Consolidated Financial Statements of

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Years ended December 31, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

To the Unitholders of Primaris Retail
Real Estate Investment Trust

We have audited the accompanying consolidated financial statements of Primaris Retail Real Estate Investment Trust, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising 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 our 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, we 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 consolidated financial position of Primaris Retail Real Estate Investment Trust as at December 31, 2012 and 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

March 7, 2013
Toronto, Canada

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Financial Position
(In thousands of dollars)

December 31, 2012 and 2011

	2012	2011
Assets		
Non-current assets:		
Investment properties (note 5)	$ 4,145,400	$ 3,557,900
Current assets:		
Rents receivable (note 6)	6,245	7,387
Other assets and receivables (note 7)	20,793	25,010
Cash and cash equivalents	45,622	–
	72,660	32,397
	$ 4,218,060	$ 3,590,297
Liabilities and Equity		
Non-current liabilities:		
Mortgages payable (note 8)	$ 1,431,205	$ 1,372,871
Convertible debentures (note 9)	110,525	268,766
Exchangeable units (note 12)	57,088	45,079
Accounts payable and other liabilities (note 11)	7,214	1,205
	1,606,032	1,687,921
Current liabilities:		
Current portion of mortgages payable (note 8)	151,729	53,004
Bank indebtedness (note 10)	45,000	6,779
Accounts payable and other liabilities (note 11)	75,248	61,744
Distribution payable	10,000	8,251
	281,977	129,778
	1,888,009	1,817,699
Equity (note 12)	2,330,051	1,772,598
Subsequent events (note 27)		
	$ 4,218,060	$ 3,590,297

See accompanying notes to consolidated financial statements.

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Income and Comprehensive Income
(In thousands of dollars)

Years ended December 31, 2012 and 2011

	2012	2011
Revenue:		
Minimum rent	$ 242,516	$ 219,113
Recoveries from tenants	154,235	135,464
Percentage rent	2,707	2,652
Parking	7,220	6,556
Other income	4,353	1,568
	411,031	365,353
Expenses:		
Property operating	103,297	92,745
Property taxes	76,467	68,569
Ground rent	1,353	1,246
General and administrative	25,483	9,840
Depreciation	1,207	1,039
	207,807	173,439
Income from operations	203,224	191,914
Finance income	90	168
Finance costs (note 14)	(115,648)	(109,396)
Fair value adjustment on investment properties (note 5)	178,690	149,113
Net income	266,356	231,799
Other comprehensive income (loss):		
Deferred loss on cash flow hedge	(190)	–
Amortization of deferred net loss on cash flow hedges	226	230
	36	230
Comprehensive income	$ 266,392	$ 232,029

See accompanying notes to consolidated financial statements.

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Changes in Equity
(In thousands of dollars)

Years ended December 31, 2012 and 2011

2012	Amount of units issued	Contributed surplus	Cumulative net income	Distributions	Accumulated other comprehensive income (loss)	Total
Equity, beginning of year	$ 1,124,856	$ 543	$ 1,171,792	$ (523,779)	$ (814)	$ 1,772,598
Net income for the year	–	–	266,356	–	–	266,356
Distributions	–	–	–	(108,913)	–	(108,913)
Deferred loss on cash flow hedge	–	–	–	–	(190)	(190)
Amortization of deferred net loss on cash flow hedges	–	–	–	–	226	226
Unit-based compensation plan (note 12(d))	1,310	–	–	–	–	1,310
Issuance of units under distribution reinvestment plan	16,133	–	–	–	–	16,133
Issuance of units, net of costs	219,583	–	–	–	–	219,583
Conversion of convertible debentures to units	161,539	–	–	–	–	161,539
Conversion of exchangeable units	1,409	–	–	–	–	1,409
Equity, end of year	$ 1,524,830	$ 543	$ 1,438,148	$ (632,692)	$ (778)	$ 2,330,051

See accompanying notes to consolidated financial statements.

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Changes in Equity (continued)
(In thousands of dollars)

Years ended December 31, 2012 and 2011

2011	Amount of units issued	Contributed surplus	Cumulative net income	Distributions	Accumulated other comprehensive income (loss)	Total
Equity, beginning of year	$ 847,827	$ 543	$ 939,993	$ (432,280)	$ (1,044)	$ 1,355,039
Net income for the year	–	–	231,799	–	–	231,799
Distributions	–	–	–	(91,499)	–	(91,499)
Amortization of deferred net loss on cash flow hedges	–	–	–	–	230	230
Unit-based compensation plan (note 12(d))	935	–	–	–	–	935
Issuance of units under distribution reinvestment plan	8,714	–	–	–	–	8,714
Issuance of units, net of costs	249,446	–	–	–	–	249,446
Conversion of convertible debentures to units	17,926	–	–	–	–	17,926
Conversion of exchangeable units	597	–	–	–	–	597
Purchase of units under normal course issuer bid	(589)	–	–	–	–	(589)
Equity, end of year	$ 1,124,856	$ 543	$ 1,171,792	$ (523,779)	$ (814)	$ 1,772,598

See accompanying notes to consolidated financial statements.

PRIMARIS RETAIL REAL ESTATE INVESTMENT TRUST

Consolidated Statements of Cash Flows
(In thousands of dollars)

Years ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Net income for the year	$ 266,356	$ 231,799
Adjustments for:		
Amortization of tenant improvement allowances	9,768	7,419
Amortization of tenant inducements	220	168
Amortization of straight-line rent	(2,096)	(2,030)
Value of units and options granted under unit-based compensation plan	7,552	1,957
Depreciation	1,207	1,039
Net finance costs	115,558	109,228
Fair value adjustment on investment properties	(178,690)	(149,113)
	219,875	200,467
Change in other non-cash operating working capital (note 15)	16,535	(7,069)
Leasing commissions	(990)	(773)
Tenant improvement allowances	(17,440)	(18,879)
Tenant inducements	(25)	(15)
Net cash generated from operating activities	217,955	173,731
Interest received	90	168
Cash flows from operating activities	218,045	173,899
Cash flows from financing activities:		
Mortgage principal repayments	(33,000)	(28,146)
Proceeds of new mortgage financing	209,905	333,600
Proceeds of bridge financing	–	57,500
Repayment of financing	(21,227)	(99,933)
Advance (repayment) of bank indebtedness	38,221	(3,221)
Interest paid	(87,962)	(83,723)
Capitalized debt placement costs	(1,479)	(2,736)
Cash received on exercise of options	829	457
Issuance of units	230,074	260,590
Unit issue costs	(10,491)	(11,144)
Redemption of convertible debentures	(9,458)	–
Issuance of convertible debentures	–	75,000
Convertible debenture issue costs	–	(3,029)
Distributions to Unitholders	(93,628)	(84,016)
Purchase of units under normal course issuer bid	–	(589)
Cash flows from financing activities	221,784	410,610
Cash flows from investing activities:		
Acquisitions of investment properties (note 4)	(365,897)	(585,388)
Additions to buildings and building improvements	(17,225)	(12,977)
Additions to recoverable improvements	(9,498)	(12,087)
Additions to fixtures and equipment	(1,587)	(390)
Proceeds of disposition	–	19,833
Cash flows used in investing activities	(394,207)	(591,009)
Increase (decrease) in cash and cash equivalents	45,622	(6,500)
Cash and cash equivalents, beginning of year	–	6,500
Cash and cash equivalents, end of year	$ 45,622	$ –
Supplemental disclosure of non-cash operating, financing and investing activities:		
Value of units issued from conversion of convertible debentures	$ 161,539	$ 17,926
Value of units issued under distribution reinvestment plan	16,133	8,714
Value of units issued under unit-based compensation plan	481	478
Value of units issued upon conversion of exchangeable units	1,409	597
Deferred loss on cash flow hedge	(190)	–

See accompanying notes to consolidated financial statements.

Primaris Retail Real Estate Investment Trust ("Primaris") is an unincorporated open-ended real estate investment trust ("REIT") created pursuant to the Declaration of Trust dated March 28, 2003, as amended and restated, and is governed by the laws of the Province of Ontario. Primaris' units and debentures are listed on the Toronto Stock Exchange and are traded under the symbol "PMZ". The registered office of Primaris is: 1 Adelaide Street East, Suite 900, Toronto, Ontario, M5C 2V9.

1. Basis of preparation:

(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") and using accounting policies described herein.

These consolidated financial statements were approved by the Board of Trustees on March 7, 2013.

(b) Basis of measurement:

These consolidated financial statements have been prepared on a historical cost basis, except for the following material items in the consolidated statements of financial position:

- Convertible debentures measured at fair value;
- Investment properties measured at fair value;
- Exchangeable units measured at fair value;
- Liabilities for unit-based payment arrangements measured at fair value; and
- Cash flow hedges measured at fair value.

These consolidated financial statements are presented in Canadian dollars, which is Primaris' functional currency.

(c) Use of estimates and judgments:

The preparation of these consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates.

1. Basis of preparation (continued):

Significant judgments and key estimates:

The following are significant judgments and key estimates that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the year:

(i) Property valuations:

Investment properties, which are carried on the consolidated statements of financial position at fair value, are valued by either qualified external valuation professionals or by management. Each property is subject to an external appraisal at least once every three years. The valuations are based on a number of assumptions, such as appropriate discount rates and capitalization rates and estimates of future rental income, operating expenses and capital expenditures. The valuation of investment properties is one of the principal estimates and uncertainties of these consolidated financial statements. Refer to note 5 for further information on estimates and assumptions made in the determination of the fair value of investment properties.

(ii) Income taxes:

Primaris is a mutual fund trust and a REIT pursuant to the Income Tax Act (Canada). Under current tax legislation, Primaris is not liable to pay Canadian income taxes provided that its taxable income is fully distributed to Unitholders each year. Primaris is a REIT if it meets prescribed conditions under the Income Tax Act (Canada) relating to the nature of its assets and revenue (the "REIT Conditions"). Primaris has reviewed the REIT Conditions and has assessed their interpretation and application to Primaris' assets and revenue, and it has determined that it qualifies as a REIT for the year.

Primaris expects to continue to qualify as a REIT under the Income Tax Act (Canada), however, should it no longer qualify, it would not be able to flow through its taxable income to Unitholders and Primaris would therefore be subject to tax.

2. Significant accounting policies:

The accounting policies set out below have been applied consistently to all years presented in these consolidated financial statements:

(a) Principles of consolidation:

These consolidated financial statements include the accounts of all entities in which Primaris has a controlling interest. All intercompany transactions and balances have been eliminated upon consolidation.

(b) Investment properties:

Investment properties include land and buildings held primarily to earn rental income or for capital appreciation or for both, rather than for use in the production for supply of goods or services or for sale in the ordinary course of business.

On acquisition, investment properties are initially recorded at cost. Subsequent to initial recognition, Primaris uses the fair value model to account for investment properties. Under the fair value model, investment properties are recorded at fair value, determined based on available market evidence, at the consolidated statements of financial position dates. Related fair value gains and losses are recognized in net income in the year in which they arise.

Subsequent capital expenditures are recorded to investment properties only when it is probable that future economic benefits of the expenditure will flow to Primaris and the cost can be measured reliably.

Gains or losses from the disposal of investment properties are determined as the difference between the net disposal proceeds and the carrying amount and are recognized in net income in the year of disposal.

(c) Leasing costs:

Leasing costs include commissions paid to external leasing agents and payments to tenants. Leasing costs are included as components of the fair value of investment properties.

2. Significant accounting policies (continued):

Payments to tenants under lease obligations are characterized either as tenant improvements, tenant inducements or building cost. The obligation is determined to be a tenant improvement when the payment to the tenant was spent on leasehold improvements. Otherwise, the obligations under the lease are treated as tenant inducements. Both tenant improvements and tenant inducements are amortized on a straight-line basis over the term of the lease as a reduction of revenue. The obligation is determined to be a building cost, and not a leasing cost, when the payment is for construction from which Primaris will receive benefit after the tenant vacates.

(d) Cash and cash equivalents:

Cash and cash equivalents include cash and short-term investments, such as bankers' acceptances and treasury bills, with initial maturity dates of less than 90 days.

(e) Fixtures and equipment:

Fixtures and equipment, including leasehold improvements and computer hardware, are recorded at cost less accumulated depreciation and net accumulated impairment losses. Depreciation expense is recorded on a straight-line basis over the estimated useful life of each asset. The depreciation method and useful lives are reviewed at each annual reporting date and adjusted if appropriate. Gains or losses arising from the derecognition of fixtures and equipment are determined as the difference between the net disposal proceeds and the carrying amount.

(f) Convertible debentures:

The convertible debentures are convertible into trust units of Primaris. As Primaris' trust units are redeemable at the option of the holder and are, therefore, considered puttable instruments in accordance with IAS 32, *Financial Instruments: Presentation* ("IAS 32"), the convertible debentures are considered a liability containing liability-classified embedded derivatives. Primaris has elected to record the full outstanding amount of each convertible debenture at its fair value with the changes being recognized in net income.

2. Significant accounting policies (continued):

(g) Exchangeable units:

The exchangeable units of subsidiaries of Primaris are exchangeable into trust units at the option of the holder. The exchangeable units are considered puttable instruments and are required to be classified as financial liabilities. Further, the exchangeable units are classified as fair value through profit or loss financial liabilities and are, therefore, measured at fair value at each reporting period with any changes in fair value recognized in net income. The distributions paid on the exchangeable units are accounted for as finance costs (note 14).

(h) Trust units:

Primaris' 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. Primaris' trust units meet the conditions of IAS 32 and are, therefore, classified and presented as equity.

(i) Finance income and finance costs:

Finance income comprises interest income on funds invested and the amortization of gains on hedging instruments that are recognized in net income. Interest income is recognized as it accrues in net income, using the effective interest method.

Finance costs comprise interest expensed on borrowings, distributions on exchangeable units classified as liabilities, fair value changes recognized on financial assets and liabilities, the amortization of losses on hedging instruments that are recognized in net income, and debt placement costs.

Debt placement costs associated with financial liabilities, measured at amortized cost, are presented with the related debt instrument and amortized using the effective interest rate over the anticipated life of the related debt.

Debt placement costs associated with the issuance of convertible debentures, which are recorded at fair value, are expensed as incurred.

2. Significant accounting policies (continued):

(j) Revenue recognition:

Revenue from investment properties includes minimum rent earned from tenants under lease agreements, percentage rent, property tax and operating cost recoveries and other incidental income, and is recognized as revenue over the term of the underlying leases. All predetermined minimum rent adjustments in lease agreements are accounted for on a straight-line basis over the term of the respective leases. Percentage rent is not recognized until a tenant's actual sales reach the sales threshold as set out in the tenant's lease.

(k) Lease payments:

Payments made under operating leases are recognized in net income on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense over the term of the lease.

(l) Employee benefits:

Primaris maintains a defined contribution pension plan. A defined contribution pension plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in net income in the years during which services are rendered by employees.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount estimated to be paid under short-term cash bonus or profit-sharing plans.

2. Significant accounting policies (continued):

(m) Unit-based compensation:

Primaris has a unit-based compensation plan that awards options and/or restricted units to employees and trustees. Primaris has a unit option plan, which provides holders with the right to receive trust units, which are puttable. Primaris measures these awards at fair value at the grant date and compensation expense is recognized over the vesting period. The awards are fair valued at each reporting period and the change in fair value is recognized as compensation expense. The unit-based compensation is presented as a liability.

(n) Financial instruments:

Financial instruments are classified as one of the following: (i) held-to-maturity, (ii) loans and receivables, (iii) financial liabilities, (iv) financial assets or financial liabilities at fair value through profit or loss, or (v) available-for-sale. Financial instruments are recognized initially at fair value. Financial instruments classified as held-to-maturity, loans and receivables, or financial liabilities are subsequently measured at amortized cost. Financial assets and liabilities classified as fair value through profit and loss are measured at fair value with unrealized gains and losses recognized in net income. Available-for-sale financial instruments are subsequently measured at fair value, with unrealized gains and losses recognized in other comprehensive income (loss).

Primaris classifies its cash and cash equivalents, rents receivable and other receivables as loans and receivables; and classifies mortgages payable, bank indebtedness, accounts payable and other liabilities, and distribution payable as financial liabilities; and designates exchangeable units and convertible debentures as financial liabilities at fair value through profit or loss. Primaris has neither available-for-sale nor held-to-maturity instruments.

Where financial instruments are reported at their amortized cost, transaction costs that are directly attributable to the acquisition or issuance of financial assets or liabilities are accounted for as part of the carrying amount of the respective asset or liability at inception.

All derivative instruments, including embedded derivatives, that are not designated in an effective hedging relationship, are recorded at fair value and any changes in fair value are recognized in net income.

2. Significant accounting policies (continued):

(o) Hedging:

The instruments that are used in hedging transactions are formally assessed both at the inception of a transaction and on an ongoing basis as to whether the hedging instruments that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

In a cash flow hedge, the change in fair value of the hedging derivative, to the extent effective, is recorded in other comprehensive income (loss) until the asset or liability being hedged affects the consolidated statements of income and comprehensive income, at which time, the related change in fair value of the hedging derivative is recognized in net income over the life of the hedged item. Hedge ineffectiveness, if any, is recognized in net income immediately.

(p) Income taxes:

Primaris is a mutual fund trust and a REIT pursuant to the Income Tax Act (Canada). Under current tax legislation, a REIT is entitled to deduct distributions of taxable income such that it is not liable to pay income taxes provided that its taxable income is fully distributed to Unitholders. Primaris intends to continue to qualify as a REIT and to make distributions not less than the amount necessary to ensure that Primaris will not be liable to pay income taxes. Accordingly, no current or deferred income taxes have been recorded in the consolidated financial statements.

(q) Future accounting changes:

(i) IAS 1, *Presentation of Financial Statements* ("IAS 1"):

Primaris intends to adopt the presentation amendments to IAS 1 in its financial statements for the annual period beginning on January 1, 2013. Primaris does not expect IAS 1 to have a significant impact on its consolidated financial statements.

2. Significant accounting policies (continued):

(ii) IFRS 9, *Financial Instruments* ("IFRS 9"):

IFRS 9 was issued to replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple classification rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of its financial assets. The standard is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. Primaris does not expect IFRS 9 to have a significant impact on its consolidated financial statements and will not early adopt the standard.

(iii) IFRS 11, *Joint Arrangements* ("IFRS 11"):

IFRS 11 replaces IAS 31, *Interest in Joint Ventures*. The new standard redefines joint operations and joint ventures and requires joint operations to be proportionately consolidated and joint ventures to be equity-accounted. Primaris has one investment that is currently proportionately consolidated. Under IFRS 11, this investment will be classified as a joint operation and, therefore, will continue to be proportionately consolidated. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. Primaris does not expect any impact on the consolidated financial statements from this standard.

(iv) IFRS 12, *Disclosure of Interests in Other Entities* ("IFRS 12"):

IFRS 12 outlines the disclosures for interests in subsidiaries, joint ventures and associates. The standard requires Primaris to disclose information that enables users of financial statements to evaluate the nature, risks and financial effects associated with its interests in other entities. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. Primaris does not expect IFRS 12 to have a significant impact on its consolidated financial statements and will not early adopt the new disclosures.

2. Significant accounting policies (continued):

(v) IFRS 13, Fair Value Measurement ("IFRS 13"):

IFRS 13 provides a single source of guidance on how to measure fair value where fair value is already required or permitted by other IFRS standards (except IFRS 2, *Share-Based Payment*, and IAS 17, *Leases*). The standard also enhances disclosure requirements for information about fair value measurements and the use of management's judgment. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. Primaris does not expect IFRS 13 to have a significant impact on its consolidated financial statements and will not early adopt the new standard.

3. Corporate developments:

On December 10, 2012, KS Acquisition II LP (the "KingSett-led consortium") made an unsolicited offer to purchase all of the outstanding units of Primaris. This offer was scheduled to expire on January 17, 2013 and was subsequently extended to expire on February 4, 2013. An Independent Committee of the Primaris' Board of Trustees was formed to review the offer and to consider strategic alternatives. The committee engaged financial, legal, and other advisors to assist in this exercise. A Trustee's circular dated December 19, 2012 was issued in response to the offer. The financial statements for 2012 include $10,550 of costs related to the takeover, as part of general and administrative expenses on the consolidated statement of income and comprehensive income. This amount includes costs incurred by year end, as well as, minimum amounts that could be due under certain advisory agreements.

On January 16, 2013 Primaris announced that it had entered into an Arrangement Agreement with H&R REIT whereby H&R REIT would acquire all of the issued and outstanding units of Primaris.

3. Corporate developments (continued):

On February 4, 2013, Primaris, PRR Investments Inc., H&R REIT, and H&R Finance Trust entered into an amended and restated Arrangement Agreement and Primaris entered into various conditional sales contracts with members of the KingSett-led consortium. Pursuant to these transactions, the KingSett-led consortium would acquire 18 properties from Primaris for cash and the assumption of debt. As part of the transactions, H&R REIT would then acquire substantially all of the remaining assets of Primaris and Primaris would become a wholly-owned subsidiary of H&R REIT. Holders ("Primaris Unitholders") of units ("Primaris Units") of Primaris will be entitled to receive, in exchange for each Primaris Unit held, at their election: (i) $28.00 in cash, subject to an aggregate cash amount of $1,278,443,575 (the "Actual Cash Consideration"), or (ii) 1.166 H&R stapled units (each H&R stapled unit consisting of one H&R REIT unit and one H&R Finance Trust unit), (the "Non-Cash Consideration"). In the event Primaris Unitholders elect less or more cash than the Actual Cash Consideration, the Actual Cash Consideration and Non-Cash Consideration will be prorated among Primaris Unitholders so that the Actual Cash Consideration is paid.

These proposed transactions are subject to the approval of both 66 2/3 of the voting Unitholders of Primaris who vote at a Special Meeting to be held on March 22, 2013 as well as the majority of Unitholders of H&R REIT who vote at their Special Meeting to be held on March 22, 2013. These transactions are also subject to certain other approvals, consents, and customary conditions. If all approvals and consents are received, these transactions are expected to be completed in early April 2013. As part of this Arrangement Agreement, Primaris has agreed to pay a $100,000 cash break fee under certain conditions, including the acceptance by Primaris of an unsolicited superior proposal from a third party.

4. Acquisitions:

During the year ended December 31, 2012, Primaris purchased Driftwood Mall in Courtenay, British Columbia and a property adjacent to an existing shopping centre. Also, during the fourth quarter, Primaris completed the purchase of Regent Mall in Fredericton, New Brunswick and McAllister Place in Saint John, New Brunswick.

During the year ended December 31, 2011, Primaris completed the purchase of six properties: Burlington Mall in Burlington, Ontario; Oakville Place in Oakville, Ontario; Place Vertu in Saint-Laurent, Quebec; St. Albert Centre in St. Albert, Alberta; Tecumseh Mall in Windsor, Ontario; and a property adjacent to an existing shopping centre.

(In thousands of dollars)

4. Acquisitions (continued):

The purchases have been accounted for as asset acquisitions with the results of operations included in these consolidated financial statements. The purchase price allocation to net assets was as follows:

	2012	2011
Investment properties	$ 371,524	$ 584,546
Other assets	2,044	3,534
Other liabilities	(6,009)	(2,692)
	367,559	585,388
Less mortgage payable	(1,662)	–
Purchase price paid in cash, including acquisition costs of $2,307 (2011 - $9,546)	$ 365,897	$ 585,388

In 2012, with the acquisition of the property adjacent to an existing shopping centre, Primaris assumed a mortgage of $1,662. The mortgage matures December 1, 2014 and bears interest at a fixed rate of 3.78%.

In 2012, Primaris received mortgage funding of $114,000 for a term of 10 years at a fixed interest rate of 4.034% for Regent Mall and $76,000 for a term of 7 years at a fixed interest rate of 3.682% for McAllister Place.

In 2011, Primaris arranged third-party mortgage funding of $108,600 and $115,000 with respect to the acquisitions of Burlington Mall and Oakville Place, respectively. The respective loans have terms of 5 years and 10 years and bear interest at fixed rates of 3.83% and 4.74%.

(In thousands of dollars)

5. Investment properties:

	2012	2011
Balance, beginning of year	$ 3,557,900	$ 2,804,900
Acquisitions of investment properties, including acquisition costs of $2,307 (2011 - $9,546)	371,524	584,546
Additions:		
Capital expenditures	26,723	25,064
Direct leasing costs	18,455	19,667
Dispositions	–	(19,833)
Fair value adjustment on investment properties	178,690	149,113
Amortization of leasing costs and straight-line rents included in revenue	(7,892)	(5,557)
Balance, end of year	$ 4,145,400	$ 3,557,900

Investment properties are stated at fair value. The fair value was determined by a combination of valuations made by independent external appraisers having appropriate professional qualifications and internal management valuations primarily using a discounted cash flow model.

(a) External appraisals:

Each property is subject to an external appraisal at least once in every three years.

Aggregate fair value of properties externally appraised for the quarter ending:

	2012	2011
March 31	$ 210,800	$ 21,900
June 30	236,250[1]	1,028,900[1]
September 30	435,550[1]	297,600
December 31	1,002,300[1]	348,000
Year-to-date total	$ 1,884,900	$ 1,696,400

[1]Includes properties acquired during the quarter at their fair values.

(In thousands of dollars)

5. Investment properties (continued):

(b) Internal appraisals:

Fair values were primarily determined by using a discounted cash flow model. Using this model, discount rates were applied to the projected annual operating cash flows, generally over a term of 10 years, including a terminal value based on a capitalization rate to estimated year 11 cash flows. As at December 31, 2012 and 2011, the fair values of investment properties purchased during the previous 12 months were determined to be equal to the purchase price, net of acquisition costs.

Valuations are most sensitive to changes in discount rates and capitalization rates. Primaris received quarterly capitalization rate reports from independent external appraisers and these reports support management's view on the investment metrics used. Below are the key rates used in the modeling process for both internal and external appraisals:

	2012			2011		
	Maximum	Minimum	Weighted average	Maximum	Minimum	Weighted average
Discount rate	10.0%	6.3%	7.0%	10.7%	6.5%	7.3%
Terminal cap rate	9.0%	5.5%	6.1%	9.5%	5.5%	6.3%
Investment horizon (years)	10	10	10	10	10	10

Primaris' Yonge Street assets, which represent less than 1% of the portfolio value, were appraised at a capitalization rate lower than this range, reflecting, in part, the redevelopment potential of these locations.

(In thousands of dollars)

5. Investment properties (continued):

(c) Fair value sensitivity:

Valuations are most sensitive to change in discount rates and capitalization rates. The following table summarizes the rate sensitivity:

Capitalization rate sensitivity increase (decrease)	Weighted average Discount rate	Weighted average Terminal cap rate	Fair value of investment properties	Fair value variance	% change	Debt to total assets
(0.75)%	6.3%	5.4%	$ 4,742,400	$ 597,000	14.4 %	35.7%
(0.50)%	6.5%	5.6%	4,525,600	380,000	9.2 %	37.4%
(0.25)%	6.8%	5.9%	4,327,000	181,900	4.4 %	39.1%
December 31, 2012	7.0%	6.1%	4,145,400	–	–	40.8%
0.25%	7.3%	6.4%	3,977,800	(167,600)	(4.0)%	42.5%
0.50%	7.5%	6.6%	3,823,100	(322,300)	(7.8)%	44.2%
0.75%	7.8%	6.9%	3,679,600	(465,800)	(11.2)%	45.9%

Two land leases meet the definition of a finance lease and are included in the fair value of investment properties.

Included in investment properties is $37,923 (2011 - $33,983) of net improvements to be recovered from tenants.

The investment properties have been pledged as security for Primaris' mortgages payable and bank indebtedness. In addition, Primaris' interest in one property remains pledged as security for a $5,129 obligation (2011 - $19,466) of its joint venture partner, which matures on April 1, 2013. Primaris has been indemnified and has implemented appropriate additional protective measures to minimize the risk of any loss.

(In thousands of dollars)

6. Rents receivable:

	2012	2011
Rents receivable, net of allowance of $790 (2011 - $1,167)	$ 2,257	$ 2,159
Accrued recovery revenue	1,927	2,739
Accrued percentage rent	896	724
Other amounts receivable	1,165	1,765
	$ 6,245	$ 7,387

7. Other assets and receivables:

	2012	2011
Prepaid realty taxes	$ 5,694	$ 4,207
Prepaid ground rent	294	318
Fixtures and equipment, net of accumulated depreciation of $2,236 (2011 - $2,445)	4,695	4,315
Other assets	10,110	3,143
Escrow funds	–	13,027
	$ 20,793	$ 25,010

A portion of the proceeds of a sale of a property were released from escrow upon registration of a mortgage secured by a different shopping centre in the Primaris portfolio.

(In thousands of dollars)

8. Mortgages payable:

Mortgages payable are secured by investment properties and, in many cases, by corporate guarantees, and bear interest at fixed rates ranging between 3.68% and 7.20% (2011 - 3.83% and 7.45%). The weighted average interest rate for the mortgages payable, excluding the finance costs, is 5.12% (2011 - 5.41%). This rate reflects the marking-to-market of interest rates for all debts assumed in conjunction with property acquisitions. Mortgages payable mature at various dates between 2013 and 2022.

	2012	2011
Mortgages payable	$ 1,588,948	$ 1,431,608
Mark-to-market adjustment, net	292	665
Debt placement costs, net of accumulated amortization of $4,032 (2011 - $4,198)	(6,306)	(6,398)
	1,582,934	1,425,875
Less current portion	(151,729)	(53,004)
	$ 1,431,205	$ 1,372,871

Future principal payments on the mortgages payable are as follows:

	Payments on maturity	Total annual payments	Total
2013	$ 115,369	$ 37,605	$ 152,974
2014	99,054	37,349	136,403
2015	96,920	36,104	133,024
2016	130,239	33,306	163,545
2017	129,537	29,231	158,768
Thereafter	747,802	96,432	844,234
	$ 1,318,921	$ 270,027	$ 1,588,948

(In thousands of dollars)

9. Convertible debentures:

	6.75% convertible debentures	5.85% convertible debentures	6.30% convertible debentures	5.40% convertible debentures	2012 Total	2011 Total
Principal balance, beginning of year	$ 2,789	$ 93,476	$ 68,937	$ 75,000	$ 240,202	$ 179,252
Issued	–	–	–	–	–	75,000
Conversions	(922)	(84,018)	(52,560)	–	(137,500)	(14,050)
Redemptions	–	(9,458)	–	–	(9,458)	–
Principal balance, end of year	1,867	–	16,377	75,000	93,244	240,202
Fair value adjustment	2,136	–	10,645	4,500	17,281	28,564
	$ 4,003	$ –	$ 27,022	$ 79,500	$ 110,525	$ 268,766

Fair value is calculated using the quoted market price on December 31, 2012 and 2011.

The full terms of the convertible debentures are contained in the public offering documents and the following table summarizes some of the terms:

Debenture series	Principal balance, December 31, 2012	Maturity	Interest rate	Conversion price	Redemption date after
PMZ.DB	$ 1,867	June 30, 2014	6.75%	$ 12.25	June 30, 2010
PMZ.DB.A	–	August 1, 2014	5.85%	22.55	August 1, 2012
PMZ.DB.B	16,377	September 30, 2015	6.30%	16.70	October 1, 2014
PMZ.DB.C	75,000	November 30, 2018	5.40%	28.84	December 1, 2016

Under certain circumstances, redemption of the convertible debentures may occur sooner than the redemption date.

(a) 6.75% convertible debentures:

During year ended December 31, 2012, holders of $922 (2011 - $1,059) of convertible debentures at face value exercised their option to convert to units. A total of 75,253 units (2011 - 86,444) were issued on conversion. As at December 31, 2012, the face value of this series of debentures was $1,867 (2011 - $2,789).

9. Convertible debentures (continued):

(b) 5.85% convertible debentures:

During the year ended December 31, 2012, holders of $84,018 (2011 - nil) of convertible debentures at face value exercised their option to convert to units. A total of 3,725,847 units (2011 - nil) were issued on conversion. On August 17, 2012, Primaris redeemed the remaining $9,458 of convertible debentures at face value. As at December 31, 2012, the face value of this series of debentures was nil (2011 - $93,476).

(c) 6.30% convertible debentures:

During the year ended December 31, 2012, holders of $52,560 (2011 - $12,991) of convertible debentures at face value exercised their option to convert to units. A total of 3,147,285 units (2011 - 777,891) were issued on conversion. As at December 31, 2012, the face value of this series of debentures was $16,377 (2011 - $68,937).

(d) 5.40% convertible debentures:

During the years ended December 31, 2012 and 2011, there were no conversions and no repurchases under Primaris' normal course issuer bid of this series of convertible debentures. As at December 31, 2012, the face value of this series of debentures was $75,000 (2011 - $75,000).

10. Bank indebtedness:

Primaris had an operating line of $100,000. Subsequent to December 31, 2012, the operating line was increased to $138,000, expiring on July 31, 2013. The operating line is secured by fixed charges on certain investment properties and a corporate guarantee. Draws on the operating line are subject to certain conditions (note 21); interest is at prime plus applicable premiums or, at the option of Primaris, at bankers' acceptance rates, plus applicable premiums. As at December 31, 2012, $45,000 of the operating line was in use (2011 - $6,779).

(In thousands of dollars)

11. Accounts payable and other liabilities:

	2012	2011
Accounts payable and other liabilities	$ 72,238	$ 57,073
Tenant deposits	7,036	5,573
Deferred revenue	3,188	303
	82,462	62,949
Less non-current portion of accounts payable and other liabilities	(7,214)	(1,205)
	$ 75,248	$ 61,744

12. Equity:

Primaris is authorized to issue an unlimited number of trust units. Each trust unit represents a single vote at any meeting of Unitholders and entitles the Unitholder to receive a pro rata share of all distributions. The Unitholders have the right to require Primaris to redeem their trust units on demand. Upon receipt of the redemption notice by Primaris, all rights to and under the trust units tendered for redemption shall be surrendered and the holder thereof shall be entitled to receive a price per trust unit ("Redemption Price"), as determined by a market formula. The Redemption Price will be paid in accordance with the conditions provided for in the Declaration of Trust.

Primaris' trust units are liability instruments because the trust units are redeemable at the option of the holder. Primaris' trust units meet the conditions of IAS 32 and are, therefore, classified and presented as equity.

Primaris has also issued exchangeable units. As at December 31, 2012, there were 2,122,261 exchangeable units issued and outstanding by subsidiaries of Primaris with a carrying value of $57,088 (2011 - 2,187,261 units with a carrying value of $45,079). These exchangeable units are economically equivalent to trust units and are entitled to receive distributions equal to those provided to holders of trust units. However, these units are not the class of instruments subordinate to all other classes of instruments. As a result, they are not eligible for equity presentation and are presented as liabilities. Exchangeable units are recognized at fair value, which is calculated using the quoted market price of Primaris' trust units at the end of each reporting period.

(In thousands of dollars)

12. Equity (continued):

Since the exchangeable units are presented as liabilities, the distributions on these units are recognized as part of finance costs (note 14).

Primaris' Trustees have discretion in declaring distributions.

(a) Units outstanding:

	2012		2011	
	Units	Amount	Units	Amount
Trust units, beginning of year	80,552,971	$ 1,124,856	66,577,418	$ 847,827
Issuance of units under the distribution reinvestment plan	690,778	16,133	422,088	8,714
Conversion of debentures (note 9)	6,948,385	161,539	864,335	17,926
Purchase of units under normal course issuer bid	–	–	(31,000)	(589)
Units issued under equity compensation arrangement	60,123	1,310	40,130	935
Units issued, net of costs	9,907,250	219,583	12,650,000	249,446
Conversion of exchangeable units	65,000	1,409	30,000	597
Trust units, end of year	98,224,507	$ 1,524,830	80,552,971	$ 1,124,856
Exchangeable units, beginning of year	2,187,261	$ 45,079	2,217,261	$ 43,325
Conversion to trust units	(65,000)	(1,409)	(30,000)	(597)
Fair value adjustment	–	13,418	–	2,351
Exchangeable units, end of year	2,122,261	$ 57,088	2,187,261	$ 45,079
Total trust units and exchangeable units, end of year	100,346,768		82,740,232	

Primaris issued 4,904,750 units on November 9, 2012, 5,002,500 units on May 22, 2012, 11,000,000 units on June 13, 2011, and 1,650,000 on June 20, 2011.

(b) Distribution reinvestment plan:

During 2012, Primaris had a distribution reinvestment plan that allowed Unitholders to use the monthly cash distributions paid on their existing units to purchase additional units directly from Primaris. Unitholders who elected to participate in the distribution reinvestment plan received a further distribution, payable in units, equal in value to 3% of each cash distribution. On February 4, 2013, Primaris indefinitely suspended its distribution reinvestment plan.

12. Equity (continued):

(c) Normal course issuer bid:

No units were repurchased pursuant to the issuer bid (note 21) during the year ended December 31, 2012 (2011 - $589). No convertible debentures were repurchased in the year ended December 31, 2012 (2011 - nil).

(d) Unit-based compensation plan:

In order to provide long-term compensation to certain officers, employees and Trustees of Primaris, there may be grants of restricted units or options, which are subject to certain restrictions. Under Primaris' unit-based compensation plan, the maximum number of total units available for grant is limited to 7% of the issued and outstanding units at the time the plan was approved.

For restricted units granted to Trustees, the units vest at the earlier of two events: (i) four years from the grant date; and (ii) Trustee departure. As the Trustees can control when the restricted share units vest, they are considered fully vested when issued. Upon exchange of the restricted share units, the Trustees have the option to settle in cash instead of units issued from treasury and, therefore, the awards are classified as cash-settled unit-based payments and presented as liabilities. The restricted share units accrue distributions in the form of additional grants of restricted share units with all the same terms. These restricted share units are recognized as liabilities, which are indexed to changes in fair value of Primaris units.

Restricted units granted to employees are recognized based on the grant date fair value. The awards will be satisfied by trust units issued from treasury. Since trust units are redeemable at the option of the holder, the restricted share units are classified as cash-settled unit-based payments and presented as liabilities. The restricted units are subject to vesting conditions and are subject to forfeiture until the employees have been employed by Primaris for a specified period of time. The restricted share units accrue cash distributions during the vesting period and accrued distributions will be paid when the restricted units vest. These restricted share units are recognized as liabilities, which are indexed to changes in fair value of Primaris units.

(In thousands of dollars)

12. Equity (continued):

Option values are initially calculated based on the grant date fair value. Typically, options vest 25% at the end of the year the award was granted, and a further 25% at the end of each of the following three years. Since trust units are redeemable at the option of the Unitholder, the options are classified as cash-settled unit-based payments and are recognized as liabilities, which are to be indexed to changes in fair value of the options.

Primaris accounts for its unit-based compensation using the fair value method, under which compensation expense is recognized over the vesting period. Unit-based compensation expense and assumptions used in the calculation thereof are as follows:

	2012	2011
Unit-based compensation:		
Compensation expense	$ 1,662	$ 1,292
Fair value adjustments	5,890	665
Unit options granted	466,647	308,148
Unit option holding period (years)	7	7
Volatility rate	18.25%	20.0%
Distribution yield	5.6%	6.1%
Risk-free interest rate	1.7%	3.1%
Weighted average fair value, at grant date:		
Options	$ 1.80	$ 2.37
Restricted share units	21.38	20.14

(In thousands of dollars)

12. Equity (continued):

The number of options outstanding changed as follows:

	2012		2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	932,793	$ 17.43	664,775	$ 15.73
Granted	466,647	$ 21.54	308,148	$ 20.32
Exercised	(56,863)	$ 14.58	(40,130)	$ 11.40
Expired/forfeited	(6,857)	$ 20.32	–	$ –
Balance, end of year	1,335,720	$ 18.98	932,793	$ 17.43
Exercisable, end of year	761,375		508,334	

As at December 31, 2012, the following options were outstanding:

Exercise price	Number of options	Remaining weighted average life (in years)
$10.70	28,088	3.0
$14.06	90,000	3.6
$16.81	255,258	4.0
$17.17	3,878	4.1
$17.25	203,216	4.1
$20.32	288,633	5.0
$21.54	466,647	6.0
$10.70 - $21.54	1,335,720	4.9

(In thousands of dollars)

12. Equity (continued):

The number of restricted share units outstanding changed as follows:

	2012	2011
Balance, beginning of year	103,190	53,037
Granted	47,715	50,153
Exercised	(3,260)	–
Cancelled/forfeited	(1,599)	–
Balance, end of year	146,046	103,190
Exercisable, end of year	35,321	23,696

As at December 31, 2012, the carrying value of total unit-based compensation liability was $11,156 (2011 - $4,091).

13. Investment in joint venture:

During 2009, Primaris entered into an agreement to establish a joint venture, in which Primaris has a 50% interest. The joint venture became effective on December 17, 2009 with contributions of cash and fixed assets by the venturers which were recognized and measured at their fair values.

(In thousands of dollars)

13. Investment in joint venture (continued):

The consolidated financial statements include Primaris' proportionate share of the assets, liabilities, revenue and expenses of the joint venture.

	2012	2011
Assets:		
Non-current	$ 135,285	$ 113,185
Current	3,211	3,066
Liabilities:		
Non-current	–	–
Current	644	644
Revenue	$ 12,047	$ 11,992
Expenses	4,920	4,803
Cash provided by (used in):		
Operations	$ 7,020	$ 7,703
Investments	(1,015)	(220)

In addition to the above, Primaris' liabilities include a $63,000 (2011 - $63,000) mortgage secured by its interest in the joint venture. Primaris' interest in the joint venture has also been pledged as security for a $5,129 obligation (2011 - $19,466) of its joint venture partner, which matures on April 1, 2013. The joint venture partner is the manager of the property.

(In thousands of dollars)

14. Finance costs:

	2012	2011
Mortgages payable	$ 75,010	$ 70,819
Convertible debentures	9,541	12,535
Bank indebtedness	529	1,385
Amortization of net loss on cash flow hedges	226	230
Amortization of debt placement costs	1,571	1,385
Interest incurred	86,877	86,354
Distributions on exchangeable units	2,597	2,673
Convertible debenture issuance costs	–	3,029
Fair value adjustment on convertible debentures	12,756	14,989
Fair value adjustment for exchangeable units	13,418	2,351
	$ 115,648	$ 109,396

Included in interest on mortgages payable for the year ended December 31, 2012 is a one-time early repayment fee of $871.

15. Change in other non-cash operating working capital:

	2012	2011
Rents receivable	$ 1,142	$ (1,291)
Other assets and receivables, excluding fixtures and equipment and escrow funds	(6,386)	1,908
Escrow funds	13,027	(13,027)
Accounts payable and other liabilities	9,125	5,905
Mortgage mark-to-market adjustment, net	(373)	(564)
	$ 16,535	$ (7,069)

16. Segment disclosure:

Substantially all of Primaris' assets are in and its revenue is derived from the Canadian real estate industry segment. No single tenant accounts for more than 3.8% (2011 - 4.6%) of Primaris' gross rent.

(In thousands of dollars)

17. Income taxes:

The Income Tax Act (Canada) contains legislation (the "SIFT Rules") affecting the tax treatment of "specified investment flow-through" trusts ("SIFT"). A SIFT includes a publicly traded trust. The SIFT Rules provide for a transition period until 2011 for publicly traded trusts like Primaris, which existed prior to November 1, 2006. Under the SIFT Rules, distributions of certain types of income by a SIFT are not deductible in computing the SIFT's taxable income, and a SIFT is subject to tax on such income at a rate that is substantially equivalent to the general tax rate applicable to a Canadian corporation. The SIFT Rules do not apply to a publicly traded trust that qualifies as a REIT under the Income Tax Act (Canada). Primaris completed the necessary tax restructuring to qualify as a REIT effective December 31, 2010.

18. Total employee benefits:

The following amounts were expensed in relation to Primaris' employees:

	2012	2011
Salaries, wages and benefits	$ 34,391	$ 30,474
Pension expense	1,257	1,001
Unit-based compensation	7,552	1,957
	$ 43,200	$ 33,432

19. Related parties:

The remuneration of key management personnel and trustee compensation was as follows:

	2012	2011
Salaries, fees, incentives and short-term benefits	$ 3,011	$ 2,404
Post-employment benefits	89	85
Unit-based compensation	1,118	1,161
	$ 4,218	$ 3,650

20. Subsidiaries:

The significant wholly owned entities included in Primaris' consolidated financial statements are as follows:

PRR Trust
Primaris Management Inc.
ORG Leasing Inc.
GPCO Trust
385 Yonge Street Limited Partnership
Sugarloaf Mall Limited Partnership
FG Shopping Centre Limited Partnership
Alliston Mills Shopping Centre Limited Partnership
AM Shopping Centre Limited Partnership
South Cambridge Shopping Centre Limited Partnership
Dufferin Mall Limited Partnership
Eglinton Square Shopping Centre Limited Partnership
Lambton Mall Limited Partnership
Midtown Plaza Limited Partnership
Northland Professional Centre Limited Partnership
Grant Park Limited Partnership
Place du Royaume Limited Partnership
Place Fleur de Lys Limited Partnership
Place Fleur de Lys Partnership

21. Capital management:

Primaris manages its capital structure in order to support ongoing property operations, developments and acquisitions, as well as to generate stable and growing cash distributions to Unitholders - one of Primaris' primary objectives. Primaris defines its capital structure to include: mortgages payable, bank indebtedness, acquisition credit facilities, convertible debentures, exchangeable units and trust units. There were no changes to Primaris' approach to capital management for the year ended December 31, 2012.

Primaris reviews its capital structure on an ongoing basis. Primaris adjusts its capital structure in response to investment opportunities, the availability of capital and anticipated changes in economic conditions and their impact on Primaris' portfolio. Primaris also adjusts its capital structure for budgeted development projects and distributions.

(In thousands of dollars)

21. Capital management (continued):

Primaris' strategy is driven in part by external requirements from certain of its lenders and by policies as set out under the Declaration of Trust. Primaris' Declaration of Trust requires that Primaris:

(a) will not incur any new indebtedness on its properties in excess of 75% of the property's market value;

(b) will not incur any indebtedness that would cause the Debt to Total Assets Ratio (as defined in the Declaration of Trust) to exceed 65%; and

(c) will not incur floating rate indebtedness aggregating more than 15% of Total Assets.

In addition, Primaris is required by its lenders under the operating line to meet four financial covenants, as defined in the agreement:

(a) a Debt to Total Assets Ratio of not more than 60%;

(b) an Interest Coverage Ratio of greater than 1.75;

(c) a Debt Service Coverage Ratio of greater than 1.5; and

(d) a minimum equity of $800,000.

Those amounts as at December 31, 2012 and 2011 were as follows:

	2012	2011
Debt to Total Assets	40.8%	46.6%
Interest Coverage (rolling four quarters)	2.5	2.3
Debt Service Coverage (rolling four quarters)	1.8	1.7
Equity	$2,387,139	$1,817,677

For the year ended December 31, 2012, Primaris met all externally imposed requirements.

Primaris' mortgage lenders require security for their loans. The security can include: a mortgage, an assignment of the leases and rents receivable, corporate guarantees and assignment of insurance policies.

21. Capital management (continued):

Primaris had a normal course issuer bid, which entitled Primaris to acquire up to 3,000,000 units, $283 of the 6.75% convertible debentures, $9,347 of the 5.85% convertible debentures, $6,894 of the 6.30% convertible debentures, and $7,500 of the 5.40% convertible debentures. The bid commenced on December 23, 2011 and terminated on December 22, 2012. No purchases were made pursuant to this bid.

22. Financial risk management:

In the normal course of business, Primaris is exposed to a number of risks that can affect its operating performance. Risk management policies and processes are reviewed regularly to reflect changes in market conditions and Primaris' own activities. These risks, and the actions taken to manage them, are as follows:

(a) Credit risk:

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to pay the rents due under their lease commitments. Primaris attempts to mitigate the risk of credit loss by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant. Thorough credit assessments are conducted in respect of new leasing and tenant deposits are obtained when warranted.

Primaris' exposure to credit risk is based on business risks associated with the retail sector of the economy. Primaris measures this risk-by-tenant concentration across the portfolio. Primaris has over 1,100 different tenants across the portfolio.

Primaris establishes an allowance for doubtful accounts that represents the estimated losses with respect to rents receivable. The amounts that comprise the allowance are determined on a tenant-by-tenant basis based on the specific factors related to the tenant.

Primaris places its cash and cash equivalent investments with Canadian financial institutions with high credit ratings. Credit ratings are actively monitored and these financial institutions are expected to meet their obligations.

(In thousands of dollars)

22. Financial risk management (continued):

(b) Liquidity risk:

Liquidity risk is the risk that Primaris will not have sufficient access to cash, lines of credit and new debt and equity to fund its financial obligations as they fall due.

Primaris manages cash from operations and capital structure to ensure there are sufficient resources to operate the investment properties, fund anticipated leasing, make capital and development expenditures, meet its debt servicing obligations, fund general administrative costs and make Unitholder distributions. Primaris monitors compliance with debt covenants, estimating lease renewals and property acquisitions and dispositions. Staggering loan maturity dates mitigates Primaris' exposure to large amounts maturing in any one year and the risk that lenders will not refinance.

Primaris' exposure to refinancing risk arises from maturing mortgages payable, convertible debentures and the operating line. Maturing debt funding requirements are typically sourced from new capital from external sources. The ability to obtain funding, or favourable funding, depends on several factors, including current economic climate and quality of the underlying assets being refinanced.

The contractual future principal and interest payments on Primaris' mortgages payable for the years ended December 31 are as follows:

2013	$	226,850
2014		204,019
2015		194,066
2016		216,954
2017		201,162
Thereafter		962,067
	$	2,005,118

A schedule of mortgage principal repayment obligations is provided in note 8. Maturities of the convertible debentures, which under certain circumstances may be repaid through the issuance of units, are provided in note 9. Details on Primaris' operating line, on which $45,000 was utilized on December 31, 2012, are disclosed in note 10.

(In thousands of dollars)

22. Financial risk management (continued):

(c) Market risk:

All of Primaris' investment properties are focused on the Canadian retail sector. Market risk is the risk that changes in market prices, such as interest rates and equity prices, will affect Primaris' financial instruments. All of Primaris' operations are denominated in Canadian dollars, resulting in no direct foreign exchange risk.

Primaris' existing mortgages payable are all at fixed interest rates. Primaris staggers the maturities of its mortgages payable in order to minimize the exposure to future interest rate fluctuation.

Convertible debentures, exchangeable units and unit-based compensation liabilities are recorded at their fair value based on market trading prices. An increase of $1.00 in the underlying price of Primaris' trust units would result in an increase to liabilities, and decrease in net income and equity as follows:

- Convertible debentures $932;
- Exchangeable units $2,122; and
- Unit-based compensation $1,023.

Fair values:

In addition to those financial instruments carried at fair values, the fair values of Primaris' financial assets and financial liabilities, together with the contractual carrying amounts shown in the consolidated statements of financial position, are as follows:

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Mortgages payable	$ 1,588,948	$ 1,674,518	$ 1,431,608	$ 1,529,032

22. Financial risk management (continued):

Primaris uses various methods in estimating the fair values recognized in the consolidated financial statements. The fair value hierarchy reflects the significance of inputs used in determining the fair values.

- Level 1 - quoted prices in active markets;
- Level 2 - inputs other than quoted prices in active markets or valuation techniques where significant inputs are based on observable market data; and
- Level 3 - valuation technique for which significant inputs are not based on observable market data.

The following summarizes the significant methods and assumptions used in estimating fair values of Primaris' financial instruments:

(a) Mortgages payable:

The fair value of Primaris' mortgages payable is estimated based on the present value of future payments, discounted at the yield on a Government of Canada bond with the nearest maturity date to the underlying mortgage, plus an estimated credit spread at the reporting date for a comparable mortgage (Level 2).

(b) Convertible debentures:

The fair value of the convertible debentures is estimated based on the market trading prices of the convertible debentures (Level 1).

(c) Exchangeable units:

The fair value of the exchangeable units is estimated based on the market trading prices of Primaris' units (Level 1).

22. Financial risk management (continued):

(d) Unit-based compensation:

The fair value of unit options granted is estimated using a trinomial model for option valuation (Level 2).

The fair value of the restricted share units granted is estimated based on the market trading prices of Primaris' trust units (Level 1).

(e) Other financial assets and liabilities:

The carrying values of cash and cash equivalents, rents receivable, other assets and receivables, bank indebtedness, accounts payable and other liabilities, and distribution payable approximate their fair values due to their short-term nature.

(f) Cash flow hedge:

The fair value of the cash flow hedging instrument is estimated based on market trading prices of the underlying bonds (Level 2).

23. Hedge:

In June 2012, Primaris entered into derivative contracts with a Schedule I Canadian chartered bank that are scheduled to mature February 1, 2013. This derivative was completed to mitigate the risk of interest rate volatility in anticipation of the placement of a $125,000 new fixed-rate, five-year debt, principally to repay loans maturing during the first quarter of 2013.

Primaris achieved an effective qualifying hedge on the five-year Government of Canada bond yield of 1.448%, including the cost of the hedge. The credit spread on this anticipated loan is unknown as of December 31, 2012.

At December 31, 2012, the notional amount of the contracts was $103,821, and the fair value was a loss of $190. As at December 31, 2012, the fair value of the contracts was recorded in accounts payable and other liabilities. In addition, during the year ended December 31, 2012, a $190 loss on the cash flow hedge was recognized in other comprehensive income (loss).

Subsequent to December 31, 2012, the hedging derivative was terminated for a gain of $157.

(In thousands of dollars)

24. Minimum rent revenue:

Primaris enters into long-term lease contracts with tenants for space in its properties. Initial lease terms are generally between 3 and 10 years, with longer terms for anchor tenants at Primaris' retail properties. Leases generally provide for the tenant to pay Primaris base rent, with provisions for contractual increases in minimum rent over the term of the lease, plus operating cost and realty tax recoveries.

Future minimum rental revenue is as follows:

2013	$ 235,296
2014	215,337
2015	186,703
2016	155,233
2017	121,284
Thereafter	334,314
	$ 1,248,167

25. Operating leases:

Future minimum operating lease payments are as follows:

	Operating leases	Ground rent	Total
2013	$ 1,811	$ 1,422	$ 3,233
2014	1,811	1,422	3,233
2015	1,763	1,422	3,185
2016	1,791	1,422	3,213
2017	1,831	1,497	3,328
Thereafter	3,425	32,595	36,020
	$ 12,432	$ 39,780	$ 52,212

During the year ended December 31, 2012, Primaris recognized operating lease payments, net of incentives, totalling $1,749 (2011 - $1,404).

26. Commitments and contingencies:

(a) Under the terms of a memorandum of agreement dated June 7, 1971 between The City of Calgary and Oxford Properties Group Inc. ("OPGI") as assumed, assigned and amended from time to time, including without limiting the generality of the foregoing, by a development amending agreement between The City of Calgary, Marathon Realty Company Limited and The Cadillac Fairview Corporation Limited, OPGI is obligated to pay for certain roadway construction near Northland Village and such roadway construction obligation remains registered on title for this property. OPGI has indemnified Primaris for up to $30,000 in respect of this obligation. These obligations were assumed by an affiliate of OPGI.

(b) Primaris is involved in litigation and claims in relation to the investment properties that arise from time to time in the normal course of business. In the opinion of management, any liability that may arise from such contingencies would not have a significant adverse effect on the consolidated financial statements.

(c) At December 31, 2012, Primaris has issued letters of credit in the amount of $2,498 (2011 - $2,386).

(d) Primaris has entered into contracts for property redevelopment and has obligations for $952 of future payments.

(e) Primaris is obligated to purchase land in Sarnia, Ontario for $1,750 as part of a tenant lease contract.

27. Subsequent events:

(a) Subsequent to December 31, 2012, Primaris repaid maturing mortgages totaling $43,749.

(b) Subsequent to December 31, 2012, Primaris agreed to purchase two shopping centres and seven complementary properties in Alberta for $376,680. In order to finance the acquisition, the vendor provided $339,012 of financing and the balance was funded by a draw on the operating line. The acquisition was completed on March 4, 2013.