

H&R REAL ESTATE INVESTMENT TRUST

H&R FINANCE TRUST

Notes to Combined Financial Statements

(In thousands of dollars, except unit and per unit amounts)

Years ended December 31, 2010 and 2009

8. Debentures payable (continued):

At its option, the REIT may redeem any of the Senior Debentures, in whole at any time, or in part from time to time, prior to maturity on payment of a redemption price equal to the greater of (i) the Canada Yield Price as defined in the relevant supplemental trust indenture and (ii) par, together in each case with accrued and unpaid interest to the date fixed for redemption. The REIT will give notice of any redemption at least 30 days but not more than 60 days before the date fixed for redemption. Where less than all of any Senior Debentures are to be redeemed pursuant to their terms, the Senior Debentures to be so redeemed will be redeemed on a pro rata basis according to the principal amount of Senior Debentures registered in the respective name of each holder of Senior Debentures or in such other manner as the indenture trustee may consider equitable.

The Senior Debentures are rated BBB (with a Stable trend) by DBRS Limited.

(f) *Non-Convertible Debentures:*

In April 2009, the REIT issued \$200,000 of unsecured debentures (the "Non-Convertible Debentures") bearing interest at the annual contractual rate of 11.50% and an effective interest rate of 12.90%. The Non-Convertible Debentures mature on April 24, 2014, with interest payable semi-annually on June 30 and December 31. The Non-Convertible Debentures are not redeemable on or before April 24, 2013, except upon the satisfaction of certain conditions upon the occurrence of a change of control. After April 24, 2013 and prior to the maturity date thereof, the Non-Convertible Debentures are redeemable in whole or in part at the option of the REIT at a redemption price equal to the principal amount thereof plus accrued and unpaid interest. Upon a change of control, the holders of the Non-Convertible Debentures have the right to require the REIT to purchase the Non-Convertible Debentures at 101% of the principal amount plus accrued and unpaid interest.

In addition, for no additional proceeds, the REIT issued, simultaneously with the Non-Convertible Debentures, 28,571,429 warrants to purchase Stapled Units at an exercise price of \$7.00 per Stapled Unit exercisable until April 24, 2014. In December 2009, the REIT repurchased the outstanding 28,571,429 warrants at a purchase price of \$185,714. The cost of the redemption was in excess of the assigned value of the warrants by \$177,181, whereby \$28,873 of such excess was recorded as a reduction to contributed surplus and \$148,308 was recorded as a reduction to accumulated net earnings.

The REIT accounted for the Non-Convertible Debentures and the warrants by discounting the stream of future payments of interest and principal, due under the Non-Convertible Debenture indenture, at the prevailing market rate for a similar liability that is not issued simultaneously with warrants and allocated such amounts (net of associated issue costs) to the issuance of the Non-Convertible Debentures. The aggregate proceeds realized from the issuance of the Non-Convertible Debentures and warrants (net of issue costs), less the amount allocated to the Non-Convertible Debentures, has been allocated to the issue of the warrants and is classified as equity.

On issuance, the REIT recorded a liability of \$187,447, net of issue costs of \$1,288, and equity, which represents the warrants issued to purchase Stapled Units, of \$11,183, net of issue costs of \$82, with a further reduction of \$2,650 representing the initial future tax liability related to issuance of the Non-Convertible Debentures. Interest expense is recorded as a charge to income and is calculated at an effective rate with the difference between the coupon rate and the effective rate being credited to the debt component of the Non-Convertible Debentures such that, at maturity, the debt component is equal to the face value of the then outstanding Non-Convertible Debentures.