Management's Discussion & Analysis

Table of Contents

Other Information	1
Non-standard Measures	**1**
Forward-looking Statements	**1**
Our Business	**2**
Second Quarter Highlights	**3**
Melcor REIT	**4**
Adjusted Earnings Attributable to Melcor's Shareholders	**4**
Divisional Results	**5**
Community Development	6
Property Development	8
Investment Properties	9
REIT	10
Recreational Properties	12
General and administrative expense	12
Liquidity & Capital Resources	**12**
Financing	13
Sources and uses of cash	13
Share Data	**14**
Off Balance Sheet Arrangement, Contractual Obligations, Business Environment & Risks, Critical Accounting Estimates, Changes in Accounting Policies	**14**
Quarterly Results	14
Related Party Transactions	15
Internal Control over Financial Reporting & Disclosure Controls	**15**
Non-standard Measures	16

August 7, 2014

The following discussion of Melcor Developments Ltd.'s ("Melcor" or the "Company") financial condition and results of operations should be read in conjunction with the condensed interim consolidated financial statements and related notes for the quarter ended June 30, 2014 and the Management's Discussion & Analysis (MD&A) and consolidated financial statements for the fiscal year ended December 31, 2013.

The financial statements underlying this management's discussion and analysis (MD&A), including 2013 comparative information, have been prepared in accordance with International Financial Reporting Standards (IFRS) unless otherwise noted.

Melcor's Board of Directors, on the recommendation of the Audit Committee, approved the content of this MD&A on August 7, 2014. Disclosures contained in this MD&A are current to August 7, 2014 unless otherwise noted.

All dollar amounts included in this MD&A are Canadian dollars unless otherwise specified.

Other Information

Additional information about Melcor, including our annual information form, information circular and annual and quarterly reports, is available on SEDAR at www.sedar.com.

Non-standard Measures

We refer to terms that are not specifically defined in the CPA Handbook and do not have any standardized meaning prescribed by IFRS. These non-standard measures may not be comparable to similar measures presented by other companies. We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results.

For a definition of these measures, refer to the section "Non-standard Measures" at the end of the MD&A.

Forward-looking Statements

In order to provide our investors with an understanding of our current results and future prospects, our public communications often include written or verbal forward-looking statements.

Forward-looking statements are disclosures regarding possible events, conditions, or results of operations that are based on assumptions about future economic conditions, courses of action and include future-oriented financial information.

This MD&A and other materials filed with the Canadian securities regulators contain statements that are forward-looking. These statements represent Melcor's intentions, plans, expectations, and beliefs and are based on our experience and our assessment of historical and future trends, and the application of key assumptions relating to future events and circumstances. Future-looking statements may involve, but are not limited to, comments with respect to our strategic initiatives for 2014 and beyond, future development plans and objectives, targets, expectations of the real estate, financing and economic environments, our financial condition or the results of or outlook of our operations.

By their nature, forward-looking statements require assumptions and involve risks and uncertainties related to the business and general economic environment, many beyond our control. There is significant risk that the predictions, forecasts, valuations, conclusions or projections we make will not prove to be accurate and that our actual results will be materially different from targets, expectations, estimates or intentions expressed in forward-looking statements. We caution readers of this document not to place undue reliance on forward-looking statements. Assumptions about the performance of the Canadian and US economies and how this performance will affect Melcor's business are material factors we consider in determining our forward-looking statements. For additional information regarding material risks and assumptions, please see the discussion under Business Environment and Risks, pages 35-36 of our annual MD&A.

Readers should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Except as may be required by law, we do not undertake to update any forward-looking statement, whether written or oral, made by the company or on its behalf.

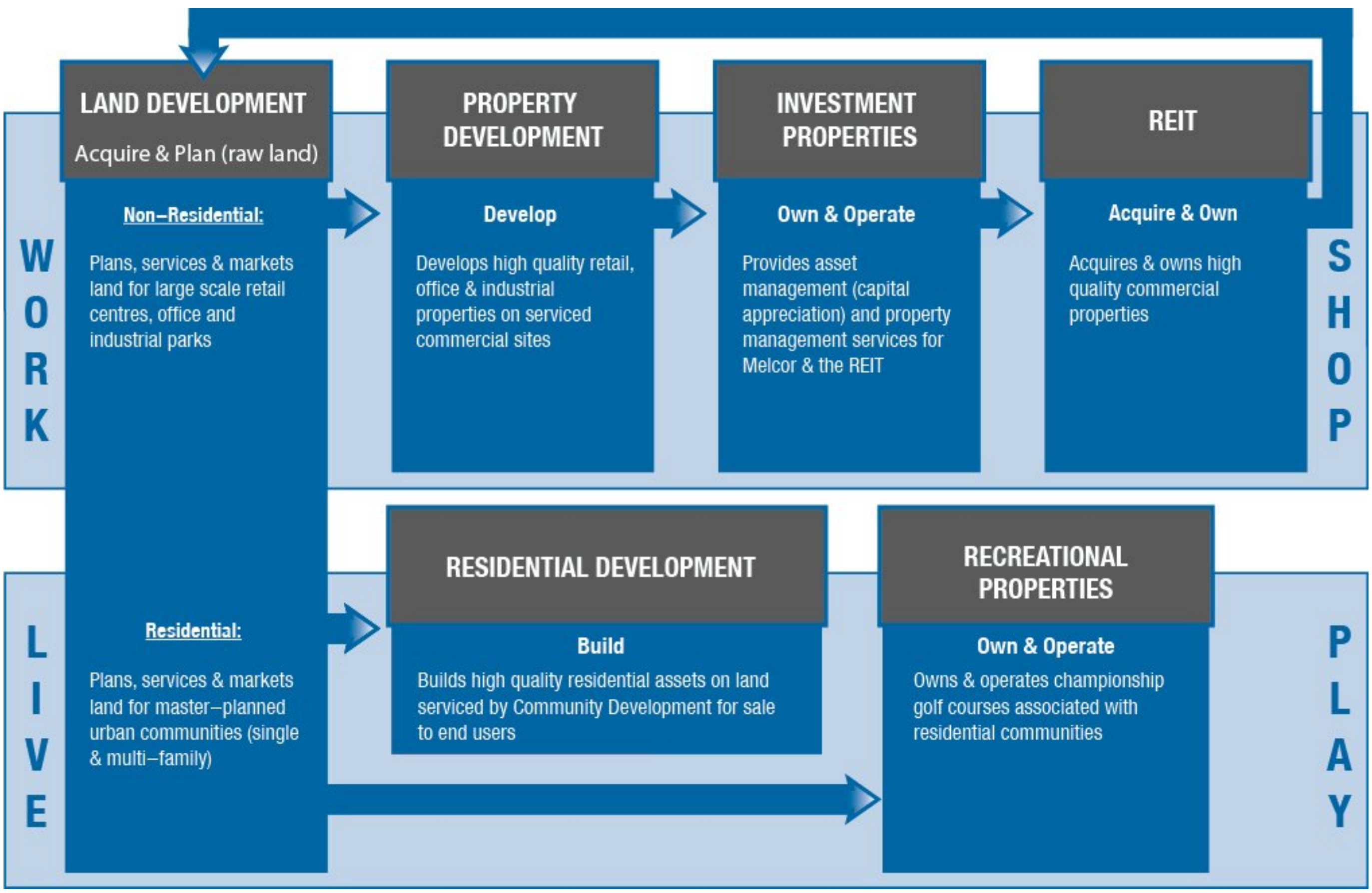
Our Business

Melcor is a diversified real estate development and asset management company with a rich heritage of integrity and innovation in real estate. We develop, manage, and own mixed-use residential communities, business and industrial parks, office buildings, retail commercial centres and golf courses. We are committed to enriching quality of life where people live, work, shop and play.

Through our integrated operating divisions, we manage the full life cycle of real estate development:

- acquiring raw land (Community Development)
- planning residential and commercial communities (Community Development)
- project managing development and construction of commercial properties (Property Development)
- operating a portfolio of commercial and residential properties, focused on property improvements and capital appreciation of owned properties and property management for Melcor REIT ("REIT") (Investment Properties)
- acquiring and owning high quality leasable office, retail and residential sites (REIT: 47.6% owned). We retain a controlling 47.6% effective interest in the REIT and continue to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. We reflect the public's 52.4% interest in the REIT as a financial liability in our financial statements.
- own and operate championship golf courses associated with our residential communities (Recreational Properties).

These diversified operating divisions enable us to manage our business through real estate cycles (both general market strength and the seasonality associated with construction and development), diversify our revenue base and build value out of our asset base.



While building a sustainable business, we also focus on building sustainable communities by sharing our time and resources to make them stronger.

We are one of Canada's leading real estate development and management companies, an accomplishment we attained by demonstrating our values – honesty, integrity, loyalty, respect, quality and pride in our products – in all that we do and in our interactions with our customers, suppliers, shareholders and employees.

Our headquarters are in Edmonton, Alberta, with regional offices in Alberta, British Columbia, and Phoenix, Arizona. Our developments span Western Canada and the US. We have been publicly traded since 1968 (TSX:**MRD**).

Second Quarter Highlights

($000s except as noted)	Three months ended			Six months ended		
	June 30, 2014	June 30, 2013	Change	June 30, 2014	June 30, 2013	Change
Revenue	**66,062**	50,737	30.2 %	**98,073**	92,354	6.2 %
Gross margin (%)	**48.5%**	46.5%	2.0 %	**49.5%**	46.6%	2.9 %
Net income	**17,585**	10,209	72.2 %	**24,449**	22,832	7.1 %
Margin on net income	**26.6%**	20.1%	6.5 %	**24.9%**	24.7%	0.2 %
Adjusted earnings*	**15,765**	21,669	(27.2)%	**25,538**	34,292	(25.5)%
Funds from operations *	**14,209**	6,341	124.1 %	**20,605**	15,662	31.6 %
Per Share Data						
Basic earnings	**0.57**	0.34	67.6 %	**0.79**	0.75	5.3 %
Diluted earnings	**0.55**	0.33	66.7 %	**0.77**	0.73	5.5 %
Adjusted basic earnings*	**0.51**	0.72	(29.2)%	**0.83**	1.13	(26.5)%
Adjusted diluted earnings*	**0.47**	0.66	(28.8)%	**0.77**	1.05	(26.7)%
Funds from operations *	**0.46**	0.21	119.0 %	**0.67**	0.51	31.4 %

As at ($000s except as noted)	June 30, 2014	Dec. 31, 2013	Change
Shareholders' equity	**786,252**	769,231	2.2 %
Total assets	**1,756,108**	1,727,933	1.6 %
Per Share Data			
Book value *	**25.49**	25.03	1.8 %

**See non-standard measures for calculation.*

Highlights for the quarter include:

- Revenue increased 30% compared to Q2-2013 and by 6% year-to-date. Strong single-family lot and multi-family land sales and growth in rental revenues contributed to this increase. Development and asset management activity remain strong:
  - Year-to-date, we registered 7 of the 38 residential community projects under active development compared to 6 of 40 projects in 2013. The timing of plan registrations have a significant impact on the recognition of revenue.
  - During the quarter, we completed 9 commercial buildings (199,762 square feet) in 4 different Edmonton projects - West Henday Promenade, The Village at Blackmud Creek , Telford Industrial and Leduc Common. These buildings were transferred to the Investment Properties division.
  - Total GLA under management in our Investment Properties and REIT divisions has grown by 40% since June 30,2013.
- We continued to invest in portfolio growth and raw land inventory with the following acquisitions:
  - We purchased 347.77 acres of land in Alberta at a cost of $18.01 million.
  - We entered into a new joint arrangement with the purchase of a 50% ownership of 147.72 acres of land at a cost of $10.49 million in our Calgary Region.
  - We continued to expand our US portfolio with the purchase of two commercial buildings with a total of 59,220 sq. ft. on 3.05 acres in the Greater Phoenix area (Arizona) for $12.27 million (US$11.12 million).
- Melcor REIT continues to execute its growth strategy with the following transactions:
  - On May 7, 2014 Melcor REIT successfully completed a bought deal issuance of 1,900,000 trust units at $10.65 for gross proceeds of $20.24 million. The underwriters subsequently exercised their over allotment option for an additional 245,000 trust units at $10.65 for gross proceeds of $2.61 million.
  - Melcor REIT completed its first Right Of First Offer (ROFO) acquisition for Melcor properties, purchasing one newly developed property (Kingsview Market, 11,555 sq. ft.) and one redeveloped property (Market Mall, 42,586 sq. ft.) for $13.50 million.
  - Melcor REIT completed its fourth external property acquisition since IPO with the purchase of 107 Avenue Building, a 23,432 sq. ft. office building in Edmonton, Alberta for a purchase price of $5.61 million (including transaction costs).
- We continued our tradition of returning capital to our investors:
  - Melcor paid its semi-annual dividend of $0.28 per share in Q2-2014.
  - Melcor REIT paid distributions of $0.05625 per trust unit in April, May and June.

Revenue & Margins:

- Revenue in Q2-2014 increased 30% to $66.06 million compared to $50.74 million in Q2-2013. This increase is a result of:
  - Strong Community Development sales, particularly in our Alberta markets. Community Development revenue increased 34% over the comparable period.
  - Investment Properties revenue growth of 64% as a result of increased GLA from the purchase of our joint arrangement partners interest in LethCentre, and as commercial properties were completed and transferred from the Property Development division.

    - The REIT division revenue growth of 14% as a result of increased GLA. Year-to-date revenue increased 6% to $98.07 million.
- Gross margin increased to 48.53% in Q2-2014. This is a result of an increase in higher margin revenue in the Community Development and Investment Properties divisions.
- Net fair value gains on investment properties of $2.42 million were recorded in Q2-2014. Property Development contributed $3.10 million to these gains, as development on our commercial properties progresses. In addition, property redevelopment and improvements contributed to higher portfolio valuation. These gains were offset by a fair value loss recorded due to tenant turnover at a retail CRU.
- FFO per share adjusts for certain non-cash earnings items included in income such as fair value adjustments on investment properties and stock based compensation expense. FFO per share was $0.46 in Q2-2014, an increase of $0.25 per share, or 119.0% from the same quarter last year as a result of higher revenue and improved margins in the quarter.
- Adjusted earnings attributable to Melcor's shareholders ("adjusted earnings"), which reflects our proportionate interest in the earnings of the REIT, was $15.77 million in Q2-2014, a decrease of 27.2% over Q2-2013. Adjusted basic earnings per share were $0.51, a decrease of 26.5% over Q2-2013. Fair value adjustments in the Investment Properties and REIT divisions, which primarily reflect market conditions outside of management's control, were higher in the comparative period by $4.61 million. Gross margin improved by $8.46 million to 49% in the quarter which offset the decrease of fair value adjustments.
- Our quarterly results are impacted by the cyclical nature of our business. Income can fluctuate significantly from period to period due to the timing of plan registrations, the cyclical nature of real estate and construction markets, the mix of lot sales and product types, and the mix of joint operation sales activity.

Melcor REIT

The REIT began operations on May 1, 2013 when its trust units were issued for cash pursuant to the initial public offering ("IPO"). Units of the REIT trade on the Toronto Stock Exchange under the symbol MR.UN. The REIT is externally managed, administered and operated by Melcor Developments Ltd. ("Melcor") pursuant to the Property Management Agreement and Asset Management Agreement.

The REIT is an unincorporated, open-ended real estate investment trust established pursuant to a declaration of trust dated January 25, 2013, which was subsequently amended and restated May 1, 2013.

On May 7, 2014 the REIT completed the issuance of 1,900,000 trust units at a price of $10.65 per unit to a syndicate of underwriters, on a bought deal basis, for gross proceeds of $20.24 million. Subsequently, the underwriters exercised their over-allotment option to purchase an additional 245,000 trust units at a price of $10.65 for gross proceeds of $2.61 million. On May 9, 2014 the REIT used partial proceeds to purchase two investment properties from Melcor at a purchase price of approximately $13.50 million. The purchase price was satisfied through cash consideration of $6.10 million and the issuance of 694,836 Class B LP Units of the REIT at $10.65 per unit, with a fair value of approximately $7.40 million.

As at August 7, 2014, Melcor, through an affiliate, holds an approximate 47.6% effective interest in the REIT through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party.

Adjusted Earnings Attributable to Melcor's Shareholders

The following analysis adjusts the consolidated net income attributable to Melcor's shareholders for the three and six months ended June 30, 2014 to reflect our proportionate interest in the earnings of the REIT. As detailed below, we have adjusted consolidated net income attributable to Melcor's shareholders for amounts recorded as a result of the non-controlling interest ("NCI") being recorded as a financial liability. The adjustments are summarized as follows:

- adjustments related to REIT units in Q2-2014 were comprised of distributions to unitholders of $1.78 million, transaction costs on REIT units of $1.74 million and a fair value gain of $3.15 million; year-to-date distributions to unitholders were $3.32 million, transaction costs on REIT units were $1.74 million and a fair value gain of $1.78 million was recognized on REIT units;
- management fees earned by Melcor under the asset management and property management agreement, which are eliminated upon consolidation; and
- the unitholders' interest in the REIT's post-formation earnings.

We consider adjusted earnings attributable to Melcor's shareholders ("adjusted earnings") to be more representative of the operational activities, financial results and earnings attributable to Melcor's shareholders. The most comparable IFRS metric is net income.

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Net income attributable to Melcor's shareholders	**17,585**	10,209	**24,449**	22,832
Adjustments related to REIT Units	**377**	12,348	**3,288**	12,348
Management fees earned from the REIT	**542**	241	**969**	241
Unitholders' portion of earnings of the REIT	**(2,739)**	(1,129)	**(3,168)**	(1,129)
Adjusted earnings	**15,765**	21,669	**25,538**	34,292
Adjusted basic EPS*	**0.51**	0.72	**0.83**	1.13
Adjusted diluted EPS*	**0.47**	0.66	**0.77**	1.05

**See non-standard measures for calculation.*

Divisional Results

Our business is comprised of five integrated and complementary operating divisions:

- Community Development, which acquires raw land for future commercial and residential community development;
- Property Development, which develops high-quality retail, office and industrial revenue-producing properties on serviced commercial sites developed by Community Development;
- Investment Properties, which manages and leases the commercial developments produced by the Property Development division and an externally purchased portfolio of assets, as well as assets held in the REIT;
- REIT, which owns and holds 32 income-producing properties; and
- Recreational Properties, which owns and operates four championship golf courses associated with Melcor residential communities.

Our Corporate division carries out support functions including accounting, treasury, information technology, administration, legal and human resources.

The following tables summarize results of our operating divisions:

	Community Development		Property Development		Investment Properties		REIT		Recreational Properties	
	Three months ended June 30		Three months ended June 30		Three months ended June 30		Three months ended June 30		Three months ended June 30	
($000s except as noted)	**2014**	2013	**2014**	2013	**2014**	2013	**2014**	2013	**2014**	2013
Revenue	**43,075**	32,187	**388**	743	**9,121**	5,551	**11,119**	9,773	**3,783**	3,331
Portion of total revenue	**65%**	63%	**1%**	1%	**14%**	11%	**17%**	19%	**6%**	7%
Cost of sales	**(24,521)**	(18,861)	**—**	—	**(3,661)**	(2,452)	**(4,406)**	(3,840)	**(1,989)**	(1,888)
Gross margin	**18,554**	13,326	**388**	743	**5,460**	3,099	**6,713**	5,933	**1,794**	1,443
Gross margin %	**43%**	41%	**100%**	—%	**60%**	56%	**60%**	61%	**47%**	43%
Portion of total margin	**58%**	56%	**1%**	3%	**17%**	13%	**21%**	25%	**6%**	6%
General and administrative expense	**(2,664)**	(2,670)	**(437)**	(418)	**(705)**	(550)	**(659)**	(416)	**(803)**	(701)
Fair value adjustment on investment properties	**—**	—	**3,096**	1,429	**628**	4,016	**568**	1,792	**—**	—
Gain on sale of assets	**—**	—	**—**	—	**—**	—	**—**	—	**51**	9
Interest income	**606**	430	**—**	1	**6**	8	**21**	17	**—**	—
Divisional income before tax	**16,496**	11,086	**3,047**	1,755	**5,389**	6,573	**6,643**	7,326	**1,042**	751

Divisional results are shown before inter-segment eliminations and exclude corporate division

	Community Development		Property Development		Investment Properties		REIT		Recreational Properties	
	Six months ended June 30		Six months ended June 30		Six months ended June 30		Six months ended June 30		Six months ended June 30	
($000s except as noted)	**2014**	2013	**2014**	2013	**2014**	2013	**2014**	2013	**2014**	2013
Revenue	56,922	58,914	559	1,397	17,469	10,123	21,766	19,461	3,875	3,509
Portion of total revenue	58%	64%	1%	2%	18%	11%	22%	21%	4%	4%
Cost of sales	(32,211)	(34,385)	—	—	(6,938)	(4,655)	(8,751)	(7,682)	(2,439)	(2,373)
Gross margin	24,711	24,529	559	1,397	10,531	5,468	13,015	11,779	1,436	1,136
Gross margin %	43%	42%	100%	—%	60%	54%	60%	61%	37%	32%
Portion of total margin	51%	57%	1%	3%	22%	13%	27%	27%	3%	3%
General and administrative expense	(4,354)	(5,007)	(1,057)	(829)	(1,267)	(569)	(1,022)	(811)	(1,120)	(973)
Fair value adjustment on investment properties	—	—	5,043	3,607	2,057	4,515	737	4,386	—	—
Gain on sale of assets	—		—		—		—		51	9
Interest income	1,179	1,032	—	2	14	14	39	23	—	—
Divisional income before tax	21,536	20,554	4,545	4,177	11,335	9,428	12,769	15,377	367	172

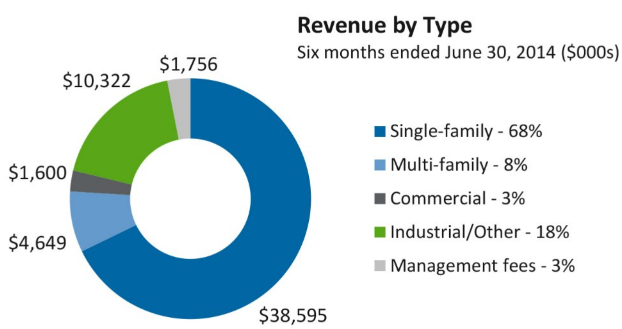
Divisional results are shown before inter-segment eliminations and exclude corporate division.

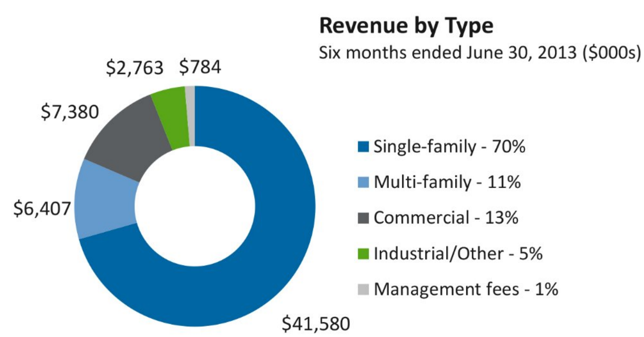
Community Development

Our Community Development division acquires raw land in strategic urban corridors and subsequently plans, develops and markets this land as builder-ready urban communities and large-scale commercial and industrial centres. This process includes identifying and evaluating land acquisitions, site planning, obtaining approvals from municipalities, developing the land, construction, marketing and ultimately selling the lots to home builders (for residential communities) or developers (for commercial/industrial centres). The division also sells sites to our Property Development division, who in turn develops the land into commercial developments.

Management fees are earned on joint venture projects for the work that Melcor performs to develop the project. Management fees fluctuate based on the level of joint venture activity each period.

Sales Activity





Income can fluctuate significantly from period to period due to the timing of plan registrations, the cyclical nature of real estate markets, the mix of land sold, and the mix of joint arrangement sales activity.

Consolidated	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Sales data: (including joint ventures at 100%)				
Single family sales (number of lots)	244	197	369	393
Gross average revenue per single-family lot ($)	181,700	153,000	172,400	128,000
Multi-family sales (acres)	10.09	7.37	10.09	10.21
Gross average revenue per multi-family acre ($)	1,003,100	951,700	1,003,100	916,500
Commercial sales (acres)	—	—	1.23	9.99
Gross average revenue per commercial land acre ($)	—	—	1,300,800	795,100
Industrial sales (acres)	6.36	5.11	9.03	11.93
Gross average revenue per industrial land acre ($)	431,000	333,300	342,400	285,000
Other land sales - Raw, Other (acres)	12.60	0.33	12.60	18.32
Gross average revenue per other land acre ($)	333,300	22,700	333,300	48,400
Financial results: (including joint arrangements at Melcor's interest)				
Revenue ($000s)	43,075	32,187	56,922	58,914
Earnings ($000s)	16,496	11,086	21,536	20,554

Strong single-family lot and land sales contributed to strong results for the Community Development division in Q2-2014. Revenue increased by 34% and earnings were up 49% compared to Q2-2013 as a result of strong demand for single-family lots and multi-family land, and the timing of plan registrations. Single-family lot sales were up 24% compared to Q2-2013. The Edmonton and Calgary regions both had robust sales activity in the quarter. Our primary market is Alberta, where overall market conditions remain strong.

Regional Sales Analysis

A summary of our lot and acre sales by region is as follows:

Regional Sales Analysis	Three months ended June 30, 2014			Three months ended June 30, 2013		
(including joint arrangements at 100%)	**Single- family (Lots)**	**Multi-family (Acres)**	**Non-Residential (Acres)**	Single- family (Lots)	Multi-family (Acres)	Non-Residential (Acres)
Edmonton Region	**153**	**2.27**	**4.47**	116	3.76	0.95
Red Deer	**7**	—	—	19	—	4.16
Calgary Region	**74**	**7.82**	**1.89**	33	3.61	—
Lethbridge	**9**	—	—	25	—	—
Kelowna	**1**	—	—	4	—	—
United States	—	—	—	—	—	—
	244	**10.09**	**6.36**	197	7.37	5.11

Regional Sales Analysis	Six months ended June 30, 2014			Six months ended June 30, 2013		
(including joint arrangements at 100%)	**Single- family (Lots)**	**Multi-family (Acres)**	**Non-Residential (Acres)**	Single- family (Lots)	Multi-family (Acres)	Non-Residential (Acres)
Edmonton Region	**227**	**2.27**	**4.47**	176	6.6	0.95
Red Deer	**50**	—	**2.67**	20	—	10.98
Calgary Region	**80**	**7.82**	**3.12**	77	3.61	9.99
Lethbridge	**11**	—	—	33	—	—
Kelowna	**1**	—	—	4	—	—
United States	—	—	—	83	—	—
	369	**10.09**	**10.26**	393	10.21	21.92

The Edmonton area continues to be the Community Development division's strongest region in Q2-2014 with 153 single-family lots sold (Q2-2013: 116), 2.27 acres of multi-family development sold (Q2-2013: 3.76 acres) and 4.47 acres of non-residential land sold (Q2-2013: 0.95 acres). Lot sales in the Edmonton Region were driven by strong sales in South Edmonton projects, including Aurora, Larch Park and Jagare Ridge, where 92 lots were sold. Calgary Region had strong single-family lot sales in Q2-2014 as a result of the registration of new phases in two communities in our Sherwood and Westmere communities. The multi-family acre sales in the Calgary Region contributed $5.47 million to the division's overall revenue.

Inventory

A summary of the movement in our developed lot inventory is as follows:

Developed Inventory	**Six months ended June 30, 2014**			Six months ended June 30, 2013		
(including joint arrangements at 100%)	**Single- family (Lots)**	**Multi-family (Acres)**	**Non-Residential (Acres)**	Single- family (Lots)	Multi-family (Acres)	Non-Residential (Acres)
Open	**1,498**	**70.93**	**181.15**	1,180	93.05	237.63
Purchases	**—**	**—**	**—**	—	—	—
New developments	**150**	**4.58**	**(4.58)**	110	9.59	9.2
Internal sales	**—**	**—**	**—**	—	—	—
Sales	**(369)**	**(10.09)**	**(10.26)**	(393)	(10.21)	(21.92)
	1,279	**65.42**	**166.31**	897	92.43	224.91

Raw land inventory

To support future growth, we acquire land in strategic growth corridors and maintain an inventory of land for future development in our primary markets. During the quarter, we purchased 310.86 acres of raw land in the Red Deer region and 36.91 acres in the Lethbridge region for $18.01 million. We also purchased a 50% interest in 147.72 acres (73.86 acres net of joint arrangement interest) in Calgary for $10.49 million. We continue to monitor our land holdings to secure our position in our target markets.

Property Development

Our Property Development division develops, manages construction, markets and leases high-quality retail, office and industrial revenue-producing properties on prime commercial sites purchased primarily from our Community Development division. The division currently operates solely in Alberta.

Revenue in the division is comprised of management fees paid by joint arrangement partners and is a percentage of the total development costs incurred, which fluctuate period to period. During Q2-2014, the division recognized $0.39 million related to these fees, a decrease of $0.36 million compared to Q2-2013 as some of those projects near completion. Development costs are typically higher earlier in the development process.

The Property Development division realizes fair value gains resulting from development and leasing activities. Built and leased properties are transferred at fair market value to the Investment Properties division for long-term property management. The Property Development division’s income is impacted by the construction season. We generally expect to see the majority of the fair value increases in the third and fourth quarters as construction and leasing are completed.

In Q2-2014, development remained active, and the division recognized fair value gains of $3.10 million, compared with $1.43 million in Q2-2013. Year-to-date gains in the property development division were $5.04 million compared to $3.61 million in 2013. These gains were primarily the result of commercial and industrial development in the Edmonton area and in Fort McMurray.

During the quarter, the division completed and transferred 9 buildings (199,762 sq. ft. GLA) in four different Edmonton projects - West Henday Promenade, The Village at Blackmud Creek , Telford Industrial and Leduc Common.

The following table is a summary of current and future development projects:

Current Projects				
Project	Location	Type	Total Sq. Ft. *	Sq. Ft. Under Development
The Village at Blackmud Creek	South Edmonton	*Regional business park*	666,000	-
Telford Industrial	Leduc	*Industrial Park*	511,000	10,000
West Henday Promenade	West Edmonton	*Regional mixed use centre*	305,000	8,000
Kingsview Market	Airdrie	*Regional shopping centre*	234,000	12,000
Stoneycreek Shopping Centre	Fort McMurray	*Regional mixed use centre*	210,000	210,000
McKenzie Industrial	Red Deer	*Industrial Park*	66,000	66,000
Chestermere Station	Chestermere	*Neighbourhood shopping centre*	58,000	12,000
Clearview Market	Red Deer	*Neighbourhood shopping centre*	36,000	36,000
Leduc Common	Leduc	*Regional shopping centre*	25,000	25,000

Expected Future Projects				
Project	Location	Type	Total Sq. Ft. *	Expected Start
The District at North Deerfoot	North Calgary	*Regional business / industrial park*	2,250,000	2014
The Shoppes at Canyons	Lethbridge	*Neighbourhood shopping centre*	105,000	2015
The Shops at Jagare Ridge	South Edmonton	*Neighbourhood shopping centre*	86,000	2015
Campsite Business Park	Spruce Grove	*Industrial Park*	36,000	2015
Greenwich	West Calgary	*Regional mixed use centre*	419,000	2016
Keystone Common	North Calgary	*Regional power centre*	775,000	2016
West Pointe Marketplace	Lethbridge	*Regional power centre*	750,000	2016
West Calgary Marketplace	West Calgary	*Regional power centre*	800,000	2017

** Size represents the estimated total square footage remaining to be developed in the project. This includes sites that may be individually sold to retailers or end-users.*

Investment Properties

Our Investment Properties division manages and leases our portfolio of high-quality residential, office, retail and industrial properties, which are located across Western Canada and the US (including the properties owned by the REIT).

Our Investment Properties division oversees 2.68 million square feet of income-producing commercial GLA and 1,285 residential units. Our portfolio has high occupancy rates with long-term tenancies from a diversified mix of tenants.

Operating results

The following table summarizes the division's key performance measures:

($000s except as noted)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Rental revenue	**8,065**	5,058	**15,540**	9,630
Management fees from Melcor REIT	**1,056**	493	**1,929**	493
Net operating income (NOI) *	**5,901**	3,136	**11,119**	5,584
Same asset NOI * (see calculation following)	**2,215**	2,357	**4,621**	4,615
Fair value gains	**628**	4,016	**2,057**	4,515
Gross leasable area	**846,009**	383,067	**846,009**	383,067
Occupancy	**87.6%**	96.4%	**87.6%**	96.4%
Fair value of portfolio	**312,411**	195,198	**312,411**	195,198
Funds from operations *	**5,549**	2,770	**10,284**	5,971
Funds from operations per share *	**0.18**	0.09	**0.33**	0.20

** See non-standard measures for definition and calculation.*

Rental revenues increased $3.00 million or 59% over Q2-2013 (year-to-date, increase of $5.91 million or 61%) primarily due to the 121% increase in GLA comprised of:

- the Q3-2013 acquisition of our Joint Venture partner's 50% interest in LethCentre, which added 223,116 sq. ft. GLA
- the Q2-2014 transfer of 9 buildings from Property Development, which added 199,762 sq. ft. GLA; in addition to the Q3-2013 transfer of 4 buildings from Property Development, which added 30,264
- the Q2-2014 acquisition of two commercial properties (59,220 sq. ft. on 3.05 acres) in the Greater Phoenix area for a purchase price of $11.10 million

These new properties contributed $2.70 million to Q2-2014 revenue ($5.09 million year-to-date). These additions were offset by the sale of two commercial properties (Market Mall and Kingsview Phase Three - 54,141 sq. ft. GLA) to the REIT during Q2-2014, which reduced revenue by $0.20 million during the three and six-month periods.

Continued strengthening of the US dollar and the resulting foreign currency translation gains, in conjunction with improved occupancy on our US residential units, contributed an additional $0.05 million to Q2-2014 revenues ($0.44 million year-to-date) over the same periods in 2013. The decrease in occupancy over Q2-2013 reflects lower average occupancy on properties recently transferred from Property Development which are in the process of being fully leased up. Same asset occupancy was steady compared to 2013.

The following is a reconciliation of our same properties net operating income (NOI) to our divisional NOI:

($000s except as noted)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Same asset NOI *	**2,215**	2,357	**4,621**	4,615
Acquisitions / transfers from Property Development division	**2,004**	76	**3,433**	76
Transfer to REIT	**62**	141	**267**	240
NOI before adjustments	**4,281**	2,574	**8,321**	4,931
Foreign currency translation	**123**	32	**281**	44
Management fees from Melcor REIT	**1,056**	493	**1,929**	493
Amortization of operating lease incentives	**788**	213	**1,307**	458
Straight-line rent adjustment	**(347)**	(176)	**(719)**	(342)
NOI *	**5,901**	3,136	**11,119**	5,584

** See non-standard measures for definition.*

Divisional NOI is defined as rental revenue less property operating costs plus amortization of tenant incentives and straight-line rent adjustments. NOI increased $2.77 million or 88% over Q2-2013, and $5.54 million or 99% year-to-date as a result of portfolio growth as detailed above, the increase in management fees from the REIT as a result of portfolio growth of 17%, and higher foreign currency translation. On a same asset basis, NOI was steady over 2013 and reflects steady occupancy and rental rates over the portfolio.

Divisional revenue includes fees earned from the REIT under the asset management and property management agreements. During the three and six months ended June 30, 2014 total management fees earned under these agreements were $1.06 million and $1.93 million respectively (2013 - $0.49 million during the three and six-month periods).

Funds from operations increased by $2.78 million over Q2-2013 and $4.31 million year-to-date. The increase was driven by higher NOI and offset by higher general and administrative expense (G&A). Analysis of G&A period over period is not meaningful due to the formation of the REIT and resulting changes in structure of the portfolio.

Fair value of investment properties will fluctuate based on changes in capitalization rates, capital and tenant lease incentives spending, and non-cash adjustments related to amortization of tenant lease incentives and straight-line rent adjustments. In Q2-2014 we realized a fair value adjustment related to higher land values on our Edmonton parking lots and fair value losses on Market Mall and Kingsview Phase 3, which were sold to the REIT during the period at a price below carrying value.

REIT

The REIT owns 32 income-producing office, retail and industrial properties, comprising 1,837,439 square feet of GLA and a land lease community at June 30, 2014. The REIT’s portfolio has a diversified tenant profile, with a mix of national, regional and local tenants, operating in a variety of industries.

On May 7, 2014 the REIT completed the issuance of 1,900,000 trust units at a price of $10.65 per unit to a syndicate of underwriters, on a bought deal basis, for gross proceeds of $20.24 million. Subsequently, the underwriters exercised their over-allotment option to purchase an additional 245,000 trust units at a price of $10.65 for gross proceeds of $2.61 million. Partial proceeds were used to purchase two investment properties from Melcor at a purchase price of approximately $13.50 million. The REIT satisfied the purchase price through cash consideration of $6.10 million and the issuance of 694,836 Class B LP Units at $10.65 per unit, with a fair value of approximately $7.40 million.

We have a controlling 47.6% effective interest in the REIT through ownership of all Class B LP Units. As Melcor controls the REIT, we consolidate 100% of the REIT's revenues, expenses, assets and liabilities. The following tables include financial information for the pre-acquisition period, as included in the comparative period, based on financial information previously reported by the Investment Properties division, at 100% interest.

Operating results

The following table summarizes the REIT's key performance measures:

($000s except as noted)	**Three months ended**		**Six months ended**	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Rental revenue	**11,119**	9,773	**21,766**	19,461
Net operating income (NOI) *	**6,898**	6,379	**13,632**	12,721
Same asset NOI * *(see calculation following)*	**5,956**	5,933	**11,672**	11,779
Fair value gains	**568**	1,792	**737**	4,386
Gross leasable area	**1,837,439**	1,691,920	**1,837,439**	1,691,920
Occupancy	**92.0%**	90.6%	**92.0%**	90.6%
Fair value of portfolio	**469,165**	440,349	**469,165**	440,349
Funds from operations *	**6,694**	6,083	**13,192**	12,118
Funds from operations per share *	**0.22**	0.20	**0.43**	0.40

** See non-standard measures for definition and calculation.*

Rental revenue in Q2-2014 increased by $1.35 million or 14% over 2013 as a result of GLA growth of 17% over June 2013. On a same-asset basis rental revenue increased by $0.35 million or 4% over the same period in the prior year. Year-to-date rental revenue increased by $2.31 million or 12% over 2013, of which $1.78 million was related to newly acquired properties over the past 12 months. Revenue growth during 2014 was also driven by higher recoveries from tenants over the comparative period and correlates with the increase in operating expenses during the period. Occupancy improved over Q2-2013 as a result of property additions to the portfolio, on a same asset basis occupancy was consistent with 2013.

The following is a reconciliation of our same properties net operating income (NOI) to our divisional NOI:

($000s except as noted)	**Three months ended**		**Six months ended**	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Same asset NOI *	**5,956**	5,933	**11,672**	11,779
Acquisitions	**757**	—	**1,343**	—
NOI before adjustments	**6,713**	5,933	**13,015**	11,779
Amortization of operating lease incentives	**619**	549	**1,160**	1,127
Straight-line rent adjustment	**(129)**	(103)	**(238)**	(185)
Divisional NOI	**7,203**	6,379	**13,937**	12,721

** See non-standard measures for definition and calculation.*

Divisional NOI is defined as rental revenue less property operating costs plus amortization of operating lease incentives plus/minus straight-line rent adjustment. Property acquisitions completed in the last half of 2013 and first half of 2014 drove the increase in NOI with 13% and 10% growth over 2013 respectively. On a same asset basis, NOI was steady over 2013 with differences in the timing of recoverable operating expenses and allocations in the comparative period negatively affective the year-to-date figures.

Funds from operations (FFO) increased by $0.61 million or 10% over Q2-13; with a year-to-date increase of $1.07 million or 9%. The increase reflects higher NOI, which was partially offset by higher general and administrative expenses during the period.

The REIT recognized fair value gains of $0.57 million in Q2-2014 and $0.74 million year-to-date. Fair value gains were driven by new property additions completed in 2014 where fair value exceeded the original purchase price. In addition, we realized fair values on two properties purchased in 2013 as a result of a decrease in capitalization rates. These gains were offset by a fair value loss recorded due to tenant turnover at a retail CRU.

Decreased fair value adjustments over 2013 reflect capitalization rate stabilization and continued capital investment across the portfolio.

Recreational Properties

Our Recreational Properties division owns and manages championship golf courses built to add value to Melcor residential communities. The quarterly financial performance of our golf courses is greatly influenced by the weather conditions during the golf season.

	Ownership interest	Six months ended June 30, 2014		Six months ended June 30, 2013	
		Season opened 2014	Rounds of Golf	Season opened 2013	Rounds of Golf
Managed by Melcor:					
Lewis Estates (Edmonton)	60%	**April 20**	**11,752**	May 1	10,311
The Links (Spruce Grove)	100%	**April 19**	**11,148**	May 1	10,138
Black Mountain (Kelowna)	100%	**March 28**	**12,637**	March 22	12,238
Managed by a Third Party:					
Jagare Ridge (Edmonton)	50%	**April 30**	**9,978**	May 8	8,382

Revenues were up 14% in Q2-2014 due to the 11% increase in rounds played to June 30 and the continued focus on increasing food and beverage and other ancillary revenues.

General and administrative expense

General and administrative expense (G&A) decreased by 2% compared to Q2-2013. Cost savings have been realized from the retirements of senior executives in 2013 and 2014, which have been offset by growth in all operating divisions.

Liquidity & Capital Resources

The following table represents selected information as at June 30, 2014, compared to December 31, 2013.

As at ($000s except as noted)	June 30, 2014	Dec. 31, 2013
Cash & cash equivalents	**24,252**	28,973
Restricted cash	**4,272**	5,969
Accounts receivable	**19,947**	21,542
Agreements receivable	**132,842**	177,961
Revolving credit facilities	**99,747**	104,618
Accounts payable and accrued liabilities	**53,664**	65,256
Total assets	**1,756,108**	1,727,933
Total liabilities	**969,856**	958,702
Debt to equity ratio	**1.23**	1.25

We employ a range of strategies to maintain operations and facilitate growth. Our principal liquidity needs are to:

- Fund recurring expenses;
- Meet debt service requirements;
- Make dividend payments;
- Make distributions to unitholders of the REIT;
- Fund land development and property development; and
- Fund investing activities such as the discretionary and strategic purchases of land inventory and/or investment property purchases.

We are able to meet our capital needs through a number of sources, including cash generated from operations, long and short-term borrowings from our syndicated credit facility, mortgage financings, convertible debentures, and the issuance of common shares and trust units. Our primary use of capital includes paying operating expenses, sustaining capital requirements on land and property development projects, completing real estate acquisitions, debt principal and interest payments, and paying dividends when declared by our board of directors.

We believe that internally generated cash flows, supplemented by borrowings through our credit facility and mortgage financings, where required, will be sufficient to cover our normal operating and capital expenditures. We regularly review our credit facility limits and manage our capital requirements accordingly.

On May 7, 2014 the REIT completed the issuance of 1,900,000 trust units at $10.65 through a bought deal for total proceeds of $20.24 million (gross). The funds were used to fund two property acquisitions from Melcor.

We continuously assess our capital needs. If capital needs arise we may consider our options to raise additional capital through the issuance of common shares, trust units, preferred shares, convertible debentures. Under certain circumstances, we would also consider these means to facilitate growth through acquisition or to reduce the utilized level on our credit facility.

Financing

As at June 30, 2014, our total general debt outstanding was $596.69 million. This compares to $574.33 million at December 31, 2013. A summary of our debt is as follows:

As at ($000s)	**June 30, 2014**	Dec. 31, 2013
Melcor - revolving credit facility	**99,725**	80,870
REIT - revolving credit facility	**22**	23,748
Project specific financing	**62,966**	64,383
Secured vendor take back debt on land inventory	**81,325**	77,194
Debt on investment properties and golf course assets	**313,215**	288,801
Convertible debenture	**39,438**	39,336
	596,691	574,332

We are subject to financial covenants on our $120.00 million (December 31, 2013 - $120.00 million) Melcor revolving credit facility. The covenants include a maximum debt to total capital ratio of 1.25, a minimum interest coverage ratio of 3.00, and a minimum net book value of shareholder's equity of $300.00 million. As at June 30, 2014, and throughout the period, we were in compliance with our financial covenants with a debt to total capital ratio of 0.90, an interest coverage ratio of 8.44 and net book value of shareholder's equity of $786.25 million.

In addition, we are also subject to financial covenants on the REIT's revolving credit facility. We have an available credit facility based on the minimum of the carrying value and adjusted NOI of specific investment properties to a maximum of $25.00 million. The covenants include a maximum debt to total capital ratio of 0.60, a minimum interest coverage ratio of 1.50, and a minimum net book value of unitholders' equity of $140.00 million. As at June 30, 2014, and throughout the period, the REIT was in compliance with its financial covenants with a debt to total capital ratio of 0.46, interest coverage ratio of 1.68, and a net book value of unitholders' equity of $250.29 million. We also have financial covenants on certain mortgages for investment properties. At June 30, 2014, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

These metrics are non-standard measures used to assess compliance with our lending agreements and are not specifically defined in the CPA Handbook or in IFRS. These non-standard measures may not be comparable to similar measures presented by other companies.

On June 25, 2014 Melcor announced a Notice of Redemption to holders of the $40,000 convertible debenture (the "debentures") due February 8, 2017. The debentures are redeemable for an amount equal to the principal amount of the debentures plus accrued unpaid interest up to, but excluding, the redemption date. On August 6, 2014 we received a Notice of Conversion from all holders and the debentures have been converted to 2,160,993 common shares at a conversion price of $18.51.

Sources and uses of cash

The following table summarizes our cash flows from (used in) operating, investing and financing activities, as reflected in our consolidated statement of cash flows:

Three months ended ($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Cash flows from operating activities	**21,493**	18,006	**33,539**	37,288
Cash flows used in investing activities	**(43,796)**	(31,363)	**(58,922)**	(41,884)
Cash flows from financing activities	**26,665**	18,878	**20,658**	16,453

Cash flows from operating activities were $21.49 million in the current quarter, an increase of $3.49 million over Q2-2013. Timing of plan registrations resulted in an increase of $5.23 million in gross profit from our largest division, Community Development which contributed to collection on agreements receivable of $11.95 million during the quarter. This was offset by a decrease in net working capital which positively impacted cash from operations by $5.84 million.

Cash flows used in investing activities increased by $12.43 million in the current period as a result of the acquisitions made during the quarter. The Community Development division purchased 495.49 acres of land during Q2-2013 (net of joint arrangement interest - 421.63 acres) for net cash of $11.15 million and the Investment Properties division purchased $18.07 million. Strong leasing on investment properties through the current quarter and throughout 2014 led to an increase of $5.47 million in payments of tenant incentives.

Cash flows from financing activities were $26.67 million an increase of $7.79 million over Q2-2013. During Q2-2013, the IPO of the REIT generated cash of $91.30 million and also through the high financing activity in the quarter, which through the net general debt repayments of $51.62 million. This compares $22.85 million raised by the REIT through the secondary offering completed in Q2-2014, and net general debt financing of $11.26 million. We also paid out a semi-annual dividend of $0.28 per share during Q2-2014 resulting in a cash outflow of $8.64 million. In the comparative period, a semi-annual dividend was $0.25 per share and a special dividend of $0.50 per share was paid resulting in a cash outflow of $22.99 million.

Share Data

Melcor has been a public company since 1968 and trades under the symbol "MRD" on the Toronto Stock Exchange. As at June 30, 2014 there were 30,850,481 common shares issued and outstanding and 817,083 options, each convertible to one common share upon exercise or exchange. There is only one class of common shares issued.

Off Balance Sheet Arrangements, Contractual Obligations, Business Environment & Risks, Critical Accounting Estimates, Changes in Accounting Policies

There are no material changes to the above titled sections at June 30, 2014 in comparison to the December 31, 2013 annual MD&A. Refer to note 3 of the condensed interim consolidated financial statements for changes in accounting policies.

Quarterly Results

The following table presents a summary of our unaudited operating results for the past eight quarters. This information should be read in conjunction with the related financial statements, notes to the financial statements and management's discussion and analysis.

	Three Months Ended							
($000s)	**30-Jun-14**	31-Mar-14	31-Dec-13	30-Sep-13	30-Jun-13	31-Mar-13	31-Dec-12	30-Sep-12
Revenue	**66,062**	32,011	152,193	59,195	50,737	41,617	141,962	64,674
Net income	**17,585**	6,864	53,909	21,882	10,209	12,623	55,468	24,832
Per Share								
Basic earnings	**0.57**	0.22	1.76	0.72	0.34	0.41	1.84	0.83
Diluted earnings	**0.55**	0.22	1.64	0.68	0.33	0.40	1.72	0.78
Book value	**25.49**	25.35	25.03	23.52	22.87	23.36	22.89	21.28

We have historically experienced variability in our results of operations due to the seasonal nature of the development business and the timing of plan registrations with the municipalities. We typically experience the highest sales in our Community Development division in the fourth quarter, as this is when the majority of plans register. The fair value gains in our Property Development division are also seasonally affected, as the majority of construction in Alberta occurs during the spring and summer months.

Related Party Transactions

Please refer to note 9 to the condensed interim consolidated financial statements for information pertaining to transactions with related parties.

Internal Control over Financial Reporting & Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer have evaluated whether there were material changes to internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. No such changes were identified.

Non-standard Measures

Throughout this MD&A, we refer to terms that are not specifically defined in the CPA Handbook and do not have any standardized meaning prescribed by IFRS. These non-standard measures may not be comparable to similar measures presented by other companies.

We believe that these non-standard measures are useful in assisting investors in understanding components of our financial results.

The non-standard terms that we refer to in this MD&A are defined below.

Net operating income (NOI): this is a measure of revenue less direct operating expenses.

Same asset NOI: this measure compares the NOI on assets that have been owned for the entire current and comparative period.

Funds from operations (FFO): this measure is commonly used to measure the performance of real estate operations.

Adjusted earnings attributable to Melcor's shareholders ("adjusted earnings"): this measure is calculated as earnings adjusted for the following: adjustments related to REIT units; management fees earned from the REIT; and unitholders' portion of earnings of the REIT.

Adjusted EPS and Adjusted diluted EPS: this measure is calculated as adjusted earnings attributable to Melcor's shareholders per basic and diluted weighted average shares outstanding.

Calculations

We use the following calculations in measuring our performance.

Book value per share = (shareholders' equity) / (number of common shares outstanding)

Gross margin (%) = (NOI) / (revenue) This measure indicates the relative efficiency with which we earn revenue

Margin on income (%) = (net income) / (revenue) This measure indicates the relative efficiency with which we earn income

Debt to equity ratio = (total debt) / (total equity)

Net operating income (NOI) = (net income) +/– (fair value adjustments on investment properties) + (general and administrative expenses) – (interest income) + (amortization of operating lease incentives) +/- (straight-line rent adjustment). A reconciliation of NOI to the most comparable IFRS measure, net income, is as follows:

Investment Properties

($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Divisional income for the period	**5,389**	6,573	**11,335**	9,428
Fair value adjustment on investment properties	**(628)**	(4,016)	**(2,057)**	(4,515)
General and administrative expenses	**705**	550	**1,267**	569
Interest income	**(6)**	(8)	**(14)**	(14)
Amortization of operating lease incentives	**788**	213	**1,307**	458
Straight-line rent adjustment	**(347)**	(176)	**(719)**	(342)
Divisional NOI	**5,901**	3,136	**11,119**	5,584

REIT

($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Divisional income for the period	**6,643**	7,326	**12,769**	15,377
Fair value adjustment on investment properties	**(568)**	(1,792)	**(737)**	(4,386)
General and administrative expenses	**659**	416	**1,022**	811
Interest income	**(21)**	(17)	**(39)**	(23)
Amortization of operating lease incentives	**619**	549	**1,160**	1,127
Straight-line rent adjustment	**(129)**	(103)	**(238)**	(185)
Divisional NOI	**7,203**	6,379	**13,937**	12,721

Funds from operations (FFO) = (net income) + (amortization of operating lease incentives) +/– (fair value adjustment on investment properties) + (depreciation of property and equipment) + (stock based compensation expense) + (non-cash interest) +/- (gain (loss) on sale of asset) + (deferred income taxes) +/– (fair value adjustment on REIT Units). A reconciliation of NOI to the most comparable IFRS measure, net income, is as follows:

Consolidated

($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Net income for the period	**17,585**	10,209	**24,449**	22,832
Amortization of operating lease incentives	**1,407**	762	**2,467**	1,585
Fair value adjustment on investment properties	**(2,423)**	(7,237)	**(6,221)**	(12,508)
Depreciation on property and equipment	**477**	445	**688**	639
Stock based compensation expense	**120**	169	**257**	341
Non-cash interest	**227**	181	**440**	368
Deferred income taxes	**14**	908	**353**	1,501
Fair value adjustment on REIT units	**(3,147)**	913	**(1,777)**	913
FFO	**14,209**	6,341	**20,605**	15,662

Investment Properties

($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Divisional income for the period	**5,389**	6,573	**11,034**	10,028
Fair value adjustment on investment properties	**(628)**	(4,016)	**(2,057)**	(4,515)
Amortization of operating lease incentives	**788**	213	**1,307**	458
Divisional FFO	**5,549**	2,770	**10,284**	5,971

REIT

($000s)	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Divisional income for the period	**6,643**	7,326	**12,769**	15,377
Fair value adjustment on investment properties	**(568)**	(1,792)	**(737)**	(4,386)
Amortization of operating lease incentives	**619**	549	**1,160**	1,127
Divisional FFO	**6,694**	6,083	**13,192**	12,118

FFO per share = (FFO) / (basic weighted average common shares outstanding)

Adjusted earnings attributable to Melcor's shareholders ("adjusted earnings"): (net income attributable to Melcor's shareholders) +/- (adjustments related to REIT units) + (management fees earned from the REIT) +/- (unitholders' portion of earnings of the REIT)

Adjusted basic EPS and Adjusted diluted EPS: (adjusted earnings attributable to Melcor's shareholders) / (basic/diluted weighted average number of common shares outstanding)

MELCOR DEVELOPMENTS LTD.

Condensed Interim Consolidated Financial Statements

For the three and six months ended June 30, 2014

(Unaudited, in thousands of Canadian dollars)

Condensed Interim Consolidated Statement of Income

	For the three months ended		For the six months ended	
Unaudited ($000s)	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
Revenue	**66,062**	50,737	**98,073**	92,354
Cost of sales	**(34,003)**	(27,138)	**(49,533)**	(49,289)
Gross profit	**32,059**	23,599	**48,540**	43,065
General and administrative expense	**(6,924)**	(6,536)	**(11,434)**	(11,261)
Fair value adjustment on investment properties (note 5 and 12)	**2,423**	7,237	**6,221**	12,508
Adjustments related to REIT units (note 11)	**(377)**	(12,348)	**(3,288)**	(12,348)
Gain on sale of asset	**51**	9	**51**	9
Operating earnings	**27,232**	11,961	**40,090**	31,973
Interest income	**653**	460	**1,252**	1,077
Interest expense	**(4,619)**	(3,726)	**(8,802)**	(7,922)
Net finance costs	**(3,966)**	(3,266)	**(7,550)**	(6,845)
Income before income taxes	**23,266**	8,695	**32,540**	25,128
Income tax expense (note 8)	**(5,681)**	1,514	**(8,091)**	(2,296)
Net income for the period	**17,585**	10,209	**24,449**	22,832
Net income (loss) attributable to:				
Melcor's shareholders	**17,585**	10,211	**24,449**	22,837
Non-controlling interest (NCI)	**—**	(2)	**—**	(5)
Net income for the period	**17,585**	10,209	**24,449**	22,832
Earnings per share attributable to Melcor's shareholders:				
Basic earnings per share	**0.57**	0.34	**0.79**	0.75
Diluted earnings per share	**0.55**	0.33	**0.77**	0.73

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Comprehensive Income

	For the three months ended		For the six months ended	
Unaudited ($000s)	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
Net income for the period	**17,585**	10,209	**24,449**	22,832
Other comprehensive income				
Items that may be reclassified subsequently to net income:				
Currency translation differences	**(4,151)**	3,225	**(622)**	5,011
Comprehensive income	**13,434**	13,434	**23,827**	27,843
Comprehensive income attributable to:				
Melcor's shareholders	**13,434**	13,367	**23,827**	27,584
Non-controlling interest (NCI)	**—**	67	**—**	259
Comprehensive income	**13,434**	13,434	**23,827**	27,843

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Financial Position

Unaudited ($000s)	**June 30, 2014**	December 31, 2013
ASSETS		
Cash and cash equivalents	**24,252**	28,973
Restricted cash	**4,272**	5,969
Accounts receivable	**19,947**	21,542
Income taxes recoverable	**3,018**	—
Agreements receivable	**132,842**	177,961
Land inventory (note 4)	**681,021**	658,590
Investment properties (note 5 and 12)	**829,280**	784,510
Property and equipment	**16,017**	15,892
Other assets	**45,459**	34,496
	1,756,108	1,727,933
LIABILITIES		
Accounts payable and accrued liabilities	**53,664**	65,256
Income taxes payable	**—**	6,612
Provision for land development costs	**140,478**	154,909
General debt (note 6)	**596,691**	574,332
Deferred income tax liabilities	**63,003**	62,641
REIT units (note 11 and 12)	**116,020**	94,952
	969,856	958,702
SHAREHOLDERS' EQUITY		
Equity attributable to Melcor's shareholders		
Share capital (note 7)	**25,474**	23,405
Contributed surplus	**3,120**	3,357
Convertible debenture	**639**	639
Accumulated other comprehensive income (AOCI)	**2,758**	3,380
Retained earnings	**754,261**	738,450
	786,252	769,231
	1,756,108	1,727,933

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Changes in Equity

Unaudited ($000s)	Share capital	Contributed surplus	Convertible debenture	AOCI	Retained earnings	NCI	Total equity
	Equity attributable to Melcor's shareholders						
Balance at January 1, 2014	**23,405**	**3,357**	**639**	**3,380**	**738,450**	**—**	**769,231**
Net income for the period	—	—	—	—	24,449	—	24,449
Cumulative translation adjustment	—	—	—	(622)	—	—	(622)
Transactions with equity holders							
Dividends	—	—	—	—	(8,638)	—	(8,638)
Employee share options							
Value of services recognized	—	257	—	—	—	—	257
Share issuance	2,069	(494)	—	—	—	—	1,575
Balance at June 30, 2014	**25,474**	**3,120**	**639**	**2,758**	**754,261**	**—**	**786,252**

Unaudited ($000s)	Share capital	Contributed surplus	Convertible debenture	AOCI	Retained earnings	NCI	Total equity
	Equity attributable to Melcor's shareholders						
Balance at January 1, 2013	15,580	4,460	639	(2,130)	672,283	3,925	694,757
Net income (loss) for the period	—	—	—	—	22,837	(5)	22,832
Contributions from non-controlling interest	—	—	—	—	—	324	324
Cumulative translation adjustment	—	—	—	4,747	—	264	5,011
Transactions with equity holders							
Dividends	—	—	—	—	(22,994)	—	(22,994)
Employee share options							—
Value of services recognized	—	341	—	—	—	—	341
Share issuance	6,833	(1,535)	—	—	—	—	5,298
Balance at June 30, 2013	22,413	3,266	639	2,617	672,126	4,508	705,569

See accompanying notes to these condensed interim consolidated financial statements.

Condensed Interim Consolidated Statement of Cash Flows

	For the three months ended		For the six months ended	
($000s) Unaudited	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
CASH FLOWS FROM (USED IN)				
OPERATING ACTIVITIES				
Net income for the period	**17,585**	10,209	**24,449**	22,832
Non cash items:				
Amortization of tenant incentives	**1,407**	762	**2,467**	1,585
Depreciation of property and equipment	**477**	445	**688**	639
Stock based compensation expense	**120**	169	**257**	341
Non cash interest	**227**	181	**440**	368
Straight-line rent adjustment	**(476)**	(279)	**(957)**	(527)
Fair value adjustment on investment properties (note 5 and 12)	**(2,423)**	(7,237)	**(6,221)**	(12,508)
Fair value adjustment on REIT Units (note 11)	**(3,147)**	913	**(1,777)**	913
Gain on sale of asset	**(51)**	(9)	**(51)**	(9)
Deferred income taxes	**14**	908	**353**	1,501
	13,733	6,062	**19,648**	15,135
Agreements receivable	**11,949**	24,791	**45,119**	43,491
Development activities	**(10,024)**	(7,938)	**(8,273)**	(4,619)
Operating assets and liabilities	**5,835**	(4,909)	**(22,955)**	(16,719)
	21,493	18,006	**33,539**	37,288
INVESTING ACTIVITIES				
Purchase of land inventory (note 4)	**(11,145)**	(3,999)	**(11,145)**	(4,805)
Payment of tenant incentives	**(7,206)**	(1,738)	**(9,592)**	(3,201)
Purchase of investment properties	**(18,073)**	(2,390)	**(24,135)**	(2,390)
Additions to investment properties	**(7,580)**	(18,220)	**(14,480)**	(26,067)
Purchase of property and equipment	**(599)**	(649)	**(845)**	(1,054)
Proceeds on disposal of property and equipment	**83**	—	**83**	—
Change in restricted cash	**724**	(4,367)	**1,192**	(4,367)
	(43,796)	(31,363)	**(58,922)**	(41,884)
FINANCING ACTIVITIES				
Proceeds from issuance of trust units	**22,845**	91,300	**22,845**	91,300
Revolving credit facilities	**6,933**	(27,901)	**(4,869)**	(39,703)
Proceeds from general debt	**24,304**	33,430	**45,929**	67,022
Repayment of general debt	**(19,974)**	(57,144)	**(36,689)**	(81,419)
Change in restricted cash	**251**	(3,375)	**505**	(3,375)
Contributions from non-controlling interest	**—**	313	**—**	324
Dividends paid	**(8,638)**	(22,994)	**(8,638)**	(22,994)
Share capital issued	**944**	5,249	**1,575**	5,298
	26,665	18,878	**20,658**	16,453
FOREIGN EXCHANGE GAIN (LOSS) ON CASH HELD IN A FOREIGN CURRENCY	**(42)**	(48)	**4**	19
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE PERIOD	**4,320**	5,473	**(4,721)**	11,876
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	**19,932**	18,031	**28,973**	11,628
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	**24,252**	23,504	**24,252**	23,504
Total income taxes paid	**5,234**	4,470	**17,301**	9,000
Total interest paid	**5,511**	4,787	**11,367**	10,264

See accompanying notes to these condensed interim consolidated financial statements.

1. CORPORATE INFORMATION

We are a real estate development company with community development, property development, investment property and recreational property divisions. We develop, manage, and own mixed-use residential communities, business and industrial parks, office buildings, retail commercial centers, and golf courses.

The parent company is Melcor Developments Ltd. ("Melcor" or "we") and is incorporated in Canada. The registered office is located at Suite 900, 10310 Jasper Avenue Edmonton, AB T5J 1Y8. We operate in Canada and the United States ("US"). Our shares are traded on the Toronto Stock Exchange under the symbol "MRD". As at June 30, 2014 Melton Holdings Ltd. holds approximately 48% of the outstanding shares and pursuant to IAS 24, Related party disclosures, is the ultimate controlling party of Melcor.

As at August 7, 2014, Melcor, through an affiliate, holds an approximate 47.6% effective interest in Melcor REIT ("REIT") through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. Melcor continues to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. We reflect the public's 52.4% interest in the REIT as a liability in our financial statements. Trust units of the REIT are traded on the Toronto Stock Exchange under the symbol "MR.UN".

Our quarterly results are impacted by the cyclical nature of our business environment. Income can fluctuate significantly from period to period due to the timing of plan registrations, the cyclical nature of real estate and construction markets, and the mix of lot sales and product types.

2. BASIS OF PRESENTATION

We prepare our condensed interim consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting.

The REIT is accounted for as a reorganization and recapitalization using the continuity of interests method, with Melcor consolidating the REIT and recording 100% of its revenues, expenses, assets and liabilities. The remaining 52.4% publicly held interest in the REIT is presented as a liability in our consolidated financial statements.

These condensed interim consolidated financial statements should be read in conjunction with our annual consolidated financial statements for the year ended December 31, 2013, which have been prepared in accordance with IFRS as issued by the IASB.

These condensed interim financial statements were approved for issue by the Board of Directors on August 7, 2014.

3. ACCOUNTING POLICIES

The accounting policies followed in these condensed interim consolidated financial statements are consistent with those of the previous financial year, except as described below.

Changes in accounting policies

We have adopted the following new and revised interpretation effective January 1, 2014.

a) ***IFRIC 21, Levies,*** is an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets'. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. This standard is required to be applied for accounting periods beginning on or after January 1, 2014, with earlier adoption permitted.

The adoption of IFRIC 21 did not result in a change in the recognition or timing of recognition of levies imposed on Melcor.

New standard not yet adopted

b) ***IFRS 15, Revenue from Contracts with Customers,*** was issued in May 2014 by the IASB and supersedes IAS 18, 'Revenue', IAS 11, 'Construction Contracts' and other interpretive guidance associated with revenue recognition. IFRS 15 provides a single model to determine how and when an entity should recognize revenue, as well as requiring entities to provide more informative, relevant disclosures in respect of its revenue recognition criteria. IFRS 15 is to be applied retrospectively or through the recognition of the cumulative effect to opening retained earnings and is effective for annual periods beginning on or after January 1, 2017, with earlier application permitted. We are currently in the process of evaluating the impact that IFRS 15 may have on our consolidated financial statements.

4. LAND INVENTORY

($000s)	**June 30, 2014**	December 31, 2013
Raw land held	**313,828**	286,504
Land under development	**151,973**	136,317
Developed land	**215,220**	235,769
	681,021	658,590

During the six-month period ended June 30, 2014, we purchased 348 acres of land at a cost of $18,010 and received vendor financing of $14,665. In addition, we entered into a joint arrangement by purchasing a 50% interest in 148 acres at a cost of $10,490 and financing of $2,690 and also amended a current joint arrangement with the purchase of an additional 10% interest in 162 acres of land at a cost of $1,718.

During the comparative six-month period ended June 30, 2013 we purchased 177 acres of land at a cost of $12,132 and received vendor financing of $7,833. In addition, we entered into a land swap by purchasing 29 acres of land at a cost of $1,325 in exchange for 16 acres of land and $506 in cash. Exchange amounts approximate fair market value.

5. INVESTMENT PROPERTIES

Investment properties consists of the following:

($000s)	**June 30, 2014**	December 31, 2013
Investment properties	**736,192**	642,275
Properties under development	**93,088**	142,235
Total	**829,280**	784,510

The following table summarizes the change in investment properties during the period:

			Six months ended June 30, 2014
($000s)	**Investment Properties**	**Property under Development**	**Total**
Balance - beginning of period	642,275	142,235	**784,510**
Additions			
Direct acquisition	11,863	—	**11,863**
Acquisition through business combination	12,272	—	**12,272**
Direct leasing costs	422	—	**422**
Property improvements	2,464	—	**2,464**
Development costs	—	10,947	**10,947**
Capitalized borrowing costs	—	647	**647**
Transfers	65,784	(65,784)	**—**
Net fair value adjustment on investment properties	1,178	5,043	**6,221**
Change in provision	22	—	**22**
Foreign currency translation (included in OCI)	(88)	—	**(88)**
Balance - end of period	**736,192**	**93,088**	**829,280**

5. INVESTMENT PROPERTIES (continued)

	Investment Properties	Property under Development	Year ended December 31, 2013 Total
Balance - beginning of year	537,358	61,870	599,228
Additions			
Direct acquisition	49,047	11,466	60,513
Transfer from land inventory	—	7,522	7,522
Direct leasing costs	1,480	—	1,480
Property improvements	4,763	—	4,763
Development costs	—	55,973	55,973
Capitalized borrowing costs	—	1,030	1,030
Transfers	26,142	(26,142)	—
Net fair value adjustment on investment properties	17,055	30,516	47,571
Change in provision	109	—	109
Foreign currency translation (included in OCI)	6,321	—	6,321
Balance - end of year	642,275	142,235	784,510

Direct acquisitions:

On January 10, 2014 the REIT completed the acquisition of an industrial warehouse, LC Industrial, located in Lethbridge, Alberta for $5,968 (including transaction costs).

On May 26, 2014 the REIT completed the acquisition of an office building, 107 Avenue Building, located in Edmonton, Alberta for $5,614 (including transaction costs).

During the six months ended June 30, 2014 we also purchased three condo units in Arizona at a cost of $281 (US$255).

These acquisitions have been accounted for as asset purchases, in accordance with our policy, as detailed in the 2013 annual financial statements.

Business combinations:

On April 23, 2014 we completed the acquisition of two office properties in in the Greater Phoenix area for a purchase price of $12,272 (US$11,124). The purchase price was satisfied with cash on hand. These acquisitions were accounted for as business combinations.

Judgment is required in determining if an acquisition is an asset purchase or a business combination. Unlike the other acquisitions completed during the period, Melcor will not directly manage these buildings and acquired all the inputs, processes and outputs related to these buildings to meet the definition of a business under IFRS 3, Business Combinations.

The amount of revenue and net income before tax related to these properties since the acquisition date and included in the interim consolidated statement of income for the reporting period are $244 and $75 respectively (US$223 and US$69 respectively).

We are unable to present pro forma revenue and earnings as through the acquisition date had been January 1, 2014 as the information necessary to determine these amounts is not available.

In accordance with our policy we record our investment properties at fair value. Investment properties were valued by qualified independent external valuation professionals as at December 31, 2013. We obtained updated market data and considered whether changes to any valuation model variables resulted in significant changes to any of the property fair values at June 30, 2014. Fair values of investment properties were revised based on the updated data and model variables.

Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized NOI, while development activity on properties under development and leasing activity drive fair value adjustments on properties under development. Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 12.

6. GENERAL DEBT

($000s)	June 30, 2014	December 31, 2013
Melcor - revolving credit facility	99,725	80,870
REIT - revolving credit facility	22	23,748
Project specific financing	62,966	64,383
Secured vendor take back debt on land inventory	81,325	77,194
Debt on investment properties and golf course assets	313,215	288,801
Convertible debenture	39,438	39,336
	596,691	574,332

7. SHARE CAPITAL

Issued and outstanding common shares at June 30, 2014 are 30,850,481 (December 31, 2013 – 30,729,074). During the three and six months ended June 30, 2014, there were 71,773 and 121,407 options exercised (Q2-2013 – 472,350 and 476,650).

8. INCOME TAX EXPENSE

Income tax expense is recognized based on management's estimate of the weighted average annual income tax rate expected for the full financial year. The estimated average annual tax rate used for the period is 24.9% (2013 – 9.1%).

Income tax for the six month period ended June 30, 2013 also included adjustments resulting from the closing of the IPO. The REIT, under the Specified Investment Flow-Through (SIFT") rules in the Canadian Income Tax Act, does not expect to pay income tax. As such, upon closing of the Offering and transfer of certain properties to the REIT, Melcor is no longer subject to tax on the public's interest in the REIT.

9. RELATED PARTY TRANSACTIONS

During the three and six months ended June 30, 2014, there were debenture coupon payments of $343 and $682 (Q2-2013 - $342 and $681) paid to companies controlled by two members of our executive management team who are also directors of Melcor.

These transactions occurred in the normal course of operations and were measured at their exchange amount, which approximates carrying value.

10. SEGMENTED INFORMATION

Geographic Analysis

A reconciliation of our revenues and assets by geographic location is as follows:

External Revenues	For the three months ended		For the six months ended	
(in Canadian dollars) ($000s)	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
United States	3,887	2,784	6,998	9,137
Canada	62,175	47,953	91,075	83,217
	66,062	50,737	98,073	92,354

Total Assets

As at (in Canadian dollars) ($000s)	June 30, 2014	December 31, 2013
United States	165,824	132,219
Canada	1,590,284	1,595,714
	1,756,108	1,727,933

(Unaudited – in $000s except per share, share and acre amounts)

10. SEGMENTED INFORMATION (continued)

Divisional Analysis

The following segment analysis has been amended from the prior period to include the results of the newly formed REIT. Results for the REIT's comparative six months ended June 30, 2014 includes the pre-acquisition results previously reported under the Investment Properties division.

Our divisions reported the following results:

For the three months ended June 30, 2014	**Community Development**	**Property Development**	**Investment Properties**	**REIT**	**Recreational Properties**	**Corporate**	**Intersegment Elimination**	**Total**
Segment revenue	43,075	388	9,121	11,119	3,783	—	(1,424)	66,062
Cost of sales	(24,521)	—	(3,661)	(4,406)	(1,989)	(125)	699	(34,003)
Gross profit	18,554	388	5,460	6,713	1,794	(125)	(725)	32,059
General and administrative expense	(2,664)	(437)	(705)	(659)	(803)	(2,357)	701	(6,924)
Fair value adjustment on investment properties	—	3,096	628	568	—	—	(1,869)	2,423
Gain on sale of assets	—	—	—	—	51	—	—	51
Interest income	606	—	6	21	—	20	—	653
	16,496	3,047	5,389	6,643	1,042	(2,462)	(1,893)	28,262
Interest expense								(4,619)
Adjustments related to REIT units								(377)
Income before tax								23,266
Income tax expense								(5,681)
Net income								17,585

For the three months ended June 30, 2013	**Community Development**	**Property Development**	**Investment Properties**	**REIT**	**Recreational Properties**	**Corporate**	**Intersegment Elimination**	**Total**
Segment revenue	32,187	743	5,551	9,773	3,331	—	(848)	50,737
Cost of sales	(18,861)	—	(2,452)	(3,840)	(1,888)	(95)	(2)	(27,138)
Gross profit	13,326	743	3,099	5,933	1,443	(95)	(850)	23,599
General and administrative expense	(2,670)	(418)	(550)	(416)	(701)	(2,629)	848	(6,536)
Fair value adjustment on investment properties	—	1,429	4,016	1,792	—	—	—	7,237
Gain (loss) on sale of assets	—	—	—	—	9	3,156	(3,156)	9
Interest income	430	1	8	17	—	4	—	460
	11,086	1,755	6,573	7,326	751	436	(3,158)	24,769
Interest expense								(3,726)
Adjustments related to REIT units								(12,348)
Income before tax								8,695
Income tax recovery								1,514
Net income								10,209

(Unaudited – in $000s except per share, share and acre amounts)

10. SEGMENTED INFORMATION (continued)

For the six months ended June 30, 2014	**Community Development**	**Property Development**	**Investment Properties**	**REIT**	**Recreational Properties**	**Corporate**	**Intersegment Elimination**	**Total**
Segment revenue	56,922	559	17,469	21,766	3,875	—	(2,518)	98,073
Cost of sales	(32,211)	—	(6,938)	(8,751)	(2,439)	(245)	1,051	(49,533)
	24,711	559	10,531	13,015	1,436	(245)	(1,467)	48,540
General and administrative expense	(4,354)	(1,057)	(1,267)	(1,022)	(1,120)	(3,804)	1,190	(11,434)
Fair value adjustment on investment properties	—	5,043	2,057	737	—	—	(1,616)	6,221
Gain on sale of assets	—	—	—	—	51	—	—	51
Interest income	1,179	—	14	39	—	20	—	1,252
	21,536	4,545	11,335	12,769	367	(4,029)	(1,893)	44,630
Interest expense								(8,802)
Adjustments related to REIT units								(3,288)
Income before tax								32,540
Income tax expense								(8,091)
Net income								24,449

For the six months ended June 30, 2013	**Community Development**	**Property Development**	**Investment Properties**	**REIT**	**Recreational Properties**	**Corporate**	**Intersegment Elimination**	**Total**
Segment revenue	58,914	1,397	10,123	19,461	3,509	—	(1,050)	92,354
Cost of sales	(34,385)	—	(4,655)	(7,682)	(2,373)	(192)	(2)	(49,289)
	24,529	1,397	5,468	11,779	1,136	(192)	(1,052)	43,065
General and administrative expense	(5,007)	(829)	(569)	(811)	(973)	(4,122)	1,050	(11,261)
Fair value adjustment on investment properties	—	3,607	4,515	4,386	—	—	—	12,508
Gain (loss) on sale of assets	—	—	—	—	9	3,156	(3,156)	9
Interest income	1,032	2	14	23	—	6	—	1,077
	20,554	4,177	9,428	15,377	172	(1,152)	(3,158)	45,398
Interest expense								(7,922)
Adjustments related to REIT units								(12,348)
Income before tax								25,128
Income tax expense								(2,296)
Net income								22,832

11. NON-CONTROLLING INTEREST IN MELCOR REIT

On May 7, 2014 the REIT completed the issuance of 1,900,000 trust units at a price of $10.65 per unit to a syndicate of underwriters, on a bought deal basis, for gross proceeds of $20,235. Subsequently, the underwriters exercised their over-allotment option to purchase an additional 245,000 trust units at a price of $10.65 for gross proceeds of $2,609. On May 9, 2014 the REIT used partial proceeds to purchase two investment properties from Melcor at a purchase price of approximately $13,500. The purchase price was satisfied through cash consideration of $6,100 and the issuance of 694,836 Class B LP Units of the REIT at $10.65 per unit, with a fair value of approximately $7,400. As at June 30, 2014 Melcor owns a 47.6% interest in the REIT through ownership of all 10,225,634 Class B LP Units. We have assessed and concluded that Melcor continues to retain control of the REIT in accordance with IFRS 10, Consolidated Financial Statements.

In accordance with our policy, we account for the remaining 52.4% publicly held interest in the REIT as a financial liability measured at fair value through profit or loss ("FVTPL"). As at June 30, 2014 there were 11,275,000 REIT units outstanding at a fair value of $10.29 per unit or $116,020 (December 31, 2013 - $94,952). We recorded adjustments related to REIT units for the three and six months ended June 30, 2014 of $377 and $3,288 (2013 - 12,348 and 12,348). As illustrated in the table below, the adjustment is comprised of:

	For the three months ended		For the six months ended	
($000s)	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
Fair value adjustment on REIT units	**(3,147)**	913	**(1,777)**	913
Distributions to REIT unitholders	**1,782**	1,027	**3,323**	1,027
Transaction costs on REIT unit issuance				
Capitalized against REIT trust units	**1,594**	9,304	**1,594**	9,304
Expensed in Melcor	**148**	1,104	**148**	1,104
Adjustments related to REIT units	**377**	12,348	**3,288**	12,348

The following tables summarize the financial information relating to Melcor's subsidiary, the REIT, that has material non-controlling interest (NCI), before intra-group eliminations.

($000s)	**June 30, 2014**	December 31, 2013
Assets	**476,468**	454,743
Liabilities	**216,402**	225,005
Net assets	**260,066**	229,738
Cost of NCI	**103,959**	82,709
Fair value of NCI	**116,020**	94,952

	For the three months ended		For the six months ended	
($000s)	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
Revenue	**11,119**	9,773	**21,766**	19,461
Net income and comprehensive income	**5,296**	3,036	**6,174**	9,047
Cash flows from operating activities	**1,806**	2,105	**4,102**	9,141
Cash flows used in investing activities	**(13,126)**	(6,534)	**(20,387)**	(7,377)
Cash flows from financing activities, before distributions to REIT unitholders	**9,527**	9,361	**13,676**	3,337
Cash flows from financing activities - cash distributions to REIT unitholders	**(1,782)**	(1,027)	**(3,323)**	(1,027)
Net increase (decrease) in cash and cash equivalents	**(3,575)**	3,905	**(5,932)**	4,074

12. FAIR VALUE ESTIMATION

Fair value is the price that market participants would be willing to pay for an asset or liability in an orderly transaction under current market conditions at the measurement date.

The fair value of Melcor's financial instruments were determined as follows:

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivables and accounts payable and accrued liabilities approximate their fair values based on the short term maturities of these financial instruments.
- fair values of general debt is estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of REIT units are estimated based on the closing trading price of the REIT's trust units (Level 1).

In addition, Melcor carries its investment properties at fair value which is determined by using unobservable inputs (Level 3).

The following table summarizes the REIT's assets and liabilities carried at fair value and its financial assets and liabilities where carrying value may not approximate fair value.

				June 30, 2014		December 31, 2013
($000s)	**Fair Value**	**Amortized Cost**	**Total Carrying Value**	**Total Fair Value**	Total Carrying Value	Total Fair Value
Non-financial assets						
Investment properties	**829,280**	**—**	**829,280**	**829,280**	784,510	784,510
Financial liabilities						
General debt	**—**	**596,691**	**596,691**	**590,033**	574,332	580,651
REIT units	**116,020**	**—**	**116,020**	**116,020**	94,952	94,952

The table below analyzes assets and liabilities carried at fair value in the condensed interim consolidated statement of financial position, by the levels in the fair value hierarchy. The fair hierarchy categorizes fair value measurement into three levels based upon the inputs to valuation technique, which are defined as follows:

- Level 1: quote prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: unobservable inputs for the asset or liability.

There were no transfers between the levels of the fair value hierarchy during the period.

($000s)	**Level 1**	**Level 2**	**Level 3**	**Total**
Non-financial assets				
Investment properties	—	—	829,280	829,280
Financial liabilities				
REIT units	116,020	—	—	116,020

Investment properties

Investment properties are remeasured to fair value on a recurring basis and categorized as Level 3 in the fair value hierarchy. Investment properties were valued by qualified independent external valuation professionals as at December 31, 2013. We obtained updated market data at June 30, 2014 and considered whether changes to any valuation model variables resulted in significant changes to any of the investment property fair values at June 30, 2014. Fair values of investment properties were revised based on the updated data and model variables with fair value gains of $6,221 (June 30, 2013 - $12,508) recorded as fair value adjustment on investment properties in income.

(Unaudited – in $000s except per share, share and acre amounts)

The following table summarizes the valuation approach, significant unobservable inputs, and the relationship between the inputs and the fair value:

Asset	Valuation approach	Significant unobservable inputs	Relationship between inputs and fair value
Investment properties	Direct capitalization or discounted cash flows	- Capitalization rate - Discount rate - Terminal rate - Stabilized NOI - Cash flows	Inverse relationship between capitalization, discount and terminal rates and fair value (higher rates result in decreased fair value); whereas higher stabilized NOI or cash flows results in increased fair value.
Properties under development	Direct capitalization less cost to complete	- Capitalization rate - Stabilized NOI - Costs to complete	Inverse relationship between capitalization rate and fair value (higher capitalization rate results in lower fair value); whereas higher stabilized NOI results in increased fair value.
Properties under development - undeveloped land	Direct comparison	- Comparison to market transactions for similar assets	Land value reflects market value.

The significant unobservable inputs in the Level 3 valuation under the above methods are as follows:

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items;
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;
- Terminal rate - taking into account assumptions regarding vacancy rates and market rents; and
- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

In determining the fair value of our investment properties judgment is required in assessing the 'highest and best use' as required under IFRS 13, *Fair value measurement*. We have determined that the current uses of our investment properties are their 'highest and best use'.

Melcor's executive management team is responsible for determining fair value measurements including verifying all major inputs included in the valuation and reviewing the results with the independent valuator. Management, along with the Audit Committee, discuss the valuation process and key inputs on a quarterly basis.

Weighted average stabilized net operating income for investment properties as at June 30, 2014 is $1,343 (December 31, 2013 - $1,364). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

	Investment Properties			**Properties under Development**		
June 30, 2014	**Min**	**Max**	**Weighted Average**	**Min**	**Max**	**Weighted Average**
Capitalization rate	**5.50%**	**9.00%**	**6.34%**	**6.00%**	**6.75%**	**6.12%**
Terminal capitalization rate	**5.75%**	**9.25%**	**6.49%**	**6.25%**	**7.00%**	**6.37%**
Discount rate	**6.50%**	**10.00%**	**7.37%**	**7.00%**	**7.75%**	**7.48%**

	Investment Properties			Properties under Development		
December 31, 2013	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	9.00%	6.46%	6.00%	7.00%	6.07%
Terminal capitalization rate	5.75%	9.25%	6.77%	6.25%	7.25%	6.33%
Discount rate	6.50%	10.00%	7.66%	7.00%	7.75%	7.45%

(Unaudited – in $000s except per share, share and acre amounts)

A change in capitalization rates by a 50 basis points increase or decrease would change the carrying amount of investment properties by $47,824 or $56,019 (December 31, 2013 - $38,437 or $44,883) respectively.

REIT units

REIT units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the REIT units at the period end date. At June 30, 2014 the fair value of the REIT units was $116,020, resulting in a fair value gain of $3,147 and $1,777 (2013 - fair value loss of $913 and $913) in the statement of income and comprehensive income during the three and six months ended June 30, 2014.

13. SUBSEQUENT EVENTS

Distributions on REIT trust units

On July 15, 2014 Melcor REIT declared a distribution of $0.05625 per unit for the months of July, August and September 2014. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
July 2014	July 31, 2014	August 15, 2014	$0.05625 per unit
August 2014	August 29, 2014	September 15, 2014	$0.05625 per unit
September 2014	September 30, 2014	October 15, 2014	$0.05625 per unit

Redemption of Convertible Debenture:

On June 25, 2014 Melcor announced a Notice of Redemption to holders of the $40,000 convertible debenture (the "debentures") due February 8, 2017. The debentures are redeemable for an amount equal to the principal amount of the debentures plus accrued unpaid interest up to, but excluding, the redemption date. On August 6, 2014 we received a Notice of Conversion from all holders and the debentures have been converted to 2,160,993 common shares at a conversion price of $18.51.

14. COMPARATIVE FIGURES

We have reclassified $445 and $639 in depreciation expense to cost of sales in the comparative figures for the three and six months ended June 30, 2013 in the statement of income and comprehensive income to conform to the current years presentation. We have reclassified $1,104 in expenses related to the formation of Melcor REIT from general and administrative expense to adjustments related to REIT units (note 11) in the comparative figures for the three and six months ended June 30, 2013 in the statement of income and comprehensive income to conform to the current years presentation.