable, on a one-for-one basis, into Killam Trust Units at any time at the option of the holder. Prior to such exchange, distributions will be made on these Exchangeable Units in an amount equivalent to the distributions which would have been made had the units been exchanged for Killam Trust Units.

	2016	
	Number of Exchangeable Units	**Value**
Balance, January 1	—	$—
Trust units exchanged for Exchangeable Units on conversion	4,748,061	36,567
Fair value adjustment on conversion	—	12,860
Exchangeable Units exchanged	(882,225)	(11,043)
Fair value adjustment	—	8,354
Balance, September 30	**3,865,836**	**$46,738**

Dollar amounts in thousands of Canadian dollars

9. Unitholders' Equity/Capital Stock

Under the reorganization of the Company to a real estate investment trust, the former shareholders of the Company received Trust Units or Exchangeable Units. The interests in Killam are represented by two classes of units: a class described and designated as "Trust Units" and a class described and designated as "Special Voting Units". The Special Voting Units are used to provide voting rights to holders of Exchangeable Units that are exchangeable for Trust Units. The Exchangeable Units are classified as a financial liability in accordance with IAS 32 (refer to note 3).

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

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

Unitholders have the right to redeem their units at the lesser of (i) 90% of the Market Price of the Trust Unit (market price is defined as the weighted average trading price of the previous 10 trading days) and (ii) the most recent closing market price (closing market price is defined as the weighted average trading price on the specified date) at the time of the redemption. The redemption price will be satisfied by cash, up to a limit of $50 thousand for all redemptions in a calendar month, or a note payable. For the nine months ended September 30, no unitholders redeemed units.

The units issued and outstanding are as follows:

	Number of Trust Units	Number of Common Shares	Value
Balance, January 1, 2015	—	60,475,979	$459,138
Dividend reinvestment plan	—	469,441	4,858
Stock options exercised	—	367,907	3,458
Shares issued for acquisition	—	1,341,859	14,489
Restricted share units redeemed	—	18,882	157
Repurchase through normal course issuer bid	—	(21,000)	(167)
Balance, September 30, 2015	—	62,653,068	$481,933
Dividend reinvestment plan	—	198,153	2,050
Restricted share units redeemed	—	11,813	150
Balance December 31, 2015	—	62,863,034	$484,133
REIT conversion, January 1, 2016	58,114,973	(4,748,061)	(36,567)
Distribution reinvestment plan	411,178	—	4,742
Restricted trust units redeemed	30,177	—	208
Units issued on exchange of Exchangeable Units	882,225	—	$11,043
Units issued for cash	8,165,000	—	$93,623
Balance, September 30, 2016	**67,603,553**	**—**	**$557,182**

Distribution Reinvestment Plan ("DRIP")

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

Dollar amounts in thousands of Canadian dollars

10. Distributions

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

For the three and nine months ended September 30, 2016, the distributions declared related to the Trust Units were $10.1 million and $28.1 million (dividends declared three and nine months ended September 30, 2015 - $9.4 million and $28.0 million), respectively. For the three and nine months ended September 30, 2016, distributions declared related to the Exchangeable Units were $0.7 million and $2.1 million (three and nine months ended September 30, 2015 - $nil and $nil), respectively. The distribution on the Exchangeable Units are recorded in financing costs.

On October 18, 2016, Killam announced a distribution of $0.05 per unit, payable on November 15, 2016, to Unitholders of record at October 31, 2016.

11. Unit-based Compensation

Unit/**Stock *****Option Plan***

Killam replaced its stock option plan with a restricted share unit plan in 2011. All remaining outstanding stock options were exercised in May 2015. For the three and nine months ended September 30, 2016, there were no options granted (three and nine months ended September 30, 2015 - nil and nil).

Restricted Trust Units ("RTUs") / Restricted Share Units ("RSUs")

Killam's Restricted Trust Unit Plan gives members of the senior executive team and directors the right to receive a percentage of their annual bonus and non-executive members of the Board of Trustees the right to receive a percentage of their annual retainer, in the form of RTUs 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 RTUs:

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

Killam will match the elected amount in the form of RTUs having a value equal to the volume weighted average price of all Trust Units traded on the TSX for the five trading days immediately preceding the date on which the compensation is payable. The RTUs earn distributions based on the same distributions paid on the Trust Units, and such distributions are used to acquire additional RTUs. The initial RTUs and RTUs acquired through distribution reinvestment are credited to each person's account and are not issued to the employee or board member until they redeem such RTUs. The RTUs will be redeemed and paid out in Trust Units by December 31 of the year in which the RTUs have vested. The RTUs shall vest with the following schedule: (a) 50% on the second anniversary of the grant rate; and (b) 50% on the third anniversary of the grant date.

The RTUs are considered a financial liability because there is a contractual obligation for the Trust to deliver Trust Units (which are accounted for as liabilities, but presented as equity instruments under IAS 32) upon conversion of the RTUs. The RTUs are measured at fair value with changes flowing through the condensed consolidated interim statements of income and comprehensive income. The fair value for the nine month period ended September 30, 2016, is $3.4 million (September 30, 2015 - $nil). As at December 31, 2015, $1.4 million was included in contributed surplus related to the RSUs.

Dollar amounts in thousands of Canadian dollars

11. Unit-based Compensation (continued)

For the three and nine months ended September 30, 2016, compensation expense of $0.2 million and $1.2 million (September 30, 2015 - $0.1 million and $0.3 million) has been recognized in respect of the RTUs/RSUs.

The details of the RTUs issued under the RTU Plan are shown below:

	2016		2015	
	Number of RTUs	**Weighted Average Issue Price**	Number of RSUs	Weighted Average Issue Price
Outstanding, January 1	184,106	$10.40	140,513	$11.01
Granted	149,488	10.88	75,148	10.76
Redeemed	(49,781)	10.51	(29,504)	12.37
Forfeited	(517)	10.88	—	—
Additional restricted trust unit/share distributions	10,168	11.20	7,408	10.45
Outstanding, September 30	293,464	$10.65	193,565	$10.60

12. Financing Costs

	Three months ended September 30,		**Nine months ended September 30,**	
	2016	2015	**2016**	2015
Mortgage, loan and construction loan interest	**$7,775**	$7,991	**$23,317**	$23,905
Interest on exchangeable units	**663**	—	**2,079**	—
Amortization of fair value adjustments on assumed debt	**(127)**	(153)	**(394)**	(429)
Amortization of loss on interest rate hedge	**15**	15	**45**	45
Unrealized (gain) loss on derivative liability	**(15)**	—	**116**	—
Convertible debenture interest	**660**	1,706	**3,552**	5,122
Capitalized interest	**(236)**	(163)	**(700)**	(925)
	$8,735	$9,396	**$28,015**	$27,718

13. Deferred Income Tax

Trusts that satisfy the REIT Exemption are excluded from the specified investment flow-through ("SIFT") definition and therefore will not be subject to taxation under the SIFT Rules. Effective January 1, 2016, Killam qualified for the REIT Exemption and continues to meet the REIT Exemption as at September 30, 2016, and is therefore not subject to taxation. Killam expects to continue to meet the REIT Exemption through the remainder of 2016. For the nine months ended September 30, the deferred tax expense relates to the corporate subsidiary entity of the REIT.

Dollar amounts in thousands of Canadian dollars

14. Segmented Information

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

- Apartment segment - acquires, operates, manages and develops multi-family residential properties across Canada;
- MHC segment - acquires and operates MHC communities in Ontario and Eastern Canada;
- Other segment - includes three commercial properties, and Killam's head office and regional office administration costs.

Killam’s administration costs, other income, financing costs, depreciation and amortization, fair value adjustments, gain on disposition and deferred tax expense are not reported to the members of executive management on a segment basis.

The accounting policies of these reportable segments are the same as those described in the summary of significant accounting policies described in note 2 of the audited consolidated financial statements for the year ended December 31, 2015, plus additions in note 2(c) through 2(e) of the condensed consolidated interim financial statements. Reportable segment performance is analysed based on NOI. The operating results, and assets and liabilities, of the reportable segments are as follows:

For the three months ended September 30, 2016	**Apartments**	**MHCs**	**Other**	**Total**
Property revenue	**$39,112**	**$4,803**	**$1,163**	**$45,078**
Property operating expenses	**(14,337)**	**(1,705)**	**(686)**	**(16,728)**
Net operating income	**$24,775**	**$3,098**	**$477**	**$28,350**

For the three months ended September 30, 2015	Apartments	MHCs	Other	Total
Property revenue	$37,459	$4,629	$1,105	$43,193
Property operating expenses	(13,865)	(1,599)	(551)	(16,015)
Net operating income	$23,594	$3,030	$554	$27,178

For the nine months ended September 30, 2016	**Apartments**	**MHCs**	**Other**	**Total**
Property revenue	**$116,133**	**$11,412**	**$3,588**	**$131,133**
Property operating expenses	**(45,731)**	**(4,305)**	**(2,045)**	**(52,081)**
Net operating income	**$70,402**	**$7,107**	**$1,543**	**$79,052**

For the nine months ended September 30, 2015	Apartments	MHCs	Other	Total
Property revenue	$110,819	$11,092	$2,270	$124,181
Property operating expenses	(45,786)	(4,193)	(1,173)	(51,152)
Net operating income	$65,033	$6,899	$1,097	$73,029

As at September 30, 2016	**Apartments**	**MHCs**	**Other**	**Total**
Total assets	**$1,706,615**	**$133,090**	**$116,509**	**$1,956,214**
Total liabilities	**$938,801**	**$59,906**	**$204,482**	**$1,203,189**

As at December 31, 2015				
Total assets	$1,639,988	$126,394	$109,894	$1,876,276
Total liabilities	$893,914	$59,360	$237,674	$1,190,948

Dollar amounts in thousands of Canadian dollars

15. Supplemental Cash Flow Information

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	**2016**	2015
Net change in non-cash operating assets and liabilities				
Rent and other receivables	**($112)**	($596)	**($103)**	($3,187)
Inventory	**—**	(142)	**—**	(161)
Other current assets	**3,592**	1,436	**(4,335)**	(5,115)
Accounts payable and other liabilities	**457**	(4,607)	**4,679**	(4,373)
	$3,937	($3,909)	**$241**	($12,836)

16. Financial Instruments and Financial Risk Management Objectives and Policies

During Q2-2016, Killam entered into an interest rate swap agreement fixing the rate on one $15.0 million commercial mortgage at 3.14%, which matures in April 2023, for which hedge accounting is not being applied. The mark-to-market loss on the derivative instrument for the nine months ended September 30, 2016, of $0.1 million has been been recorded in net income and the swap derivative liability is recorded within other non-current liabilities on the Statement of Financial Position.

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

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

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

As at September 30, 2016, no mortgages or vendor debt had floating interest rates except for five demand loans totaling $11.7 million and two revolving demand facilities. These loans and facilities have interest rates of prime plus 1.0% - 2.0% (December 31, 2015 - prime plus 1.0% - 2.0%). As at September 30, 2016, Killam also has a construction loan for $8.5 million with a floating interest rate of prime to prime plus 0.75% and consequently, Killam is exposed to short-term interest rate risk on this loan.

An annualized 100 bps change in the interest rate on Killam's entire mortgage and vendor debt as at September 30, 2016, would affect financing costs by approximately $9.9 million per year. However, only $109.4 million of Killam's fixed mortgage and vendor debt matures in the next 12 months. Assuming these mortgages are refinanced at similar terms, except at a 100 bps increase in interest rates, financing costs would increase by $1.1 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. Killam mitigates the risk of credit loss through the diversification of its existing portfolio and limiting its exposure to any one tenant. Credit assessments are conducted with respect to all new leasing and Killam 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 Killam's exposure to bad debt is not significant. Killam's bad debt expense experience has historically been less than 0.4% of revenue. None of Killam's tenants account for more than 1% of the tenant receivables as at September 30, 2016, or 2015. The maximum exposure to credit risk is the carrying amount of each class of financial assets as disclosed in this note.

Dollar amounts in thousands of Canadian dollars

16. Financial Risk Management Objectives and Policies (continued)

(iii) Liquidity Risk

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

During the nine month period ended September 30, 2016, Killam refinanced $80.0 million of maturing apartment mortgages with new mortgages totaling $123.7 million for net proceeds of $43.7 million. As well, Killam refinanced $1.5 million of maturing MHC mortgages with new mortgages totaling $3.8 million for net proceeds of $2.3 million.

The following table presents the principal payments (excluding interest) and maturities of Killam’s liabilities over the next five years and thereafter:

For the twelve months ended September 30,	Mortgage and loans payable	Construction loans	Convertible debentures	Total
2017	$147,314	$8,517	$—	$155,831
2018	122,373	—	46,000	168,373
2019	161,593	—	—	161,593
2020	197,946	—	—	197,946
2021	122,281	—	—	122,281
Thereafter	250,604	—	—	250,604
	$1,002,111	$8,517	$46,000	$1,056,628

Capital Management

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

Killam monitors capital using a total debt to total assets ratio. Killam’s strategy is for its total debt to total assets ratio to not exceed 65%. The calculation of the total debt to total assets is summarized as follows:

As at	**September 30, 2016**	December 31, 2015
Mortgages, loans payables and construction loans	**$988,859**	$944,962
Convertible debentures	**$46,000**	$99,627
Total debt	**$1,034,859**	$1,044,589
Total assets(1)	**$1,943,614**	$1,850,076
Total debt as a percentage of assets	**53.2%**	56.5%

(1) Total assets adjusted for Killam's non-controlling interest related to The Alexander - $12.6 million (December 31, 2015 - total assets adjusted for Killam's non-controlling interest related to The Alexander - $7.1 million and Garden Park - $19.1 million). Refer to the Killam *Q3- 2016 Management's Discussion and Analysis* for additional detail.

The above calculation is sensitive to changes in the fair value of investment properties, in particular, cap-rate changes. A 10 bps increase in the weighted average cap-rate as at September 30, 2016, would increase the debt as a percentage of assets by 90 bps.

Dollar amounts in thousands of Canadian dollars

17. Fair Value Measurement

Fair Value of Financial Instruments

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

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

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

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

(iv) the fair value of the deferred unit-based compensation and the Exchangeable Units are estimates at the reporting date, based on the closing market price of the Trust Units listed on the TSX.

These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in estimates could significantly affect fair values. The significant financial instruments of Killam and their carrying values as at September 30, 2016 and December 31, 2015, are as follows:

As at	**September 30, 2016**		December 31, 2015	
Classification	**Carrying Value**	**Fair Value**	Carrying Value	Fair Value
Financial assets carried at amortized cost:				
Loans receivable[1]	**$950**	**$955**	$4,950	$4,949
Financial liabilities carried at amortized cost:				
Mortgages payable	**$980,342**	**$1,030,410**	$940,847	$995,709
Convertible debentures	**$—**	**$—**	$99,627	$102,160
Financial liabilities carried at FVTPL:				
Exchangeable units	**$46,738**	**$46,738**	$—	$—
Convertible debentures	**$47,150**	**$47,150**	$—	$—
Unit-based compensation	**$3,400**	**$3,400**	$—	$—
Derivative liability	**$131**	**$131**	$—	$—

[1]The $0.95 million loan receivable is included in the other non-current assets within the condensed consolidated interim financial statements of financial position.

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

As at	**September 30, 2016**	December 31, 2015
Mortgages - Apartments	**1.82%**	1.73%
Mortgages - MHCs	**3.24%**	3.33%

The fair value of Killam's mortgages payable exceeded the recorded value, due to changes in interest rates since the dates on which the individual mortgages were last contracted. The fair values of the mortgages payable have been estimated based on the current market rates for mortgages with similar terms and conditions. The fair value of Killam's mortgages payable is an amount computed based on the interest rate environment prevailing at September 30, 2016, and December 31, 2015, respectively.

Dollar amounts in thousands of Canadian dollars

17. Fair Value Measurement (continued)

Assets and Liabilities Measured at Fair Value

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

As at	September 30, 2016			December 31, 2015		
	Level 1	**Level 2**	**Level 3**	Level 1	Level 2	Level 3
Assets						
Investment properties	—	—	**$1,911,883**	—	—	$1,840,256
Liabilities						
Exchangeable units	**$46,738**	—	—	—	—	—
Convertible debentures	**$47,150**	—	—	—	—	—
Unit-based compensation	**$3,400**	—	—	—	—	—
Derivative liability	**$131**	—	—	—	—	—

The three levels of the fair value hierarchy are described in note 3 to the audited consolidated financial statements for the year ended December 31, 2015. Transfers between levels in the fair value hierarchy are recognized on the date of the event or change in circumstances that caused the transfer. As at September 30, 2016, and December 31, 2015, there were no transfers of assets or liabilities between Level 1, Level 2 and Level 3.

18. Commitments and Contingencies

Commitments primarily related to capital investment in investment properties and IPUC of $14.4 million were outstanding at September 30, 2016 (December 31, 2015 - $8.1 million).

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

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

Area	Usage Coverage	Term	Cost
Ontario	70%	November 01, 2016 - October 31, 2017	$12.60/m3